

The Legal Intelligencer

\$2.2T COVID-19 Stimulus Package and Fraud: Part 2, TARP's Role

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As discussed [in the first article of this series](#) published on April 24, the COVID-19 stimulus packages are, by any measure, unprecedented in size. That is not to say they are unprecedented in need and purpose. As we noted in the first installment, in 2008—at the outset of the Great Recession—the federal government acted aggressively to stabilize an economy imploding because of the fallout from the collapse of the subprime mortgage market. To do so, Congress enacted the Emergency Economic Stabilization Act of 2008 (EESA). The EESA created the Trouble Asset Relief Program (TARP)—originally a \$700 billion program—and, at that point, the largest stimulus package in American history. Through TARP, the U.S. government provided financial institutions substantial funds through various mechanisms that injected much-needed liquidity into the economy. Because the federal government was appropriately concerned about fraud associated with this massive injection of funds, it took great steps to provide oversight to deter criminal activity and ensure that those who fraudulently took advantage of the program were prosecuted. The efforts and enforcement structure that the federal government created to combat fraud under TARP is illustrative of the steps that it will likely take to combat fraud related to the CARES Act, and other legislation passed to lessen the economic tumult caused by the COVID-19 pandemic.

THE GREAT RECESSION

By the fall of 2008, it was clear that the economy was in dire need of assistance. Lehman Brothers filed for bankruptcy. American International Group (AIG) sought a \$40 billion bridge loan from the Federal Reserve Board to simply stay in business. Bank of America purchased Merrill Lynch for \$50 billion. As each of these events unfolded, the stock market plummeted and investors began to fear the economic crisis would lead to paralysis in the markets and a potential run on the banks.

In an attempt to stabilize the markets and calm fears, Treasury Secretary Hank Paulson Jr. and Federal Reserve Chairman Ben Bernanke, implored Congress to take action and quickly. As a result, on Oct. 3, 2008, President George W. Bush signed EESA into law. At the time, EESA and TARP represented an unprecedented bailout of the financial and housing industries. The centerpiece of EESA, TARP was created to provide financial institutions with liquidity that could be used to help spark economic recovery. To do so, TARP authorized the Treasury Secretary to purchase or insure up to \$700 billion in illiquid assets from banks and other financial institutions. Subsequently, Congress expanded the scope of TARP expanded through the Capital Purchase Program (CPP) to permit the Treasury Department to obtain equity in banks and other financial institutions through the purchase of preferred shares, with the hope that the influx of additional capital into the banking market would ease the effects caused by the housing crisis.

TARP

TARP comprised several programs that were each designed to help stabilize the economy. The programs were aimed toward supporting the banking industry, the credit market, the automobile industry and the housing market. CPP was the largest and most significant program. Through CPP, the Treasury Department invested approximately \$205 billion into the country's financial institutions. To obtain funds through the program, an institution had to submit an application and provide the Treasury Department preferred stock or debt securities in return for the government's investments. The federal government then purchased preferred stock in eight major banks, among many other financial institutions. Similar to the provisions of the CARES Act, TARP also provided funding to the Small Business Administration thereby increasing the credit available to small business.


TARP also designated \$46 billion for foreclosure relief available to individual homeowners. One such program was called the Making Home Affordable (MHA) Program. The MHA assisted homeowners in avoiding foreclosure by allowing individuals to either modify or refinance their foreclosures, obtain temporary forbearance if unemployed, or transition out of homeownership by way of a short sale or deed-in-lieu of foreclosure. During the term of the program, which expired in December 2016, MHA helped more than 1.8 million families obtain relief and avoid foreclosure. Another program aimed at assisting homeowners was the Hardest Hit Fund (HHF). The HHF helped homeowners pay their mortgages, and provided funds for both buying and demolishing homes.

TARP OVERSIGHT AND ENFORCEMENT

In enacting EESA, Congress recognized that this influx of monetary relief came with a significant risk of waste, fraud and abuse. To ensure appropriate oversight of the distribution of funds through TARP, Congress developed a number of oversight mechanisms. First, it created the Congressional Oversight Panel (COP). The purpose of this bi-partisan panel was to "review the current state of financial markets and the regulatory system." It had the authority to hold hearings, review official data and issue reports on the actions taken by the Treasury Department and financial institutions pursuant to the program.

Second, the EESA created the Office of the Special Investigator General for TARP (SIGTARP). This temporary office is solely dedicated to the investigation of financial institution fraud related to TARP. Congress created SIGTARP to "conduct, supervise, and coordinate audits and investigations of the purchase and management, and sale of assets by the Secretary of Treasury" pursuant to TARP. Its mission is "to advance economic stability by promoting the efficiency and effectiveness of TARP management, through transparency, through coordinated oversight, and through robust enforcement against those, whether inside or outside of Government, who waste, steal or abuse TARP funds." Thus, the office acts as both a federal law enforcement agency and an independent auditor.

