Why Money Managers/Advisors Shouldn't Take PPP Loans

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On April 3, the U.S. Treasury and Small Business Administration (SBA) instituted the Paycheck Protection Program (PPP) to assist small businesses and non-profits through forgivable loans. In its haste to act quickly in response to the economic impact of the Covid-19 pandemic, the program wasn't tightly stipulated and offered limited and changing guidance on eligibility requirements. Any small entity with 500 or fewer employees may be eligible including small businesses, S corporations, C corporations, LLCs, private nonprofits, faith-based organizations, tribal groups and veteran groups. The only requirement for the loan to be forgivable was that recipients spend 100 percent of the funds on payroll, mortgage interest, rent, and utilities in the eight weeks after receiving the loan. Part of this requirement was that the entity must spend at least 75 percent of the loan proceeds, specifically on payroll.

It created an overwhelming amount of interest and applications. By April 16, the initial $394 billion in funding was exhausted and lawmakers added an additional $310 billion in a second round. Since the launch of PPP, 3.8 million loans totaling more than $500 billion have been made, according to the Trump administration as of May 1.

PPP's lack of clarity and specificity allowed applicants of all sizes and types to participate. Large universities with multi-billion dollar endowments and publicly traded firms such Ruth Chris' Steakhouse and Shake Shack received funds, causing public outrage and have since returned the funds. Private K-12 schools were eligible and many received funds, without feeling significant impact because current year tuition has already been received. It is also been alleged that minority applicants and community banks were treated unfairly given their low approval rate and inconsistent access to the SBA loan portals, respectively.

Here's why I think most advisors should not participate in PPP. Most advisors are paid management fees based on assets under management or assets under advisement. First, while assets under management dropped due to March's negative returns, many firms didn't experience a catastrophic loss of revenue. I've not heard of any significant layoffs in asset management or wealth management industries. Second, unlike a restaurant or salon that will never recoup lost sales, advisors who remained in business did not experience a permanent loss of revenue. Asset markets tend to move in cycles. This bear market is coming after an 11-year bull market in asset returns. In April, asset markets were generally positive. So, there is already a recovery that will be reflected in future client billings.

In response to criticisms regarding the types of firms that received PPP loans, the SBA later released further guidelines clearly say that "need must be established." The Treasury Department has warned that it will investigate companies who did not properly certify on their PPP application in good faith that "current economic uncertainty made the loan request necessary to support ongoing operations" of the company and borrowers must show that they did not have access to additional funds. Borrowers have until May 7 to return PPP funds to avoid significant legal consequences and potential public censure.

On April 27, 2020, the Securities and Exchange Commission issued guidance that may require advisors who have received PPP loans to disclose to clients through their Form ADV filing. The rationale is that the circumstances leading to needing a PPP loan to operate is a material fact related to the advisory relationship. The SEC is saying if an advisor needs a loan to make payroll, rent and utilities, then the Advisor's financial condition should be disclosed to clients.

PPP was loosely modeled after the SBA 7(a) program. Under the 7(a) program, investment advisors and managers are not eligible for borrowing. On May 1, SBA released additional guidance suggesting that "hedge funds and private equity are primarily engaged in investment or speculation, and such businesses are therefore ineligible to receive a PPP loan." I know investment advisors aren't hedge funds and private equity, but I don't think PPP was intended for asset managers, investment advisors and wealth managers. PPP funds were meant for businesses such as local restaurants, cleaners, churches or social service agencies that have been significantly impacted from the lockdowns.

PPP should have been explicitly written to help small businesses and non-profits that experienced an immediate, significant loss of revenue from pandemic-induced lockdowns and had no access to capital to retain their employees.

With 30 million unemployed Americans and a potential avalanche of small business failures, advisors shouldn't take PPP loans taking away critical funding from those small, local businesses that need it most. Regulatory oversight, legal enforcement and public scrutiny are coming.