

CLIENT ALERT

Funds Today, Investigation Tomorrow: SBA OIG Warns of Serious Concerns of Rampant Fraud with COVID-19 Relief Funds and Calls for Immediate Action

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On July 28, 2020, the U.S. Small Business Administration (SBA) Office of the Inspector General (OIG) issued a report titled, “Serious Concerns of Potential Fraud in the Economic Injury Disaster Loan Program Pertaining to the Response to COVID-19.” The report identifies and summarizes OIG’s “serious concerns” of potential fraud and calls for “immediate attention and action” concerning the emergency funding provided under the Economic Injury Disaster Loan and Advance grant programs created pursuant to the Coronavirus Preparedness and Response Supplemental Appropriations Act, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), and the Paycheck Protection Program and Health Care Enhancement Act (PPP Act). While OIG focuses its attention on how SBA has administered the funds, the report highlights the significance that OIG is placing on rooting out fraud in these programs, as demonstrated by the swift opening of investigations into relief fund applicants just months or weeks after they submitted a loan request.

In its report, OIG identifies “potentially rampant fraud” as well as issues with internal controls related to the emergency funding programs. OIG has already opened dozens of investigations that will undoubtedly implicate the False Claims Act. And OIG is not acting alone in its investigative efforts. Financial institutions have played a large role, with nearly 440 contacting OIG to express “serious” concerns, including reporting at least nine types of “suspicious” activity to OIG, such as account holders claiming to use the funds to open a business; account holders attempting to withdraw loan funds in cash or transfer the funds to other newly established accounts; and economic injury loans or advance grants being deposited into personal accounts of customers of the financial institution—with no evidence of business activity. In response, these financial institutions have frozen funds on suspicious accounts, with nine institutions reporting a combined total of \$187.3 million in suspected fraudulent transactions. One federal credit union reportedly audited 60 SBA deposits and determined that 59 of those were fraudulent.

OIG further found that SBA issued 6,132 economic injury loans and 20,692 advance grants to potentially ineligible businesses. Indeed, the report states that as of June 19, 2020, SBA had approved more than \$250 million in COVID-19 economic injury loans and advance grants to potentially ineligible businesses and that, as of June 6, 2020, SBA had made duplicate economic injury loans to nearly 300 businesses. The report also identified numerous SBA economic injury loan fraud schemes developed through social media.

In light of these findings, OIG recommended that the SBA take two actions: (1) assess vulnerabilities for the purpose of strengthening or implementing internal controls to address notices of potential fraud; and (2) create an effective process and method for lenders to report suspected fraud to the Office of Disaster Assistance and to recover funds. The OIG noted that at the time of its review, SBA did not have a process or partnership in place with financial institutions to review instances of suspected fraud.

SBA’s response to OIG’s recommendations, attached to the report, highlighted the “robust internal controls” implemented by SBA in administering the relief funds and pointed to \$17.7 billion in loans rejected and \$78 billion in duplicate loans prevented

on account of these controls, none of which were mentioned by OIG. Nevertheless, SBA noted that it is taking steps to further enhance its controls, including by providing additional guidance to banks on reporting suspicious fraud activity and improving SBA's coordination with OIG with respect to potentially fraudulent applications. Indeed, OIG noted that it has since been in contact with SBA program officials on a daily basis to discuss specific instances of potential fraud. Moreover, banks are receiving formal (e.g. grand jury subpoenas) and informal inquiries from the Department of Justice—working with SBA—in connection with these loans.

SBA's OIG and the Pandemic Response Accountability Committee (PRAC), to which the OIG reports with regard to use of federal funds in response to the pandemic, continue their mandate to focus on fraud, waste and abuse related to COVID-19 relief funding, including scrutinizing the Paycheck Protection Program and the Economic Injury Disaster Loan Program at issue in this report. Crowell & Moring will continue to monitor these developments. Please reach out to any of the contacts below for more information or assistance.

For more information, please contact the professional(s) listed below, or your regular Crowell & Moring contact.

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