

## Special Inspector General for TARP Takes Control

### **TARP Watchdog Comes out Swinging**

The Emergency Economic Stabilization Act of 2008 (Act) established the Office of Special Inspector General for the Troubled Asset Relief Program to oversee compliance with its rules and regulations and investigate waste, fraud and abuse. Neil M. Barofsky, a veteran federal prosecutor in Manhattan, was sworn in as Special Inspector General (SIG) on December 15, 2008, and has begun the process of staffing up his office. On January 22, 2009, Barofsky announced plans to request each firm that has received TARP funds to provide a narrative explanation of the firm's use of TARP funds and a description of their plans for compliance with the executive compensation restrictions. With a \$50 million budget and increasing public and political outcry over the perceived lack of transparency and accountability of the TARP, we expect the SIG to be a proactive and robust watchdog. Indeed, of all the entities overseeing the TARP, the SIG likely will assert the most aggressive investigatory role.

### **Duties of the Special Inspector General**

Section 121(c)(1) of the Act provides that the SIG shall “conduct, supervise, and coordinate audits and investigations of the purchase, management, and sale of assets by the Secretary of the Treasury under any program established by the Secretary under section 101, and the management by the Secretary of any program established under section 102.” These duties include oversight of the executive compensation limits, conflict of interest provisions, and other conditions imposed on recipients of TARP funds. Section 121(c)(1) also lists examples of the type of information that should be collected and summarized, including information regarding the nature of troubled assets purchased, the reasons for such purchases, the management of the assets, and costs estimates for the disposition of the assets. Section 121(c)(2) provides the SIG with discretion to “establish, maintain, and oversee such systems, procedures, and controls as the [SIG] considers appropriate to discharge the duty under paragraph (1).”

The SIG is independent from the Department of Treasury and reports directly to Congress, not the Secretary of Treasury. This is contrary to inspectors general in other agencies, who report to the agency head and are under their general supervision. The SIG's reporting duties to Congress include submitting a report summarizing its activities and the activities of the Secretary under the Act within 60 days after confirmation and every calendar quarter thereafter. The Act provides the SIG with a \$50 million budget to carry out its duties. The Office of the SIG will continue to operate until the later of — “(1) the date that the last troubled asset acquired by the Secretary under section 101 has been sold or transferred out of the ownership or control of the Federal Government; or (2) the date of expiration of the last insurance contract issued under section 102.” Section 121 (h).

The focus of the TARP legislation was on granting the Treasury Department authority to purchase “troubled assets,” either at auction or by direct purchase from individual financial institutions. Thus, the SIG's duties, as drafted, are focused on overseeing the purchase and disposition of troubled assets. After passage of the Act, Treasury shifted its focus to a preferred stock and warrant purchase program, known as the Capital Purchase

Program (CPP). This shift has created some ambiguities as to the extent of the SIG's duties.

For example, just days after confirming Mr. Barofsky as SIG, the Senate passed a bill (S. 3731) by unanimous consent that would clarify that the SIG has investigative authority over all actions taken under the Act. With the bailout having shifted away from purchasing troubled assets in favor of direct capital infusions to banks, some lawmakers were concerned that the SIG would not have clear authority over the new aspects of the program. The House, however, did not move on the bill, and there is no indication that the SIG has taken a narrow view of its authority. Indeed, the early actions of the SIG suggest the opposite.

### **Early Actions of Special Inspector General Neil M. Barofsky**

Neil M. Barofsky was sworn in by the Senate as SIG on December 15, 2008. In eight years as a federal prosecutor in the Southern District of New York, Barofsky has prosecuted corporate fraud as an Assistant U.S. Attorney and more recently, headed up the mortgage fraud task force in that office. During his confirmation hearing, Barofsky highlighted his experience as a prosecutor in preparing him for the position, and his actions as SIG undoubtedly will be shaped by that background.

Oversight activities began immediately upon the SIG's swearing in. Although the first official report to Congress is not due until next month, the SIG provided a progress report in a January 7, 2009 letter to Barney Frank, the Chairman of the House Committee of Financial Services.<sup>1</sup> The SIG reported steady progress in filling the senior management positions within the office, securing permanent office space, and continued recruiting efforts to hire an investigative staff. The SIG also reported progress in coordinating its activities with the other relevant oversight bodies, namely the Comptroller General and his team at the Government Accountability Office (GAO), and the Congressional Oversight Panel and the Financial Stability Oversight Board.

Most significantly, the SIG noted immediate actions taken to reinforce its oversight role over recent TARP

activity. In connection with the recent TARP contracts with General Motors, Chrysler and Citigroup, the SIG suggested additional language in the transaction term sheets that acknowledged the SIG's oversight role and expressly granted access to the SIG's office to relevant documents and personnel. The SIG also had additional language added to the transaction terms sheets establishing appropriate internal controls to account for the recipients' use of TARP funds and ensure that all conditions in the agreement are being met. All of these measures, which will be included in future contracts as well, are intended to strengthen the SIG's oversight role going forward.

