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Professional Perspective

Banking Industry Risks Under CARES Act and FCA

Glen Donath, Michelle Williams, Joshua Berman, and Doug Tomlinson, Clifford Chance

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Industries, like health care, that receive funds from federal government programs are very familiar with the False Claims Act. At the center of the Coronavirus Aid, Relief, and Economic Security (CARES) Act, however, is the banking industry—an industry that does not regularly have exposure to the FCA.

While this industry is heavily regulated and many banks in recent years have invested significant resources in areas such as anti-money laundering (AML), economic sanctions, anti-bribery and corruption, and the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), compliance programs at even the most sophisticated multi-national banks generally do not attempt to manage FCA risk or exposure.

Accordingly, those compliance programs will not protect banks from potential FCA exposure under the CARES Act funding programs. Banks should prepare to mitigate against potential liability with newly tailored compliance programs.

Background

The CARES Act is the largest economic stimulus package in American history, providing over $2 trillion in funding to address the economic fallout from the Covid-19 pandemic, including more than $800 billion in loans to businesses. Numerous loan programs of the CARES Act are designed with banks in the middle: The government provides funds to banks, which then disburse loans to businesses. Because the federal government compensates banks for providing government loan funds to borrowers, their role in processing the CARES Act funds puts them squarely within the FCA's ambit.

Despite the rushed nature of the CARES Act and lack of clear guidelines for banks and businesses to follow in receiving and disbursing funds, the government has been clear that it plans to strictly enforce the CARES Act requirements. Attorney General William Barr has directed all U.S. Attorneys to prioritize Covid-19-related fraud. There are already examples of this enforcement: In May 2020, the U.S. Department of Justice subpoenaed several large banks as part of an investigation into possible abuse of the Paycheck Protection Program (PPP), a $660 billion CARES Act loan program designed to help small businesses.

Additionally, banks will likely face FCA liability not only from cases brought by the government but also from whistleblowers, who may be disgruntled employees who lost their employment as a result of the pandemic or borrowers who find fault in banks' administration of the loan programs. These factors are coalescing together to create a unique vulnerability for banks. Banks need to start preparing for this vulnerability, now.

How the FCA Creates Exposure

The FCA provides liability for anyone who knowingly submits a false claim to the government or makes a false record or statement to get a claim paid by the government. The FCA defines "knowingly" as actual knowledge of the falsity, acting in deliberate ignorance of the truth, or acting in reckless disregard of the truth.

While the claim at issue must be presented to an "officer, employee, or agent of the United States," and the government can file suit under the FCA, actions may also be commenced by private parties on behalf of the government. In such situations, the government can choose whether or not to intervene. Regardless of whether the government intervenes, successful private plaintiffs are awarded between 15-30% of the total damages. This is a strong incentive for whistleblowers to come forward given that defendants will owe three times the amount of the government's damages and up to $10,000 per false claim if found liable. These penalties are considered punitive in nature and can reach astronomical levels.

Prior to 2016, there was disagreement among courts over what constituted "false" claims. Some believed false claims required affirmative misrepresentations of express conditions of payments. Others believed that omissions regarding non-compliance with express conditions of payments satisfied the requirement. A third category believed that misrepresenting compliance with implied conditions of payments also constituted false claims.

In 2016, the U.S. Supreme Court in *United Health Services v. Escobar*, 136 S. Ct. 1989 (2016), held that misrepresentations of compliance with "statutory, regulatory, or contractual requirements" can constitute violations of the FCA even if they are not express conditions of payments, thereby confirming the applicability of the implied false certification theory. While *Escobar* expanded false claims to include implied certifications, it also limited the scope of false claims to those that are material—including for express certifications. The court stated that a false claim is likely material if the government would not have provided payment had it known about the falsity.

In late 2019, the Second Circuit held that banks can be liable under the FCA for claims made to the Federal Reserve banks even though the Federal Reserve banks are not employees or officers of the U.S. government. This is particularly relevant in the CARES Act context as many of the loan programs are provided through the Federal Reserve banks.

CARES Act Funding Programs

On March 27, 2020, President Donald Trump signed the CARES Act in response to the Covid-19 pandemic and its collateral damage to the economy. The CARES Act establishes programs and facilities to stimulate the economy, including the PPP which is administered by the Small Business Administration (SBA) and provides forgivable loans to assist small businesses with expenses during the Covid-19 shutdown. The loans under the PPP are provided to businesses through banks and are forgivable if borrowers maintain their payrolls during the crisis.

The CARES Act also provides $500 billion to the Treasury Department for loans, loan guarantees, and other investments, of which $454 billion is allocated in support of the Federal Reserve's emergency lending facilities to provide "liquidity to the financial system that supports lending to eligible businesses, States, or municipalities." CARES Act, Pub. L. No. 116-136 § 4003(b)(4). Some of the key facilities established by the Federal Reserve pursuant to the CARES Act include the Main Street Lending Program, Money Market Mutual Fund Liquidity Facility (MMLF), and Term Asset-Backed Securities Loan Facility (TALF).

