TESTIMONY OF THE HONORABLE BRIAN D. MILLER, SPECIAL INSPECTOR GENERAL FOR PANDEMIC RECOVERY (SIGPR), BEFORE THE SENATE COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS' EMERGING THREATS AND SPENDING OVERSIGHT SUBCOMMITTEE

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Good morning, Chairman Hassan, Ranking Member Romney, and members of the Subcommittee. I am Brian Miller, Special Inspector General for Pandemic Recovery (SIGPR). Thank you for the opportunity to appear before you today to address critical issues relating to SIGPR's mission to fight fraud, waste and abuse in the administration of CARES Act loans.

BACKGROUND

The CARES Act and the Creation of SIGPR

In March of 2020, Congress passed the Coronavirus Aid, Relief and Economic Security Act (CARES Act), a $2.2 trillion economic relief bill designed to provide emergency financial assistance to Americans during the COVID-19 pandemic. The CARES Act created a large number of loan and other relief programs aimed at different sectors of the economy that were impacted by the COVID-19 pandemic.

When Congress passed the CARES Act, it recognized that the infusion of trillions of dollars of relief funds into the economy necessitated vigorous and effective oversight to prevent and/or detect fraud, waste and abuse in the administration of CARES Act relief programs. For this reason, the CARES Act created SIGPR and authorized it to conduct audits and investigations, among other things, of investments made and programs managed by the Secretary of the Treasury under that statute. Specifically, SIGPR was charged with the duty to "conduct, supervise, and coordinate audits and investigations of the making, purchase, management, and sale of loans, loan guarantees, and other investments made by the Secretary of the Treasury . . . and the management by the Secretary of any program . . . ." (CARES Act § 4018(c)(1).) The creation of SIGPR reflected the observation, by Senator Schumer and others, that "real oversight and transparency" were "vitally important" to the success of the CARES Act relief programs.

SIGPR is staffed with seasoned federal prosecutors, investigators and auditors. As a result, as I will relate in a few minutes, SIGPR has provided exceptional service to the taxpayers despite a lean budget. SIGPR received an initial appropriation of $25 million under Section 4027 of the CARES Act in March 2020 to start up. In Fiscal Years 2022 and 2023, SIGPR received $8 million and $12 million, respectively, to supplement its no-year start-up funding.

In April 2021, however, the Department of Justice's Office of Legal Counsel issued a written opinion that the specific way in which Congress granted SIGPR authority to conduct audits and

investigations meant that SIGPR did not have legal authority to act with respect to most of the programs created by the Act, including the Paycheck Protection Program (PPP), the Coronavirus Relief Fund (CRF), and the Payroll Support Program (PSP). As a result, while SIGPR has conducted thorough and effective audits and investigations, SIGPR has been largely limited to audits involving the direct loans that the Treasury Department was authorized to make to airlines, air cargo carriers and businesses critical to national security, and the Main Street Lending Program. (SIGPR has worked on PPP-related cases that the Pandemic Response Accountability Committee (PRAC) authorized SIGPR to investigate.)

Direct Loans by the Treasury Department

Section 4003 of the CARES Act authorized the Treasury Department to make up to $46 billion in direct loans as follows:

- $25 billion in loans to passenger air carriers, aviation repair stations, and ticket agents;
- $4 billion for cargo air carriers; and
- $17 billion for businesses "critical to maintaining national security."

The Treasury Department ultimately authorized 24 aviation industry loans totaling approximately $21 billion, and 11 national security loans totaling approximately $736 million.

Because of the way they were structured, the best possible assessment of the risk of fraud, waste and abuse in these direct loans will not be possible until the maturity dates of the direct loans that remain outstanding. For all of these direct loans, there were no interest payments in the first year, and ***all*** payments of principal were deferred until the maturity dates, which range from September 2024 through November 2025.

Even now – before the maturity of those loans – as of September 1, 2023, Treasury has reported that 8 direct loans valued at $772 million are in default. It is not farfetched to expect that, as principal payments become due during late 2024 and throughout 2025, there will be additional defaults on these loans. SIGPR's audit staff has issued numerous reports relating to the Treasury Department's extension and administration of these direct loans, and SIGPR has several open investigations into potential criminal or civil liability arising from the obtaining or use of these loans.

