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# INSIGHT: U.S. banks face oversight risks from government COVID-19 stimulus plans

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The vast sums of money being pumped into the U.S. economy due to COVID-19 will soon be subject to Congressional oversight committees looking for evidence of fraud and whether the funds found their way to businesses most in need. In that review, banks will be on the front lines given the critical role they play in distributing the money, a future reality they should be preparing for, say legal experts and former government officials.

The government programs are varied, complex and politically charged. The Paycheck Protection Program (PPP), for example, is targeted at small businesses and has already come under fire for channeling money to larger businesses. An analysis by the Financial Times this week found that over 80 public companies have tapped into the $350 billion fund designed to keep small businesses afloat through the economic shutdown.

The bulk of the government's assistance falls under the CARES Act, which authorizes funding for a variety of programs to help businesses hurt by the coronavirus pandemic. At a high level, the act includes $46 billion for air carriers and businesses critical to national security; $350 billion for small business loans through the PPP, and $454 billion for the U.S. Treasury to provide support to Federal Reserve programs for businesses, states and municipalities that unlock trillions of dollars in liquidity.

As Treasury secretary Steven Mnuchin said: "Working with the Federal Reserve — we'll have up to $4 trillion of liquidity that we can use to support the economy."

Critics of how the programs are designed and the perceived lack of oversight have already made themselves known. Democratic Senator Elizabeth Warren, no stranger to the oversight process, said: "The Federal Reserve is handing out billions of dollars with little oversight and failing to require basic protections that companies retain workers and maintain payroll, failing to include protections against outsourcing, and failing to retain basic protections for union workers."

While the oversight process will look at all industries receiving financial assistance, the banking sector will undoubtedly come under scrutiny. Under enormous political pressure to get funds out the door, mistakes will inevitably be made, and given the lingering negative sentiment towards banks from the 2008 financial crisis, they will be subject to scrutiny and criticism.

"The banks have been a punching bag for at least a decade and it has been a long road for the them to regain trust," said Cliff Stanford, a regulatory expert at the law firm Alston & Bird. "The heat is still on and really never left and now they are back in the thick of things in administering these programs."

"Emergency relief programs create a perfect storm of oversight risk, with the need to quickly move large amounts of federal money with vague and evolving guidance," added Michael Gordon, a partner at the law firm Bradley, and who previously held senior positions in U.S. House committees and also served as counselor to the General Counsel of the U.S. Department of the Treasury.

**Several oversight programs – GAO appears out in front**

Under the CARES Act, three oversight bodies were established:

- the Office of the Special Inspector General for Pandemic Recovery within the Treasury Department;
- the Pandemic Response Accountability Committee, which consists of attorney generals for the Departments of Defense, Education, Health and Human Services, Homeland Security, Justice, Labor and the Treasury, among others; and
- the Congressional Oversight Commission

In addition, there is a select House committee to serve as another watchdog over the government's coronavirus spending, called the House Select Committee on the Coronavirus and chaired by Representative James E. Clyburn, a Democrat from South Carolina.

However, these oversight committees have yet to begin work. Congressional leaders still have to appoint a chair to monitor the $500 billion Treasury fund for distressed industries and companies. President Trump nominated a White House lawyer to fill the post to oversee the Treasury fund, but his pick has generated controversy and is unlikely to see confirmation for weeks.

And in early April, Trump upended the Pandemic Response Accountability Committee of existing inspectors generals when he effectively ousted its chairman and left the panel scrambling to regroup.

But then there is the General Accounting Office, which played an important role in overseeing government funds used to bailout banks after the financial crisis. Importantly, as it sits within the legislative branch, the watchdog may be difficult for Trump to meddle with. According to some reports, by the end of April, at least 30 CARES Act reviews and audits are expected to be underway at the GAO.

**Banks may be in a “no win” situation**

For the banking sector, despite their best efforts at ensuring the funds are properly distributed and in line with existing beneficial ownership and anti-money laundering controls, experts say past experience suggests the oversight process nearly always uncovers problems.

“Large financial institutions, in particular, will be pressured to deliver enormous sums of money quickly to struggling businesses and individuals pursuant to regulations and other guidance that may be ambiguous, incomplete, unevenly administered, or subject to frequent amendment. As past precedent shows, moreover, what seems clear now may turn out to be less clear later, especially as the political focus shifts from response to oversight and assessment,” said Davis Polk in an analysis of the CARES Act.

The irony of the oversight process this time around is that banks have scrambled to do what the government wants – lend quickly to lessen the economic blow to businesses -- unlike the financial crisis which was of their own making. But in the end, it may not matter in terms of accountability.

“There is an oversight structure that was put in place for the funds and all of the money will be subject to scrutiny,” said Chris Lu, former U.S. Deputy Secretary of Labor who also served as Assistant to the President and White House Cabinet Secretary for President Barack Obama. “I think banks will be scrutinized, but in some ways they are doing what the government asked them to do.”

Some of the largest financial firms already are reported to be facing lawsuits over how they handled the Paycheck Protection Program, alleging that the banks processed applications based on the size of fees they'd receive rather than on a first-come, first-served basis.

**What should banks be doing now?**

Because it’s impossible to identify and map all of the potential risks that could emerge from the government’s relief programs, legal experts nonetheless warn firms to take a cautious and risk-based approach to their participation. Davis Polk, for example, suggests:

- Developing clear internal processes for identifying, assessing, and categorizing programmatic risks, with internal or external counsel given clearly defined roles with respect to the assessment and resolution of risks that exceed a certain threshold;
- Ensuring that all program documentation (e.g., application or loan materials) is aligned with any internal risk assessment processes, and has been subject to business and legal / compliance review; and
- Obtaining the advice of external counsel for especially significant programmatic considerations, in order to ensure that all potential compliance vulnerabilities are carefully scrutinized and to provide the basis for raising an advice-of-counsel defense should the need later arise.

“Notwithstanding the immense pressure on CARES Act program participants to distribute or obtain funds as quickly as possible, participants should be careful to ensure that short-term needs are not unintentionally creating longer-term, more significant risks,” the law firm added.

Another area that firms should focus on is their internal whistleblower programs. Given the amount of money being channeled and the speed of the process, the environment is ripe for employees to discover problems that will be brought to management’s attention.

“This is a time when whistleblower programs will be tested,” said Stanford of Alston & Bird. “If there is a time when you are following those procedures it’s now.”

(Henry Engler, Regulatory Intelligence, New York)

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