The Main Street Lending Program includes three facilities to provide credit support to help small and medium-sized businesses maintain their operations and payroll during the pandemic. Although similar to the PPP in that banks receive the funds before disbursing loans to businesses in need, the program's loans are not forgivable and are targeted more towards medium-sized businesses. The MMLF and TALF do not involve banks serving as lenders but banks may nevertheless participate.

Under the MMLF, the Federal Reserve Bank of Boston provides loans to eligible borrowers including U.S. depository institutions, bank holding companies, and branches and agencies of foreign banks, taking as collateral eligible securities purchased from prime and municipal money market funds. The TALF is designed to support the flow of credit to consumers and businesses through securitization by enabling the issuance of asset-backed securities, such as securities backed by student loans, auto loans, credit card loans, loans guaranteed by the SBA, and other eligible assets.

These programs and facilities require participating banks to make several express certifications. Importantly, under both the PPP and the Main Street Lending Program, the lender bank must confirm the borrower's eligibility criteria—i.e., under the PPP a borrower must certify that it was in operation on Feb. 15, 2020, had employees to whom it paid salaries and payroll taxes, and that the information in the loan application and supporting documents is true and accurate. Lenders must certify to the SBA that they have confirmed borrower eligibility through a good-faith review. Both programs also place limits on the loans themselves, such as setting interest rates, dates of origination, and terms and maturities.

Clear Exposure

The SBA, which administers the PPP program, has issued guidelines providing that banks may rely on borrowers' representations in connection with loan applications so long as the banks complete a good-faith review of the loan application. Specifically, the SBA's April 2, 2020 Interim Rule states that the SBA "will hold harmless any lender that relies on … borrower documentations and [an] attestation from the borrower." Unfortunately, this guidance—which is not binding on the Department of Justice—does not provide sufficient protection to banks in shielding them from potential FCA exposure. The SBA requires a lending bank to conduct an independent good-faith review of each loan application and also must comply with Bank Secrecy Act, AML, and Customer Identification Program (CIP) compliance protocols.

The Main Street Lending Program places additional restrictions on the relationship between the lender and the borrower. For example, lenders must certify that they will not request early repayment of other debt to the lender by the borrower, that they will not cancel or reduce any existing committed lines of credit to the borrower, that they will retain 5% direct ownership of the loan, and that the loan is not contractually subordinated to any of the borrower's other loans. The PPP does not appear to set similar express restrictions on the relationship between the lender and the borrower.

Avenues of Enforcement

Like many federal programs, participation in the CARES Act funding programs requires an extensive series of express and implied certifications, and any false statements or misrepresentations regarding compliance with material certifications can constitute FCA violations. Some of these violations will be easy to spot; failure to comply with certain express certifications, such as a failure to properly review borrower application documents and explicit eligibility requirements, or failure to comply with the BSA and AML compliance protocols, can constitute FCA violations if misrepresented to the Federal Reserve banks when seeking payment under the CARES Act funding programs.

Other violations, however, will be harder to recognize—even for express certifications. As the CARES Act was established under extreme time pressure, the scope and meaning of the rules pertaining to the programs have been a source of widespread industry confusion, presenting high risk to the participants.

For example, under the PPP, borrowers must certify that the loan is "necessary to support the ongoing operations," and lenders must certify to the SBA that this eligibility requirement has been met. The rule, however, does not define what is "necessary." These ambiguous terms and lack of guidance puts participants at risk of making inadvertent, inaccurate representations, which could trigger FCA liability. In addition, given the novel nature of the CARES Act funding programs, it remains to be seen which express conditions the government will consider "material."

FCA violations stemming from implied certifications will be even more opaque. Any violations of material "statutory, regulatory, or contractual requirements" not disclosed by the bank lenders to the Federal Reserve banks, even if not express conditions of payment, may constitute FCA violations. FCA whistleblowers have previously pursued banks under this theory in connection with the 2008 financial crisis.

It is also important to note that liability for banks stemming from the CARES Act funding programs will not come solely from the FCA. Borrowers may rely on state law claims such as negligence, fraud, and breach of fiduciary duty as a basis for liability in situations where borrowers were found ineligible for CARES Act loans or denied loan forgiveness under the PPP.

In such cases, borrowers may claim consequential damages that far exceed the loan amount. They may also form class actions thereby increasing the possible damages that banks may have to pay. The government can also use other federal statutes to pursue banks participating in CARES Act funding programs, such as the general wire fraud or bank fraud statutes. Lastly, scrutiny can also come from congressional investigations, which in the past have been particularly interested in the use of discounted loans for preferred customers.

Mitigating the Risks

Banks are exposed to FCA liability like they have never been before, and banks participating in any of the CARES Act funding programs should consider the various risks they face and take appropriate action now to ensure that any certifications and representations they make to the government are accurate. It is not enough to rely on current compliance programs which were not designed with FCA exposure in mind.

When the pandemic abates, government authorities and whistleblowers will start second-guessing banks' certifications and representations. Especially given the uncertainties and lack of concrete guidelines, banks should consider taking steps to protect themselves by implementing preventative measures and tailored compliance programs to mitigate the risks associated with FCA liability. Most importantly, banks should be extremely diligent in reviewing borrower loan applications and documents, refrain from submitting loan requests to the government if any inconsistencies are found, and document all of the steps taken to collect and confirm the accuracy of information submitted in connection with the CARES Act.