Main Street Lending Program (MSLP)

Section 4003(b)(4) of the CARES Act authorized the Treasury Department to make investments in "programs or facilities established by the Board of Governors of the Federal Reserve System . . . for the purpose of providing liquidity to the financial system that supports lending to eligible businesses, States, or municipalities." (CARES Act § 4003(b)(4).) The Main Street Lending Program (MSLP) was one of a number of lending facilities that the Treasury Department and the Federal Reserve created pursuant to this directive under the authority of Section 13(3) of the Federal Reserve Act. Ultimately, the following facilities were created with the following investments:

- Term Asset-Backed Securities Facility (TALF) ($100 billion authorized, and $10 billion Treasury Department equity investment)
- Municipal Liquidity Facility (MLF) ($500 billion authorized, and $35 billion Treasury Department equity investment)
- Corporate Credit Facilities (Primary Market Corporate Credit Facility (PMCCF) and Secondary Market Corporate Credit Facility (SMCCF)) ($750 billion authorized, and $75 billion Treasury Department investment)
- Main Street Lending Program (MSLP) ($600 billion authorized, and $75 billion Treasury Department investment)

The Main Street Lending Program was designed to address the needs of small to medium-sized companies that were potentially too large to qualify for loans under the Paycheck Protection Program but were not large enough to have direct access to the credit markets themselves. The Main Street program included three loan facilities for for-profit businesses:

- The Main Street New Loan Facility (MSNLF)
- The Main Street Priority Loan Facility (MSPLF) (which provided loans to companies with other substantial debts that were subordinated to the new Main Street loan)
- The Main Street Expanded Loan Facility (MSELF) (which provided for additional MSLPs to companies that had already received a loan)

The Main Street program also included two facilities for non-profit businesses: the Nonprofit Organization New Loan Facility (NONLF), and the Nonprofit Organization Expanded Loan Facility (NOELF).

To implement the MSLP, the Federal Reserve Board authorized the Federal Reserve Bank of Boston to establish a special purpose vehicle (“SPV") to purchase 95% participation interests in MSLP loans originated by private institutions (eligible lenders, including U.S. federally insured depository institutions, branches or agencies of foreign banks, bank holding companies, savings and loan holding companies, or intermediate holding companies of foreign banking organizations).

The SPV was established as a Delaware limited liability company named MS Facilities LLC. The Federal Reserve Bank of Boston serves as its Managing Member, with the exclusive right to manage the SPV, and the Treasury Department serves as its only Preferred Equity Member. The Federal Reserve Bank of Boston loaned money to the SPV to finance the SPV’s purchase of the 95% participation interests in the eligible Main Street loans. The Treasury Department made a capital contribution of $37.5 billion to serve in a first loss credit protection position to prevent the Federal Reserve Bank of Boston from suffering a loss on its loan to the SPV. Such a loss could occur if the SPV’s losses from defaults on purchased loans, as well as operating expenses, professional fees, and servicing costs, exceed the SPV’s income in the form of interest and principal payments received from the purchased loans, transaction fees received from eligible

lenders, and investment income received from the Treasury Department's initial equity contribution and the SPV's unused cash receipts.[1]

As of December 31, 2022, the Treasury Department held contributed equity totaling $11,452,701,000 in capital in the Main Street Lending Program, and its net operating loss was $12,793,000.[2] The Federal Reserve Bank of Boston does not publicly offer details on the specific inflows and outflows, or their timing, that drive this undistributed net operating contribution loss, other than to report that after the Federal Reserve Bank of Boston is repaid in full, if there are residual proceeds from the SPV's operations, then the net operating income will be distributed between the Managing Member and Preferred Equity Member.[3]

For each MSLP loan that a qualified private financial institution executed with a borrower, the SPV purchased 95 percent participation—that is, it absorbed 95 percent of the potential exposure of nonrepayment of principal. The lending institution received an origination fee and a servicing fee (based on 100 percent of the principal) and retained exposure for only 5 percent of the amount loaned. By design, between the purchase of the participation by the SPV and the fees that the lending institution receives from the SPV, virtually all of the risk of these loans was ultimately assumed by the Treasury Department.

To be eligible for the SPV's purchase of that participation, an MSLP loan was required to include a number of standard features:

- Five-year maturity
- Adjustable interest rate of LIBOR (1 or 3 month) plus 300 basis points
- Interest payments deferred for one year (with unpaid interest capitalized)
- Principal payments deferred for two years
- Principal amortization of 15 percent at the end of the third year, 15 percent at the end of the fourth year, and a balloon payment of 70 percent at maturity at the end of the fifth year
- Pre-payment permitted without penalty

For a loan to be eligible for a commitment by the SPV to purchase its 95 percent participation—the lender and borrower were also required to execute standard certifications and covenants. The certification that the borrower was required to execute included a number of representations, including that the business was not ineligible under applicable regulations issued by the Small Business Administration. Lenders' certifications were more limited, requiring (with respect to

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[1] *See* KPMG, Financial Statements: Main Street LLC (March 14, 2023), available at https://www.federalreserve.gov/aboutthefed/files/msllcfinstmt2022.pdf) .

