VENABLE LLP

AUTHORS

Michael J. Rivera

Joanna P. Breslow Boyd

RELATED PRACTICES

Litigation

Investigations and White Collar Defense

Banking and Financial Services Regulation

Securities Enforcement and Compliance

RELATED INDUSTRIES

Financial Services

ARCHIVES

2014	2010	2006
2013	2009	2005
2012	2008	2004
2011	2007	

Articles

June 2014

Credit Unions Beware – the TARP Watchdog Is Ready to Pounce

Credit unions participating in the Troubled Asset Relief Program (TARP) are now a major blip on the radar screen of the TARP watchdog, the Special Inspector General for TARP (SIGTARP). TARP, often referred to as the "bank bailout," is most remembered for investing over $200 billion of taxpayer money in banks through its Capital Purchase Program (CPP). Less remembered is the Community Development Capital Initiative (CDCI), which provided TARP funds to numerous credit unions and small banks. With the CPP quickly winding down – banks have repaid over 96% of CPP funds, according to Treasury – SIGTARP has turned its attention to the credit unions remaining in the CDCI program. Recent warnings issued by SIGTARP suggest that CDCI credit unions should expect more oversight by Treasury and a visit from SIGTARP agents at the first hint of improper conduct.

Forty-eight credit unions received TARP funds through the CDCI. The purpose of CDCI is to support small business lending in the "hardest-hit" rural and urban areas by making low cost capital available to credit unions and small banks. To date, only eight credit unions have repaid the funds and exited the program. SIGTARP recently commented in its **April 30, 2014 Quarterly Report to Congress** (April Quarterly Report) that credit unions are likely to remain in CDCI for several more years because (1) the program allows participants to pay Treasury a dividend rate of a mere 2% until 2018 (at which point the dividend rate will spike to 9% and create inherent pressure on institutions to repay TARP) and (2) credit unions continue to face economic challenges that impair their financial stability and ability to repay TARP. With respect to the latter, SIGTARP observed that the capital and balance sheets of credit unions have suffered over the last few years due to increases in loan delinquencies and loan charge-offs and decreases in lending activity. Moreover, credit unions serve the most economically harmed areas around the country that continue to struggle to recover from the financial crisis.

SIGTARP resolutely advocated for stronger oversight of CDCI institutions by Treasury in its April Quarterly Report. SIGTARP urged Treasury to "keep careful watch over the financial stability of these institutions the entire time they are in TARP so that these institutions can lend to small businesses while getting themselves in a position to repay TARP." SIGTARP recommended two ways Treasury could more closely monitor the financial stability of CDCI institutions. First, Treasury could better enforce the provision in TARP contracts requiring CDCI participants to annually report on their use of CDCI funds. The information included in these reports could provide Treasury insight into the financial stability of CDCI institutions, which are otherwise required to disclose significantly less financial information than large banks. Second, Treasury could more vigilantly pursue its right to participate on the Board of Directors of CDCI institutions that miss a certain number of dividend payments. Such Board participation would yield Treasury important information regarding the financial stability of these institutions.

CDCI credit unions should be on high alert. In light of SIGTARP's pronounced concern over the financial stability of CDCI credit unions and its criticism of Treasury's oversight of them, these institutions should expect heightened scrutiny from Treasury and SIGTARP. We offer the following recommendations to help CDCI credit unions navigate this treacherous environment.

1. Maintain detailed records of the institution's use of the TARP funds received. File timely and accurate annual use of funds reports with Treasury.

- Despite being required as a condition of receiving TARP funds, SIGTARP reported that six CDCI credit unions have *never* submitted an annual report to Treasury and many other credit unions have failed to file reports in certain years. Failure to file such a report is dangerous in that it violates the TARP contract and may draw unwanted attention to a credit union.
- Enforcing compliance with this reporting requirement might become a priority for Treasury given SIGTARP's disclosure in its April Quarterly Report that "[n]ever in the history of the CDCI program have all 84 CDCI banks and credit unions complied with the contractual requirement to report annually to Treasury on their use of funds."

2. Implement comprehensive policies and procedures to ensure compliance with all related banking regulations and foster a culture of cooperation and compliance with the institution's regulators, particularly in connection with regulatory examinations.

- SIGTARP undoubtedly is closely monitoring the activities of CDCI credit unions. After years of monitoring hundreds of CPP banks, SIGTARP's team of elite investigators and financial analysts has developed an expertise in identifying banks that are experiencing financial difficulty or exhibiting signs of fraud or other improprieties. This expertise has led to numerous successful investigations and prosecutions involving CPP banks (see data below on SIGTARP-related indictments and convictions).
- Among other things, SIGTARP's investigation team tracks consent decrees and other regulatory enforcement and disciplinary actions against financial institutions. Credit unions subject to such actions assuredly will attract scrutiny by SIGTARP agents. Accordingly, credit unions should cooperate with regulatory examinations and reviews and seek to resolve them amicably.

3. Closely monitor the institution's loan portfolio and follow current accounting guidance to properly treat impaired and non-performing loans on the institution's balance sheet.

- Some of SIGTARP's most successful investigations have uncovered improper transactions by bankers designed to hide the financial institution's faltering financial condition, often stemming from deteriorating loan portfolios. For example, bankers have been subject to TARP prosecutions for implementing "extend and pretend" schemes, pursuant to which bankers hid non-performing loans by issuing new loans that were used to falsely record past-due loans as current. In May 2013, **a senior executive at TARP recipient bank Wilmington Trust** pleaded guilty to extending new loans to clients in order to enable those clients to keep existing loans current, causing the bank to misrepresent its past due and non-performing loans. Other bankers have been prosecuted following SIGTARP investigations for improperly moving repossessed real estate properties off the bank's books. **Executives from the Bank of the Commonwealth** were convicted of perpetrating a massive fraud that involved, among other things, providing preferential financing to troubled borrowers to purchase bank-owned properties, thereby enabling the bank to convert non-earning assets into earning assets. Several Bank of the Commonwealth executives received lengthy prison sentences, including a 23 year sentence for the former Chief Executive Officer.
- Accordingly, reviewing a financial institution's loan portfolio is a top priority for SIGTARP agents when they begin to investigate an institution.

4. Treat all contacts from SIGTARP seriously and with caution.

- SIGTARP is a powerful law enforcement agency that has been highly successful in prosecuting financial fraud, particularly involving small banks. SIGTARP reports that its investigations have resulted in criminal charges against 188 defendants (123 of which were senior executives), convictions of 129 defendants, and permanent bans (or suspensions) of 94 defendants from the banking, financial or other industries.
- Moreover, SIGTARP is showing no signs of slowing down. Anyone who doubts SIGTARP's resolve to continue putting executives of TARP financial institutions in jail need only read the agency's April Quarterly Report (in which SIGTARP continues to report an inventory of "more than 150 ongoing criminal and civil investigations") or review the article published last week by Special Inspector General Christy Romero in the Spring 2014 issue of ***Criminal Justice*** magazine. Special Inspector General Romero concluded her article with this chilling warning: "The message that must be sent is clear: those who break the banking laws and abuse trust should be held accountable for their crimes, and those who are contemplating breaking those laws should be aware that if they do so they will be prosecuted to the fullest extent of the law."
- Therefore, it is critical to carefully assess and respond to any information request or other contact received from SIGTARP. No such contact should be considered or treated as routine by a financial institution.

For information regarding SIGTARP or any program under TARP, please contact **Michael J. Rivera**, who Chairs Venable's **Securities Enforcement and Compliance Practice Group**. From 2010 to 2013, Mr. Rivera served as Chief Investigative Counsel at SIGTARP.