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Watch Out for Fraud Tied to $2.2T COVID-19 Stimulus Package: Part I

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By enacting the $2.2 trillion stimulus package, Congress tried to buoy an economy that has been racked by unprecedented economic hardship. While it is unknown whether this effort will be successful, history has taught us that fraud tied to large disbursement of federal funds will be rampant and the government will necessarily ramp up enforcement to combat waste, fraud, and abuse.

This article—the first of a series on this topic—discusses the payment mechanisms in the COVID-19 pandemic stimulus package and sets the stage for how these programs could be abused.

INTRODUCTION

In just under three weeks in March, Congress drafted and approved legislation allocating approximately $2.2 trillion in stimulus funding intended to save the U.S. economy from the medical and economic fallout of the COVID-19 pandemic. And already more has been demanded. As of April 21, another half-trillion dollar spending package has been passed in the Senate and is awaiting final approval. While this county has seen crises and government interventions in the past, the COVID-19 relief package is in unprecedented. But, just as individuals and entities in the past have taken advantage of the distraction of emergency circumstances, the loose availability of large sums of government money, and the uneven oversight of emergency spending programs—they will again now. And the government will respond with investigations, prosecutions, and prison terms.

COVID-19

The speed and ferocity with which the COVID-19 pandemic has upended global economies has been dizzying. In late December 2019, the first cases of the novel coronavirus, the virus that causes COVID-19, were reported out of the Wuhan province in China. Just over three months later, by April 22, there have been 2,585,468 confirmed cases of COVID-19 globally according to the Johns Hopkins University Coronavirus Resource Center. Of those, 825,306 were confirmed in the United States with 258,589 cases localized in New York. More than 40,000 Americans have died so far.

The economic toll has been similarly staggering. On Feb. 12, the Dow Jones Industrial Average peaked at 29,551 before beginning its rapid descent to 18,591 on March 23—a 37% drop from its peak four weeks earlier. And, as the stock market plummeted, unemployment rates skyrocketed. Unemployment reached an historic low of 3.5% in December 2019, but exploded with 9.9 million Americans filing initial jobless claims, raising the number of unemployed Americans to over 22 million—a number that nearly all economists consider merely the tip of the iceberg. And these statistics probably understate the dramatic economic shocks that have taken place in such a short time.

Governments around the world reacted to the precipitous economic fallout by passing and enacting financial stimulus packages. In the United States, those relief/stimulus packages took the form of three initial pieces of legislation, each broadening in scope and ambition: the Coronavirus Preparedness and Response Supplemental Appropriations Act of 2020 (CPRSA) (March 6); the Families First Coronavirus Response Act (FFCRA) (March 18; and the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) (March 27).

The risk for abuse and fraud is as enormous as the spending bills themselves. Together, the stimulus packages will disburse nearly $3 trillion into the United States economy. However, unlike typical spending bills that have the benefit of resulting from a deliberate legislative process, time was (and is) of the essence for the COVID-19 bills both in terms of crafting and passing the bills and in disbursing funds necessary to protect millions. Making matters much more perilous, just as the pandemic has touched every corner of the country and every area of industry, the bills are broadly designed to reach nearly all sectors of the economy, all of which are governed by different agencies and regulated by different legislative schemes. Thus, an unprecedented quantity of government funding is flowing through a myriad of governmental channels to individuals, businesses, non-profits, and healthcare systems, Both the determination of eligibility for funding and the disbursement of funds is expected to occur almost immediately. Because of the speed with which these bills were passed and their massive breadth, there are likely loopholes and unintended consequences that will only become apparent in the succeeding months and years.

For instance, the CPRSA allocated more than $4 billion for the Department of Health and Human Services and the National Institutes of Health to disburse to for-profit and nonprofit medical suppliers or research grant recipients. Similarly, the bill contemplates private for-profit and nonprofit entities partnering with local municipalities to apply for a portion of nearly $2 billion allocated to the Centers for Disease Control and Prevention for COVID-19 response.