[2] *Id.*

[3] *Id.*

the borrower's certification that it was a business that existed prior to March 13, 2020) only that the financial institution make "Due Inquiry with Respect to Formation"—defined as receipt of supporting documentation from the borrower certified by the appropriate governmental authority and having taken "those steps to verify such formation as are required under the Lender's ordinary underwriting policies and procedures."

SIGPR'S ACCOMPLISHMENTS THUS FAR

SIGPR is investigating cases nationwide with potential fraud totaling more than $565 million. SIGPR has opened 65 investigations, of which 47 remain pending, with 130 potential defendants. SIGPR's investigations have thus far resulted in 21 federal informations or indictments, 21 arrests, four guilty pleas, and three sentencings that have generated more than $11.9 million in court ordered restitution, $9.3 million in seizure/forfeiture orders, and a $350,000 civil settlement. This includes two defendants who were recently sentenced to 6 years in prison and ordered to pay over $7.6 million in court ordered restitution. Twenty-two recommendations for suspension and debarment have been referred to the Treasury Department. In addition, $20,816,000 in MSLP loans have been repaid after borrowers received notice that SIGPR was investigating their loan transactions.

What is particularly notable about what SIGPR has accomplished through investigations is that very few of SIGPR's investigations originated from tips or referrals from other agencies. Rather, 89 percent of SIGPR's investigations were the result of SIGPR's proactive work, including a number of projects that have led SIGPR investigators to review 1216 of the 1830 MSLP loans. Through these careful and thorough reviews, SIGPR has identified numerous potential frauds that would otherwise have likely escaped the notice of other federal agencies involved in the execution and oversight of CARES Act loan programs.

SIGPR's auditors have also provided significant service to the Treasury Department. As part of its oversight, SIGPR audited the Treasury Department's process in approving a $700 million direct loan to a business identified as being critical to national security. In another project, SIGPR audited how the Treasury Department monitors borrowers' compliance with their direct loan requirements. SIGPR is currently still auditing direct loans to an airline and a national security business to evaluate those borrowers' compliance with the terms of those loans. SIGPR also reviewed 16 direct loan borrowers' Validation Memoranda—documents that the Treasury Department created to confirm that loan applicants submitted all required documentation and met other criteria. A roll-up report of all 16 attestation reviews showed that one Validation Memorandum contained material deficiencies and this loan application should not have been moved forward to the underwriting process, and that 10 other Validation Memoranda contained minor discrepancies. Such roll-up reports are critical tools to permit us to improve how similar programs are implemented in the future. As required by law, SIGPR has published the reports reflecting this audit work on its website, thus helping the American public to understand some of the oversight work that is being performed to protect the taxpayers' investment in CARES Act programs.

SIGPR's auditors have also issued four interim reports detailing their review of MSLP loan loss information as it relates to the Treasury Department's $16.6 billion investment in the program. As part of this review, SIGPR auditors reviewed data from 47 of the MSLP's top lending banks, covering 60 percent of the number of MSLP loans and 58 percent of the funds disbursed as proceeds of MSLP loans. That information revealed $879 million of loans in default, $121 million in delinquent interest payments, and $229 million in impaired loans. These figures are greater than the actual loan loss figures reported by the Federal Reserve Board, suggesting that actual recognized losses may significantly increase.

In addition, SIGPR auditors reviewed KPMG's audit of the latest financial statement of the SPV for data on actual loan losses, allowance for loan losses, and loans in non-accrual status. Auditors compared this data to data from eleven lending institutions with a similar volume of loan participations to the SPV and found that the SPV's figures in all three data points were far greater than all eleven peer lenders.

Given the modest amount of staff and other resources provided to SIGPR, I could not be prouder of the work that my staff has performed thus far in our critical role of fighting waste, fraud and abuse in these programs.

THE IMPENDING DEFAULT CRISIS

While SIGPR has conducted numerous audits and investigations thus far, we believe that there is far more work still to be done if we are to meet our oversight obligations effectively.

As I noted earlier, borrowers who received direct loans or MSLP loans were not required to make any payments whatsoever—that is, no principal and no interest—during the first year of the loan. For both of these programs, during the second year of the loans—when borrowers were required to pay interest but still owed no repayment of principal—SIGPR observed an alarming rate of defaults by borrowers who failed to make those interest payments.

