

Be Careful What You Wish For: Best Practices For Preparing and Responding to Investigations by the Office of the Special Inspector General for the Troubled Asset Relief Program

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To quote the late Barry Goldwater, “a government that is big enough to give you all you want is big enough to take it all away.”¹ Companies that have received some portion of the billions in government funds committed through the Troubled Asset Relief Program (“TARP”) may be getting the financial resources they needed, but the intense public and political scrutiny accompanying the commitment of these funds has led the government to embark on an ambitious course of audits and criminal investigations.

With the unprecedented outlay of taxpayer funding through the various programs under the TARP umbrella, companies and their counsel are entering a new era in which government investigations of a size, speed, and aggressiveness not previously encountered could become the norm. Traditional best practices for responding to government investigations are still important, but now is the time to review the unique challenges presented by the enforcement regime of the Office of the Special Inspector General for the Troubled Asset Relief Program (“SIGTARP”).

Overview of TARP Programs and Funding

As detailed in SIGTARP’s first quarterly report to Congress, the originally envisioned \$700 billion TARP program has grown into a dozen different funding programs with nearly \$3 trillion in total projected spending.² Of these twelve programs, some are directed solely to specific financial institutions, such as AIG, Citigroup, and Bank of America.

While the programs that provide TARP funds to these firms have been the focus of the media, they represent only a small fraction of the total projected TARP-related funding. Indeed, the various TARP programs are not directed solely to the Citigroup, Bank of America, and Chrysler types of the world. Dozens, and perhaps hundreds, of smaller companies and even individuals may soon participate in two additional TARP programs. The first of these is the Term Asset-Backed Securities Loan Facility (“TALF”), under which the Federal Reserve Bank of New York will provide non-recourse loans secured by asset-backed securities.³ Up to \$1 trillion will be made available for TALF loans, which may be secured by a wide range of asset-back securities, including prime and sub-prime mortgage-backed securities, credit card loans, auto financing, student loans, business-equipment loans, mortgage-servicing advances, and Small Business Administration loans.⁴ Another \$1 trillion will be made available via the Public-Private Investment Program (“PPIP”), under which Treasury and the Federal Deposit Insurance Corporation will establish and open for investment Public-Private Investment Funds to purchase mortgage-backed securities and other real-estate related securities.⁵ Given the size and scope of these programs, there is no question that TALF and PPIP will dramatically increase the number of participants in the universe of TARP programs.

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Office of the Special Investigator General for the Troubled Asset Relief Program

The political and popular outcry over the billions spent by Treasury has motivated a swift and forceful political reaction. In March, the enactment of the Special Investigator General for the Troubled Asset Relief Program Act of 2009⁶ imbued SIGTARP with broad powers to investigate and prosecute TARP-related fraud. Specifically, SIGTARP's overarching mandate is to "promot[e] transparency in TARP, through effective oversight of TARP in coordination with other relevant oversight bodies, and by robust criminal and civil enforcement against those, whether inside or outside of Government, who waste, steal, or abuse TARP funds."⁷ Backed by \$50 million in funding, and led by Special Inspector General ("SIG") Neil Barofsky, SIGTARP's authority encompasses:

- the authority, with limited exceptions, to conduct, supervise, and coordinate audits and investigations;
- the authority to subpoena documents and information from government agencies as well as non-governmental institutions and individuals;
- the authority to undertake law enforcement functions without first obtaining approval from the United States Attorney General;
- the responsibility to coordinate and cooperate with other inspectors general on oversight of TARP-related activities; and
- the duty to provide a report to Congress, by September 1, 2009, on how TARP recipients have used TARP funds.⁸

SIG Barofsky will lead an organization comprising of experienced federal agents, forensic investigators, and attorneys in several divisions.⁹ Of particular interest to companies facing potential TARP-related scrutiny are the SIGTARP's Audit and Investigations Divisions. The Audit Division is directed "to ensure that appropriate compliance and control mechanisms are in place and complied with, both by Treasury in its management of TARP and by the recipients of TARP funds."¹⁰ The Investigations Division includes "teams of experienced financial and corporate fraud investigators" (federal agents, forensic specialists, and attorneys) with authority to conduct civil and criminal investigations.¹¹