The SIG provided a subsequent update to lawmakers in a January 22, 2009 letter to Sen. Charles E. Grassley, the ranking Republican on the Finance Committee.<sup>2</sup> In this letter, the SIG outlined its plans to request information from each firm that previously received TARP funds. In the letter, the SIG reiterated the public complaints that the use of TARP money by recipients "remains almost entirely opaque." As noted in the letter, with the exception of the recent Citigroup and Bank of America investments, TARP agreements generally do not require firms to report or even track internally their use of TARP funds. According to Barofsky, tracking the recipient's use of TARP funds is critical to restore public trust, evaluate the effectiveness of TARP, and ensure compliance with the conditions in the agreements.

To that end, Barofsky announced his intentions to request information from each firm that has received TARP funds. These requests are characterized as "part of the initial data collection for the formal [SIG] audit." As outlined in the letter, the SIG intends to ask each firm to provide, within 30 days of the request, the following information:

- (a) a narrative response outlining their use or expected use of TARP funds;
- (b) copies of pertinent supporting documentation (financial or otherwise) to support such response;
- (c) a description of their plans for complying with applicable executive compensation restrictions; and
- (d) a certification by a duly authorized senior

executive officer of each company as to the accuracy of all statements, representations, and supporting information provided.

The SIG's request for information, which must be viewed against the backdrop of the public outcry over a lack of transparency, comes on the heels of last month's GAO report, "Troubled Asset Relief Program, Additional Actions Needed to Better Ensure Integrity, Accountability, and Transparency." The report was especially critical of the capital purchase program and made a number of recommendations to improve the program. It would appear that the SIG's initial actions — revising the language of new TARP contracts and requesting information on the use of TARP funds already distributed — were taken in response to the GAO report and similar public criticisms of TARP.

Given the requirement that a senior officer certify the response to the SIG, it is especially important that considerable care and deliberation be exercised in responding to the requests. As noted, Barofsky is a former federal prosecutor, and during his confirmation hearing he vowed to "tirelessly investigate and refer for prosecution any individual or entity that tries to criminally profit from the Program."<sup>3</sup> The SIG's information requests have been delayed pending an expedited review by the Office of Management and Budget under the Paperwork Reduction Act. After that review is completed, the SIG's requests will be sent out immediately and will ask for responses within 30 days.

Going forward, the SIG will continue to take a

proactive approach in responding to public and political criticism of TARP. In fact, Barofsky's plans to look at all aspects of the TARP, including the anticipated requests for information on how the funds have been used, already has earned him praise from lawmakers.<sup>4</sup> Ultimately, the SIG is in the strongest position of any of the entities overseeing the TARP to take on an aggressive investigatory role.

### **Kirkland & Ellis LLP**

The Office of the Special Inspector General for the Troubled Asset Relief Program is likely to play an important and long-term oversight and investigatory role. Given widespread demand for more transparency and accountability over the TARP, we expect the SIG's oversight to be robust, which will continue to become more apparent in the near future. Kirkland & Ellis LLP is positioned to assist clients in handling any investigations or inquiries by the SIG or other entities overseeing the TARP. We offer significant expertise in counseling individuals and companies in a wide range of regulatory inquiries. Our firm includes several former federal prosecutors and enforcement attorneys with the U.S. Department of Justice, the U.S. Securities and Exchange Commission, and other governmental agencies. And the Firm's expertise is distributed across all of its offices, including Los Angeles, Chicago, New York, and Washington, D.C.

We are interested in discussing with you in greater depth the issues discussed above. We welcome the opportunity to provide strategic counseling services relating to these critical issues.

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- <sup>1</sup> See January 7, 2009 Letter from Neil Barofsky to the Honorable Barney Frank, Chairman of the House Committee on Financial Services, <http://financialservices.house.gov/inspectorgeneralTARP.pdf>.
  - <sup>2</sup> See January 22, 2009 Letter from Neil Barofsky to the Honorable Charles Grassley, Ranking Member of the Senate Committee on Finance, <http://grassley.senate.gov/private/upload/Letter-from-Special-IG-Neil-M-Barofsky-to-Senator-Chuck-Grassley.pdf>.
  - <sup>3</sup> See November 17, 2008 Testimony by Neil Barofsky Before the Senate Finance Committee, <http://finance.senate.gov/hearings/testimony/2008test/111708nbtest.pdf>.
  - <sup>4</sup> See January 27, 2009 Letter from the Honorable Barney Frank, Chairman of the House Committee on Financial Services, to Neil Barofsky, [http://www.house.gov/apps/list/press/financialsvcs\\_dem/press012709.shtml](http://www.house.gov/apps/list/press/financialsvcs_dem/press012709.shtml).

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