



TARP PROGRAM SCAMS

In response to the credit crisis and economic turmoil of 2008, the U.S. Department of Treasury and the Federal Reserve established ten programs to strengthen the U.S. financial system, known as the Troubled Asset Relief Program (TARP).

As outlined by FinCEN's Advisory to Financial Institutions on Filing Suspicious Activity Reports Regarding TARP-related Programs, dated October 14, 2009, we describe seven of the ten TARP programs that financial institutions may recognize in the course of doing business. To find the links to these and other programs go to the Online Resources section of the FIRE Solutions course: AML – Current Issues 2010.

REPORT IF BELOW MINIMUM NET CAPITAL

If a B/D ever has less than the net capital required under 15c3-1, then this rule requires the B/D to send notice to the SEC in Washington, D.C., the regional SEC office, and the Designated Examining Authority (DEA, which for most firms is FINRA). The rule requires an immediate electronic notification. There is another rule that makes it a violation to do business as a B/D while in violation of the net capital requirements, so one of the practical implications of filing this report is that the firm should cease conducting business.

The notice shall specify the broker or dealer's net capital requirement and its current amount of net capital.

- **Capital Purchase Program (CPP)** – To build capital, increase the flow of financing, and support the economy, the U.S. Treasury Department allocated \$250 billion to establish the CPP and provide funds to qualified financial institutions. The U.S. Treasury generates these funds by purchasing senior preferred stock of the financial institutions. In consideration of this funding, the financial institution provides the Treasury with 10-year warrants to purchase additional stock.
- **Automotive Industry Financing Program (AIFP)** – The U.S. Treasury Department provided emergency loans to Financial Services Americas LLC, Chrysler, Chrysler Holding LLC, and General Motors Corporation through the AIFP. In addition, General Motors Corporation and Chrysler Holding LLC received modified loan terms. As with the CPP, the U.S. Treasury purchased senior preferred shares from GMAC LLC, and acquired warrants to purchase additional stock.
- **Capital Assistance Program (CAP)** – Similar to the previously mentioned programs, CAP provides funding by purchasing convertible preferred shares and acquiring warrants to purchase additional stock. At the program's inception, financial institutions with more than \$100 billion in assets were required to undergo a "stress test," pursuant to CAP. If the stress test found an institution needed additional capital, it was given six months to raise private capital. If after the six months the institution was unable to raise the required funds, it was required to accept CAP funding. Other financial institutions in the CPP were permitted to apply for funding without undergoing a stress test, as well as exchanging the senior preferred share issued to the U.S. Treasury under CPP into convertible preferred shares.
- **Unlocking Credit for Small Businesses (USCB)** – Twenty-one (21) of the largest financial institutions were called upon by the U.S. Treasury to begin reporting the amount they were lending to small businesses. The U.S. Treasury purchases securities backed by Small Business Administration loans through USCB.
- **Term Asset-Backed Securities Loan Facility (TALF)** – In an effort to kick-start the Asset-Backed securities market and free up funds for more availability of credit, the Federal Reserve Bank of New York, under the TALF, can issue up to \$1 trillion in non-recourse loans to investors. Collateral for these loans are secured by an interest in securities backed by credit cards, SBA loans, student loans, auto loans, and commercial mortgages. Provisions of the TALF can be expanded to posting securities backed by residential mortgages.

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- **Making Home Affordable Program (MHA)** – The MHA is a “multi-faceted foreclosure mitigation program,” sometimes referred to as Home Affordable Modification Program (HAMP). Provisions of MHA require homeowners to remain current on their mortgages, and servicers of the mortgage to reform the mortgage down to 31% of adjusted income. The U.S. Treasury pays incentives to participating servicers.
- **Public-Private Investment Program (PPIP)** – Sometimes referred to as the Public-Private Investment Fund (PPIF), the program allows the U.S. Treasury to select fund managers that purchase and manage so-called “troubled” assets. The fund managers raise private capital matched by TARP funds and leveraged with TARP loans.

Since these programs represent the allocation of substantial funds to a range of financial institutions, they are vulnerable to various forms of fraud, money laundering, and other financial crimes.

TARP-RELATED ACCOUNT DUE DILIGENCE

Using already established procedures through a firm’s Anti-Money Laundering Program, Customer Identification Program, and methods used to Know-Your-Client, the following list of due diligence activities are a natural extension for TARP-related accounts:

- Identify all customers who qualify for any TARP-related program funding
- Anticipate TARP-related transaction types that may be conducted by such customers
- Identify any suspicious activities attempted by these customers in the context of any TARP-related transactions
- Use public information to identify transactions that might involve a TARP-related entity, such as wire transactions involving the Capital Purchase Program (CPP) – funded banks or Public Private Investment Program (PPIP) fund managers

RED FLAGS WITH TARP-RELATED ACTIVITIES

Although TARP funds intended use is to lay the foundation for economic recovery, enforcement actions taken have identified some fraudulent schemes related to issuing TARP funds. The following descriptions are potential indicators of suspicious TARP-related activities:

Conflicts of Interest

Some TARP-related program uses could present significant conflicts of interest. By their very nature and design, some TARP-related programs, such as the PPIP, have a significant impact on how particular assets are priced in a stagnant mortgage-backed securities market. Therefore, anyone who already owns or manages the same security as a PPIP transaction is likely to benefit from the increase in price. Potentially, this could include the PPIP manager making investment decisions.

Examples of this activity that could raise suspicions include multiple transactions effected over a short time, “flipping,” resulting in an increased value of an asset in an otherwise stagnant product or geographical market. The institutions involved in these transactions include specifically qualified funds or investment professionals in narrowly defined markets.

Collusion

The manager of a PPIP fund could potentially be persuaded to manage the PPIPs for personal gain through kickbacks, quid pro quo transactions, or other collusive arrangements.

Collusion among parties could use the way transactions are structured to disguise the collusion in spite of program prohibitions, thus harming the PPIP and by extension, taxpayers.

One indicator of collusive activities is a seemingly arm’s-length transactions among affiliated parties with out-of-market asset pricing. In addition, entities or individuals appearing in the transactions could be nominees of a front.

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Insider Trading

There is considerable opportunity for insiders to benefit from fund diversion before the public disclosure of a TARP-related transaction, especially when you consider the substantial investment that TARP-related funds represent in existing markets.

An example of a red flag activity is if, immediately prior to a public announcement of the approval, receipt, use of or repayment of TARP-related funds, there is a spike in the trading volume of a particular CPP-funded public company. Since detection of insider trading typically happens retrospectively, reviewing trades in the days prior to an announcement may reveal suspicious trading activities.

Money Laundering

Because of the significant leverage that PPIP and TALF (Term Asset-Backed Securities Loan Facility fund) recipients can exercise, and government support for the markets through related transactions, TARP-related funding has the potential for money laundering too. Money-laundering organizations are continually looking for ways to “launder” their illicit proceeds. Red Flag activities closely resemble traditional money laundering transactions, but are related to mortgage-backed securities or TARP-related programs.

Was this excerpt everything that you thought it would be? Are there AML or TARP related issues that FIRE could report on, or investigate for you? FIRE would love to hear any and all feedback regarding this excerpt. Please [click here](#) to let us know your thoughts.

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