Beyond SIGTARP, a wide range of government agencies are committed to cooperating with SIGTARP's enforcement mandate, including: Treasury, Office of the Comptroller (OCC), Federal Reserve, Federal Deposit Insurance Corporation (FDIC), Securities and Exchange Commission (SEC), Housing and Urban Development, Small Business Administration, United States Postal Service, Department of Justice (Main Justice in D.C. and regional United States Attorneys), Internal Revenue Service (IRS), Federal Bureau of Investigation (FBI), and various state attorneys general.¹² The most significant manifestation of cooperation between SIGTARP and other agencies is the "TALF Task Force," comprised of representatives from SIGTARP, the Federal Reserve, Treasury, IRS, SEC, and Immigrations and Customs Enforcement, and charged with investigating abuses and fraud by participants in the TALF program.¹³

Investigation and Prosecution of TARP-Related Fraud by SIGTARP

Was there any doubt that SIGTARP would act aggressively to fulfill its mandate, considering SIG Barofsky's recent statement: "We stand on the precipice of the largest infusion of Government funds over the shortest period of time in our Nation's history. History teaches us that an outlay of so much money in such a short period of time will inevitably attract those seeking to profit criminally."¹⁴ Together with its partnering agencies, SIGTARP has announced that the key principle that will guide its aggressive investigative and prosecutorial mandates is *transparency*—

that is, ensuring that lawmakers, investigators, and the public can understand the uses to which TARP participants have put taxpayer dollars.¹⁵ As the SIG Report states, “Transparency is a powerful tool to ensure accountability and that all those managing and receiving TARP funds will act appropriately, consistent with the law, and in the best interests of the country.”¹⁶

In furtherance of this goal of transparency, SIGTARP has already issued audit questionnaires directed to more than 300 institutions that received TARP-related funds.¹⁷ These audits focused on the sufficiency of internal controls and accounting by TARP-fund recipients, as well as mandatory verification of reports to Treasury by executives—including the segregation of TARP funds, tracking the uses of these funds, and explaining the impact of these funds on operations (particularly lending practices).¹⁸

These audits likely represent only the beginning of SIGTARP’s wide-ranging inquiries. In fact, SIGTARP has announced its intent to pursue an aggressive program of regulatory oversight and investigations. This should put all companies with even a tangential connection to TARP programs on notice of a significant risk of government scrutiny. Even more noteworthy is SIGTARP’s public commitment to *proactive* investigation and enforcement. For example, in his testimony before the Senate Finance Committee on March 31, SIG Barofsky stated that SIGTARP “recognize[d] the inevitability of fraud in large public programs,” and accordingly would push for “law enforcement response[s] through training and the leveraging of resources *before* fraud occurs.”¹⁹

Direct government inquiries are not the only source of potential SIGTARP audits and investigations. SIGTARP’s tip hotline is now “staffed, operational, and providing an interface with the American public to facilitate the reporting of concerns, allegations, information, and evidence of violations of criminal and civil laws in connection with TARP. Reporting may include allegations of fraud, waste, abuse, and reprisals for bringing to light TARP-related concerns.”²⁰

Nor will SIGTARP’s activities be limited to audits and investigations. SIG Barofsky has testified that criminal investigations will be “a large focus of my office.”²¹ The first of many inevitable criminal prosecutions under the SIG’s authority targeted Gordon B. Grigg, a Tennessee financial advisor. The charges (principally mail and wire fraud) announced by SIG Barofsky on April 22, include allegations that Grigg solicited investments in a Ponzi scheme by characterizing the securities being offered as “government-guaranteed commercial paper and bank debt available as part of the TARP program.”²² Although the allegations in Grigg’s case may present an extreme set of facts, the SIG has stated that it has nearly 20 other criminal investigations currently pending, which “vary widely in subject matter and include large corporate and securities fraud matters affecting TARP investments, tax matters, insider trading, public corruption and mortgage-modification fraud.”²³ Unsurprisingly, there is growing political pressure to see through these initial criminal investigations—and to bring additional actions: as quoted in a recent Los Angeles Times article, one Republican Senator stated that “I would guess that 20 investigations, while a good start, is only the tip of the iceberg.”²⁴

