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The CARES Act: Litigation and Enforcement Lessons from the Financial Crisis

The Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"), which was signed into law on March 27, 2020, provides $2 trillion in emergency relief to individuals, small businesses, large corporations, and financial institutions. This includes up to $349 billion in small business loans and up to $500 billion in loans and loan guarantees to eligible businesses affected by the coronavirus crisis. As with the stimulus initiatives following the 2008 financial crisis, the CARES Act imposes significant conditions on recipients of this aid and creates a new inspector general dedicated to enforcing compliance with these conditions. All businesses should therefore be mindful of the compliance and enforcement risks that accompany participation in these stimulus initiatives.

Among its many initiatives, the CARES Act authorizes the Department of the Treasury to make loans, loan guarantees, and other investments in support of eligible businesses, states, and municipalities up to an aggregate amount of $500 billion, including $454 billion to Federal Reserve-established programs to provide liquidity to the financial system. But the CARES Act imposes operational and governance conditions on aid recipients, including limits on executive compensation, stock repurchases, dividend payments, and layoffs.

To help enforce these conditions, the CARES Act creates the Office of the Special Inspector General for Pandemic Recovery within the Department of the Treasury. This office is granted subpoena power, and the duties of this office are broad: "[to] conduct, supervise, and coordinate audits and investigations of the making, purchase, management, and sale of loans, loan guarantees, and other investments made by the Secretary of the Treasury" under the CARES Act. After an investigation, the Special Inspector General can refer matters to the Department of Justice or other agencies for prosecution. The office terminates after five years.

The creation of this new office parallels the creation of an inspector general for the Troubled Asset Relief Program ("TARP") following the 2008 financial crisis. A change in administration combined with retroactive changes to various rescue programs transformed the office into a highly aggressive law enforcement agency. In the decade following the financial crisis, investigations by the TARP inspector general led to significant civil or criminal penalties against hundreds of defendants. The duties and powers of the Special Inspector General for Pandemic Recovery generally mirror those of the inspector general for TARP.

Although enforcement activities may be slow during the crisis itself, it is a truism that the creation of an investigative arm will eventually lead to investigations.

Other provisions in the CARES Act also present litigation and enforcement risks, even though they fall outside the focus of the Special Inspector General. The Paycheck Protection Program invites financial institutions to issue small business loans guaranteed by the Small Business Administration ("SBA") and permits eligible borrowers to apply for loan forgiveness. Financial institutions are to act as key conduits between the borrowers and the SBA in this process, but the legislation does not specify what due diligence, if any, is required from the lenders, nor does it specify the required contents of any submissions from the lenders to the SBA. While the legislation includes a limited safe harbor for lenders who rely on borrower submissions, it protects only against enforcement actions by the SBA, leaving lenders exposed to potential liability under the False Claims Act and other anti-fraud statutes in the event of misrepresentations about borrower eligibility and compliance. The CARES Act also permits the sale of certain loans into the secondary market. Again, the aftermath of the 2008 financial crisis saw aggressive government use of the FCA and FIRREA to extract large settlements from financial institutions in connection with what were alleged to be reckless lending and securitization practices. It remains to be seen what will be achieved by industry efforts with the SBA to mitigate risks.

Despite these risks, there are important differences between the current enforcement environment and that following the 2008 financial crisis. In the aftermath of TARP, financial institutions were viewed as benefitting from a crisis of their own creation. By contrast, financial institutions played no role in causing the coronavirus crisis, and are playing an integral role in combatting the economic fallout by providing liquidity to small businesses. Likewise, corporations should not generally be faulted for the sudden economic dislocations wrought by COVID-19. ***None of the above should deter financial institutions and other companies from participating in these programs as appropriate. But it is a reminder that they will be well served by having a heightened focus on compliance and best practices when participating in CARES Act initiatives.***

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