As a result, SIGPR is particularly and increasingly concerned that the default rate will grow exponentially in years 3 through 5 of the Main Street Lending Program as repayment of principal comes due. Principal payments for the third year of the loan (totaling 15 percent) were due starting in July 2023 through January 2024 (depending on the loan origination date). On October 10, 2023, the Federal Reserve reported that MSLP loan losses as of September 30, 2023, totaled $257 million. That loan loss figure has steadily increased over the past 26 months since the Federal Reserve first reported a loan loss figure of $4 million as of June 2021. As of June 30, 2023, the Federal Reserve also reported that its MSLP loan loss allowance was updated to the amount of $1 billion.

We believe that this trend of increasing defaults will not only continue but is likely to accelerate as MSLP loans reach their five-year maturity date. These loans require repayment of 15 percent of principal in years 3 and 4, and we are already seeing a spike in defaults by borrowers unable to make these significantly larger payments that they now owe. In year 5 (between July 2025 and January 2026), these borrowers will be obligated to make repayment of 70 percent of the loan principal. Those balloon payments will undoubtedly lead to significant numbers of borrower

defaults at that time. To the extent that direct loans remain unpaid, the maturity of those loans between September 2024 and November 2025 may lead to similar increases in defaults among direct loan borrowers.

There is no question that, in many cases, a borrower's default on a direct loan or an MSLP loan will not mean necessarily that the borrower committed fraud in obtaining the loan or that the borrower misused the proceeds of the loan. However, there is also no question that a default is a red flag that merits further investigation. SIGPR has already undertaken an effort to obtain information about the MSLP loans that are either in default or considered impaired, and to engage in investigation about those loans. That review of information from 47 banks holding 1,094 MSLP loans valued at $10.2 billion revealed 339 reportable issues involving $2.3 billion in loaned funds. SIGPR has opened criminal investigations involving 11 of these loans – and the defaults and impairments in the loans were the signal that led SIGPR to these potential frauds. I am emphasizing defaults and the impending default crisis because we believe strongly that the increasing number of loans that go into default or are otherwise impaired will reveal additional fraud involving those loans that would not have been discovered but for these defaults and impairments.

SIGPR SCHEDULED TO SUNSET AT PEAK OF THE DEFAULT CRISIS

Thus, in mid-2025, we are going to enter a period in which an even larger number of frauds may be revealed when the perpetrators of those frauds fail to make the 70 percent balloon payment on their loans. But, by the terms of its authorizing statute, SIGPR is scheduled to sunset as of March 27, 2025. So, just at the time when SIGPR is needed most, we will not be there to undertake the thorough and effective investigations that are warranted by some of the large number of defaults that are likely to occur.

Moreover, because of the way that federal agency planning works, in anticipation of that sunset date, SIGPR staff are already engaged in planning for the execution of SIGPR's shutdown in coordination with OPM, OMB and GSA. Through reshaping efforts along with natural attrition, SIGPR has already reduced its staff from 55 FTEs to 41 FTEs, and we anticipate more staff departures through the end of the calendar year. We have been informed that this process of reducing staff and resources will continue throughout the period that remains between now and our March 2025 sunset date. Thus, because the future of the agency is uncertain, we are already experiencing staff hemorrhages that cripple our ability to provide oversight.

For this reason, I ask that Congress move swiftly to authorize extending SIGPR's operations until August 31, 2030. This extension will permit SIGPR to continue its operations at a minimal cost so that it can defend the interests of the taxpayer during the period in which the threats to those interests may be most revealed. SIGPR is the only agency that focuses specifically on potential fraud that has been committed in the Treasury's direct loans and the Main Street Lending Program, and it should be permitted to continue to do so.

There are those who may say that SIGPR's work could be absorbed by the operations of other government agencies, but I challenge those assertions. For example, at its inception, the focus of SIGPR's work included the $150 billion CARES Act Coronavirus Relief Fund (CRF), a program

for assistance to States and local governments, the District of Columbia, U.S. territories, and tribal governments. After DOJ's Office of Legal Counsel determined that SIGPR's authority did not include CRF, SIGPR no longer provided oversight for that program.

If SIGPR ceases to exist, it is highly unlikely that any other government entity will undertake thorough and effective oversight of the Treasury Department's direct loans and MSLP loans. And I should note, when my investigators and attorneys have met with federal prosecutors to discuss potential MSLP fraud cases, they have generally found that these prosecutors—who are familiar with other CARES Act programs such as PPP—are not knowledgeable about the Main Street Lending Program. To allow SIGPR to be eliminated will mean the loss of substantial institutional knowledge about the MSLP program and about the efforts that have already been undertaken to reveal fraud in that program.

For that reason, I urge this Subcommittee, and the Congress in general, to move as quickly as possible to extend SIGPR operations to September 30, 2030, so that SIGPR can continue to perform its mission of fighting waste, fraud and abuse, and to continue to serve the interests of the taxpayer in providing effective oversight of CARES Act loan programs.