Risk Factors Increasing the Likelihood of TARP-Related Government Investigations

These pronouncements by lawmakers and SIGTARP, together with the SIG’s early investigative and enforcement actions, represent the confluence of unprecedented law-enforcement resources and political pressure to use them. It is imperative that companies—and their in-house and outside attorneys—with any connection to TARP programs understand the factors that increase the risk of a criminal investigation by SIGTARP.

The most obvious risk factor is a company’s direct participation in any of the various TARP programs, including receipt of government funds through TALF or an investing partnership with the government in PPIP. But SIGTARP’s investigation into AIG’s counterparty payments demonstrates that investigations will not be limited to institutions directly connected to TARP funding. Indeed, there is a significant risk that any company or individual in a business

relationship with recipients of TARP funds, or investors in the PPIP program (either directly or through a Treasury-approved PPIP fund) will also be subjected to audits and investigations. As SIG Barofsky recently announced, his office will have authority to “investigate and audit any TARP dollar, anywhere it goes.”²⁵ Furthermore, because the government has been slow in revealing the details of the TALF and PPIP programs, there is a significant risk that early movers will encounter unforeseen or changed “rules of the road” in later months or years.²⁶

The SIG’s broad coalition of cooperating agencies also indicates that any communications by companies and their attorneys with the SEC, Department of Justice (DOJ), Treasury, or any other federal or state regulatory or law-enforcement agency may form the basis for inquiries and investigations by SIGTARP. Put differently, companies should assume that every TARP-related statement—whether in person, by phone, or in marketing materials, prospectuses, and other SEC filings—may eventually make its way to the SIG’s desk. Similarly, the SIGTARP’s tip hotline presents a risk that whistleblowers may spur SIGTARP or other agencies to investigate even in the absence of a TARP-related public statement by the company or its agents.

Best Practices for Responding to TARP-Related Investigations

Any company with connections (however tangential) should review best practices for avoiding and responding to government investigations. As made clear by SIGTARP’s report and SIG Barofsky’s public statements, the critical goal must be to ensure transparency in the receipt and uses of TARP-related funds—not only the dollars received directly from Treasury or other agencies, but also those amounts received from contractual counterparties that have received TARP funding. Companies will be best served by internal controls and accounting procedures that allow for dollar-for-dollar tracking of all TARP-related incoming and outgoing payments. Keeping these amounts in segregated accounts (to the extent possible) will allow for timely and clear responses to audits or data requests from SIGTARP and other agencies. Financial institutions, in particular, would be well advised to prepare a detailed explanation of how the receipt (direct or indirect) of TARP funds affected the frequency and volume of its lending activities. SIGTARP’s focus on misrepresentations in TARP-related oral and written communications further recommends that companies exercise cautiousness and circumspection when making any TARP-related statements and document the dates and methods of such communications.²⁷ Additionally, SIGTARP’s express intent to rely on unsolicited tips indicates that companies should review their obligations to avoid retaliatory actions toward whistleblowers.

SIGTARP’s stated commitment to proactive investigations presents additional challenges. Many companies and their attorneys are accustomed to “reactive” government investigations—for example, Financial Industry Regulatory Authority (FINRA) or the SEC often issue informal data requests based on unusual stock-trading activities in the aftermath of significant corporate events like a public offering or merger announcement. In contrast, the SIG’s description of the TALF Task Force makes clear that the government will no longer wait for indicia of fraud before taking action: “[The TALF Task Force] represents a[n] historic law enforcement effort with an ambitious goal: to redefine the policing of complex Federal Government programs by *proactively* arranging a coordinated law enforcement response *before the fraud occurs*.”²⁸ Companies cannot count on the traditional evolution of government action from data requests to formal investigations to enforcement actions. Even an informal questionnaire or audit by SIGTARP may quickly and without warning morph into an aggressive investigation.