Businesses can also exploit the Emergency Paid Sick Leave and FMLA-Public Health Emergency Leave, created by the FFCRA. Under the FFCRA, tens of billions of dollars will be available through the Department of Labor to businesses for employee leave resulting from business closures due to state and local stay-at-home orders. In conjunction with the employee leave provisions, the FFCRA also awards tax credits to entities that are required to pay sick and family leave wages pursuant to the Act, creating another channel for fraud and abuse.

Of the three stimulus packages, the CARES Act carries the greatest potential for fraud and abuse. In addition to providing direct-to-individual payments who fall within specified income brackets, it allocates enormous amounts to various economic programs to provide relief for small and large businesses and individuals who are self-employed.

To assist small businesses with meeting payroll demands, the CARES Act initially allocated $349 billion to the Small Business Administration Payroll Protection Program (PPP). On April 21, the Senate approved over $300 billion more for the PPP. A business is eligible for a PPP loan that is 2.5 times the business's 2019 average monthly payroll, not exceeding $10 million. This loan can be forgiven in full, if the recipient business meets specific criteria and does not let go of employees. Eligible small businesses applying for a loan must make certifications concerning their payroll history and uses of the loan proceeds and must retain current payroll levels to be eligible for loan forgiveness. Adding another player to the mix, the CARES Act has designated private banks as administrators of the PPP, which will lead to inconsistent standards across the program and create potential for abuse both on the borrower and lender side.

Separately, the CARES Act authorizes the SBA to make small business loans directly through the Economic Injury Disaster Loan Program (EIDL), funding that also is set to increase by $60 billion. Also administered through the SBA, the EIDL program provides loans of up to $2 million to eligible businesses for non-payroll operational expenses. Additionally, the CARES Act authorized the Department of Treasury to provide $500 billion in loans, loan guarantees, and investments to eligible businesses. Because of the breadth of this program and the discretion provided to Treasury, it is ripe for abuse and corruption.

The CARES Act further allows the IRS to provide relief for businesses. Businesses may claim a refundable payroll tax credit for 50% of wages paid by eligible employers to certain employees during the COVID-19 crisis. Eligible employers can get immediate access to the credit by reducing employment tax deposits they are otherwise required to make.

For individuals, the CARES Act, through the Pandemic Unemployment Assistance Program, expands the eligibility of those seeking unemployment compensation through state unemployment programs. The program also provides an additional $600 per week in benefits and extends unemployment compensation from 26 to 39 weeks. Employees who have reduced hours may also qualify for benefits. While these programs undoubtedly cushion the blow of job loss caused by the COVID-19 pandemic, these increased benefits will also incentivize abuse.

A PRECEDENT

The nearest historical analogue for today's economic responsive stimulus packages is the financial markets collapse of 2008 brought on by the implosion of the subprime mortgage market and collapse of Lehman Brothers. In September 2007, the Dow traded at historic highs above 17,200 points. By September 2008, when Lehman Brothers collapsed, it had fallen 26% to 12,825 and would eventually fall as low as 9,801 in January 2009 representing a 44% decline from its high one year earlier. In the recession that followed, unemployment rose as high as 9.9%. In all, Americans lost roughly $10 trillion in wealth.

Facing the most dire economic climate since the Great Depression, the government acted aggressively to stabilize the economy and, through these efforts, passed and signed into law the Emergency Economic Stabilization Act of 2008 (EESA). In order to strengthen a financial sector reeling from the subprime mortgage crisis, the EESA created the Troubled Asset Relief Program (TARP), originally a $700 billion program, through which the United States government would purchase toxic assets from financial institutions.

Where there is money being spent, there will be fraud. The Association of Certified Fraud Examiners estimates that the typical business loses 5% of its revenue to fraud each year. Estimates for fraud in government spending range from about 3% to as high at 10%. Statistically, then, we can expect anywhere from $66 billion to $220 billion in fraud arising from the COVID-19 stimulus spending. And history demonstrates that there will be significant fraud. Investigations by the special inspector general for TARP and other government agencies resulted in hundreds of prosecutions and convictions and recovery of billions of dollars related to fraudulent schemes perpetrated in relation to TARP funding.

In Part 2, we will explore TARP spending and the myriad ways individuals and entities defrauded TARP, consumers, investors and others.

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