Pursuant to EESA, SIGTARP was obligated to provide regular reports to Congress describing its activities and documenting fraud associated with TARP spending. To give SIGTARP (and the federal prosecutors) an enforcement stick, Congress amended 18 U.S.C. Section 1031 to specifically note that major fraud against the government included fraud associated with TARP and the EESA. This had the effect of providing the government the ability to seek large fines and use a seven year statute of limitations (expanded from the usual five year statute of limitations in most federal criminal cases). The federal government also strengthened its commitment to investigate and prosecute financial fraud through the enactment of the Fraud Enforcement and Recovery Act of 2009 (FERA), which provided substantial funding and resources for enforcement activity.



Though created in 2008, SIGTARP's investigations and enforcement continues today. The Office is currently led by Christy Goldsmith Romero, who previously served in the Securities and Exchange Commission (SEC), where among other things, she investigated financial fraud, insider trading and other violations of the Securities Act. SIGTARP has two divisions—investigations and audit or evaluations. In addition, the office has operational and support activities. SIGTARP special agents have the authority to search, seize and arrest. Once SIGTARP has built a case against an individual or a company, it then works with the Justice Department or state and local authorities to prosecute.


Eleven years after its creation and 10 years since the country emerged from the Great Recession, SIGTARP is still going strong. In 2019, SIGTARP had 125 employees and its investigations resulted in approximately \$900 million recovered and criminal charges against 13 defendants, including three corporations/organizations. Since inception, SIGTARP investigations have resulted in 24 enforcement actions brought by the Justice Department, the Securities & Exchange Commission and other regulators. To date, 438 individuals have been criminally charged as a result of SIGTARP investigations and 381 have been convicted, including 76 bankers and 92 bank borrowers. Ninety-five of those who received a prison term were engaged in fraud related to the homeownership-related program and were charged with bank fraud, securities fraud, money laundering, mortgage fraud and conspiracy, among others. Additionally, the government has initiated civil suits against individuals (and even their estates) and third party beneficiaries that the government believed fraudulently obtained TARP-related funds. Since its inception, SIGTARP has returned more than \$11 billion to the federal government, investors, homeowners and other victims.

SIGTARP spends 85% of its resources on law enforcement. SIGTARP has also partnered with other law enforcement agencies—including the DOJ, FBI, SEC and U.S. Postal Inspection Service—to investigate and prosecute numerous financial crimes, including money laundering, securities fraud and insider trading. Thus, it is not surprising that the office has, since its inception, been the source of a number of high-profile prosecutions and enforcement actions. And, more than 10 years after the office was created, SIGTARP continues to play an active role in investigating and prosecuting those who have committed fraud in conjunction with TARP. What is clear from SIGTARP's investigations, and the prosecutions that resulted, is that fraudsters engaged in all types of schemes to obtain TARP funds improperly.

A few of the schemes resemble what are likely to emerge from the COVID-19 stimulus spending. In some cases, financial institutions broke the law by failing to use TARP funds for the purposes for which they were intended. In other cases, noneligible companies misrepresented their financial status to obtain TARP funds. For instance, some TARP recipients cooked their books to make it appear that they were financially healthier than they actually were, so they could obtain TARP funds. Some companies that received TARP funds then went on to defraud others by either raising funds through stock sales or issuing securities based on misrepresentations about their financial health. SIGTARP investigations have also resulted in convictions for honest services fraud, where public officials received bribes in conjunction with the administration of a TARP-related program.

CRITICISM OF TARP ENFORCEMENT

While SIGTARP has had success in recouping funds to the federal government and its investigations have resulted in numerous convictions and enforcement actions, its role in the oversight of TARP has not been without criticism. Some argue that TARP was without sufficient oversight and transparency from inception, and that as a result, funds were dispersed without true knowledge of how they were being spent. Others have voiced concern that its enforcement was disproportionately targeted at executives from smaller financial institutions while chief executives of large Wall Street firms were immune to punishment. One solution SIGTARP has proposed is to create a national financial fraud registry, which will allow for prosecutors and investors to identify repeat offenders. The office launched the database Dec. 18, 2019.



In our next installment, we will look at prominent enforcement and criminal actions brought against individuals and institutions for fraud associated with TARP and how the government will approach fraud associated with the CARES Act as forecast by its approach in these cases.

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