These new realities demand that companies take their own proactive steps to prepare for fast-moving and fluid demands from SIGTARP and cooperating agencies. Ordinarily, responding to an informal government inquiry or audit may not require the effort and expense of delegating oversight of the response to a Special Committee of independent outside directors who had no involvement with the events under review. However, the unique challenges presented by TARP-related investigations requires that companies adapt their traditional best practices for responding to government inquiries. Because a SIGTARP inquiry or audit may quickly transform into a formal investigation, the company’s officers and directors should be prepared to establish a special

committee on short notice, even if such a step seems unnecessary at the outset. Given the likelihood that accounting issues will predominate a TARP-related investigation, the board's audit committee may be a sensible choice for the special committee if the members can demonstrate sufficient independence from the issues under review.

Another critical step in the investigation process is the selection and retention of an outside law firm to conduct the investigation and interface with government personnel. Just as a SIGTARP inquiry should inspire contingency plans for the formation of a special committee, companies would be well advised to retain outside counsel early in the investigation process. To maintain the credibility of the investigation in the eyes of law enforcement, outside auditors, and shareholders, the Committee will often opt to retain independent outside counsel—that is, a firm that has not previously represented the company or its board of directors.

Dedicating sufficient resources to the response—including internal finance personnel outside financial consultants (often retained by the law firm or special committee)—will increase the likelihood of a timely response demonstrating the transparency and accounting practices expected by SIGTARP. Additionally, although SIGTARP has not yet released a policy or procedures manual,²⁹ history teaches that there will be pressure on companies to cooperate with government investigators by singling out the “gatekeepers”—*i.e.*, the individual directors or officers with oversight responsibilities for TARP-related funds and counterparty contracts. Indeed, SIG Barofsky has signaled that his office may focus on fraudulent conduct by individuals acting beyond their authority.³⁰ And as with any government investigation, the disclosure of privileged material to the government or outside auditors raises a risk that the company could lose a privilege challenge related to any information it shares with the government or outside auditors.

While these best practices will put companies, individual directors and officers, and their attorneys in position to respond to TARP-related investigations, it bears repeating that SIGTARP presents a new paradigm. The timetables and demands from SIGTARP and cooperating agencies may be more aggressive than companies and their counsel expect, at least when compared to historical practices by the SEC and DOJ (among other agencies). Early reports suggest that SIG Barofsky will set a “tone at the top” that may be less cooperative than companies have come to expect. One colorful example is a recent article in which an unnamed government official compared Barofsky's ambitiousness to Eliot Ness.³¹ Companies should also expect little, if any, advance notice before receiving an audit or data request from SIGTARP; among other reasons, the White House Office of Budget Management recently waived the requirement that government investigators publish any proposed letters of inquiry to TARP recipients and await a 15-day comment period before delivering the letter.³² In addition, given SIGTARP's duty to submit congressional reports on a quarterly basis, increased levels of inquiries and publicized investigations may be expected nearer the end of each fiscal quarter.

The political and public pressures related to the financial crisis appear likely to manifest through an aggressive pattern of investigation and enforcement by SIGTARP and cooperating federal and state agencies. Understanding the congressional mandate and delegated authority of SIGTARP will enable companies and their attorneys to anticipate the possible triggers for government inquiries. As we embark on a new era of unprecedented government investment in private enterprise—and the intense scrutiny accompanying those investments—even those companies with little, if any, direct connection to TARP-related programs should review and update their best practices for responding to government investigations.

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¹ Barry M. Goldwater, Speech at Westchester, PA, Oct. 21, 1964.

