

Remaining Vigilant to Compliance and Enforcement Concerns in Times of Crisis

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In times of increased financial stress—and particularly during times of financial shock where expectations and reality diverge significantly and rapidly—internal and external pressures can lead to risk-taking with lasting consequences. For example, pressure often mounts to boost revenue to save a failing quarter, to take advantage of government bailout opportunities, and to land special purpose government contracting opportunities by all means possible, sometimes even through bribes or fraud. We also know from past experience that during turbulent times, risky or improper behavior that might have escaped detection in good economic times often comes to light. As the pressure to take risks increases, so too does scrutiny from regulators and shareholders.

An ounce of prevention is worth a pound of cure

Neglecting the warning signs or putting off dealing with problematic behavior can have long-term costs – even well after the immediate crisis has been weathered. Corporate penalties regularly involve disgorgement of all gains plus substantial fines, and executives and employees can face criminal exposure. As such, ignoring fraud now is like creating an account payable, but payable on demand at a future date outside your control.

In these times, strict adherence to and enforcement of policies on compliance, anti-bribery, sound accounting practices and internal controls should be top of mind. Organizations facing internal and external pressures should remain vigilant by immediately and thoroughly investigating and addressing any signs of misconduct or fraud.

For organizations involved in acquisitions and other due diligence processes, crisis times can present additional difficulties. Documents may be harder to obtain, and the ability to scrutinize transactions and other aspects of the deal through face-to-face interaction may be limited or altogether impossible. Organizations should give critical thought to how to approach due diligence under these circumstances, considering not only logistical concerns, but also how to assess the target's ongoing compliance functions while maintaining their own.

Government enforcement often ramps up after national emergencies

Believing the government is too busy or preoccupied to pursue fraud during a crisis is a mistake. While its focus may be elsewhere in the near term, the government's memory is long (and so are statutes of limitations). Taxpayers also demand accountability in the wake of government stimulus efforts. Here are a few notable recent enforcement examples in the US and UK, with lessons for today:

- **Special Inspector General for TARP:** The 2008 financial crisis led to the US government's establishment of the Troubled Asset Relief Program, and fraud committed against the TARP inevitably spawned an entirely new investigative and enforcement agency: SIGTARP. A decade later, SIGTARP remains active, having collected over \$11 billion (\$900M in 2019 alone) and 381 criminal convictions, including multibillion-dollar penalties across the financial industry. Many enforcement actions related to trading in residential mortgage backed securities. One case resulted in the 2013 conviction of the former CEO of The Bank of the Commonwealth for bank fraud and other crimes related to concealment of lending losses and the \$28 million in TARP funds sought by the bank. Following a 10-week jury trial, the CEO was sentenced to 23 years in prison and ordered to pay \$333,569,732 in restitution to the Federal Deposit Insurance Corporation.
- **Hurricane Katrina Fraud Task Force:** Within just two years of its establishment, the task force had brought federal charges against over 700 individuals for various hurricane fraud-related crimes, such as emergency benefit fraud, identity theft, procurement fraud and public corruption. Private whistleblowers also aided the government's post-Katrina fraud detection

efforts by bringing a slew of cases under the federal False Claims Act, including one such action by two claims adjusters who alleged that State Farm Fire and Casualty Company ordered its claims adjusters to misclassify wind damage as flood damage to shift liability away from company-issued general homeowners' policies to government-backed flood insurance policies. The lawsuit resulted in an award for the whistleblowers of \$758,250, which included treble damages and a civil penalty. Later, the task force became part of the National Center for Disaster Fraud, which focuses on detecting, preventing, investigating and prosecuting fraud relating to all types of disasters, including many such frauds perpetrated at an organizational level and not simply by opportunistic individual scammers.

- **UK Serious Fraud Office and Financial Conduct Authority investigations:** Following the economic crisis of 2008 the UK Serious Fraud Office and the Financial Conduct Authority opened numerous high-profile investigations into alleged fraud and misconduct by major financial institutions around the time of the crisis. Some of these investigations have only recently concluded and some remain ongoing even now. For instance, the FCA is currently investigating the actions of senior management at HBOS in relation to the near-collapse of the bank during the financial crisis, before it was rescued by a government bailout. This follows public criticism of the FCA for its failure to take action immediately after the collapse.

Experience shows us that there is a large increase in investigations activity by international enforcement agencies following crises and often intense political pressure for such agencies to investigate and take action. That events occurred during a time of crisis is not a defense. To the contrary, enforcement agencies will often use company action during difficult economic times to suggest that economic imperatives drove alleged misconduct and illegal activity.

Now is the time to act

Now is the time to be vigilant. Existing resources devoted to fraud detection should be leveraged, emphasized, highlighted and enforced, not relaxed. Transactions should be scrutinized with no less rigor than in good economic times, and internal complaints should be investigated, addressed and resolved. Failing to do so places organizations at greater risk tomorrow even if they successfully get through today.

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