² See Quarterly Report to Congress by the Office of the Special Inspector General for the Troubled Asset Relief Program (Apr. 21, 2009) ("SIG Report"), at 3–4.

³ *Id.* at 14.

⁴ *Id.*

⁵ *Id.* at 36.

⁶ Enacted March 25, 2009. See SIG Report at 11.

⁷ *Id.* at 12.

⁸ SIG Report at 11.

⁹ *Id.* at 25–29.

¹⁰ *Id.* at 24–25.

¹¹¹⁸ *Id.*

¹² *Id.* at 15–16.

¹³ *Id.* at 17.

¹⁴ Statement of Neil Barofsky, Special Inspector General, Troubled Asset Relief Program, Before the United States Senate Finance Committee, Mar. 31, 2009, at 8.

¹⁵ *Id.* at 12.

¹⁶ *Id.* See also E. Scott Reckard, "Banks to Get TARP Scrutiny: Executives Will Have To Vouch For Their Use of Funds Under Threat of Criminal Penalty," L.A. Times (Feb. 5, 2009).

¹⁷ *Id.* at 21.

¹⁸ See *id.*

¹⁹ Statement of Neil Barofsky, Special Inspector General, Troubled Asset Relief Program, Before the United States Senate Finance Committee, Mar. 31, 2009, at 7.

²⁰ SIG Report at 18.

²¹ Quoted in "Regulator Says Bailout Fund Is Misleading Public," N.Y. Times (Feb. 6, 2009).

²² Information filed in United States v. Grigg, No. 3:09-00089, M.D. Tenn. (Apr. 22, 2009), at ¶ 18.

²³ SIGTARP Report at 4.

²⁴ Ralph Vartabedian & Tom Hamburger, "Crimes Suspected In 20 Bailout Cases—For Starters," L.A. Times (Apr. 21, 2009). The SIG's ambitious enforcement program is not the only government response to risks of TARP-related fraud. A recently announced amendment to Senate Bill 386, the Fraud Enforcement and Recovery Act of 2009, would mandate that companies receiving TARP funds report all expenditures exceeding \$10,000 that are not deemed "vital to the company's recovery, future solvency or liquidity." Ralph Vartabedian & Tom Hamburger, "Crimes Suspected In 20 Bailout Cases—For Starters," L.A. Times (Apr. 21, 2009). Another proposed amendment to the same bill would add \$20 million to the SEC's enforcement budget, allowing the agency to hire 60 new enforcement officers. *Id.*

²⁵ Deborah Solomon & Liz Rappaport, "TARP Cop Barofsky Gets Into Tough Enforcer Role," Wall Street Journal (Mar. 9, 2009).

²⁶ See Jacqueline Bell, "Toxic Asset Plan Still Light on the Details," Law360.com (May 6, 2009).

²⁷ See SIG Report at 25 ("Those who make intentional misrepresentations in the TARP application process or in their financial reporting to Treasury may be in violation of several criminal statutes, including securities fraud, wire fraud, mail fraud, and false statements. SIGTARP intends to investigate these potential crimes vigorously.").

²⁸ *Id.* at 17 (emphasis added).

²⁹ See SIG Report at 29 (SIGTARP has begun preparing "policies and procedures concerning the roles and authorities of SIGTARP executives and divisions, standards of conduct and discipline...and subpoena authorities.").

³⁰ See Ralph Vartabedian & Tom Hamburger, "Crimes Suspected In 20 Bailout Cases—For Starters," L.A. Times (Apr. 21, 2009) ("You don't need an entirely corrupt institution to pull one of these schemes off...You only need a few corrupt managers whose compensation may be tied to the performance of these assets in order to effectively pull off a collusion or kickback scheme.").

³¹ See Deborah Solomon & Liz Rappaport, "TARP Cop Barofsky Gets Into Tough Enforcer Role," Wall Street Journal (Mar. 9, 2009).

³² See *id.*