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PRESIDENT'S PROPOSED FEE ON FINANCIAL INSTITUTIONS REGARDING TARP

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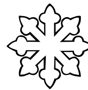
BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED ELEVENTH CONGRESS

SECOND SESSION

APRIL 20, MAY 4, AND MAY 11, 2010



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PRESIDENT'S PROPOSED FEE ON FINANCIAL INSTITUTIONS REGARDING TARP: PART 1

TUESDAY, APRIL 20, 2010

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:10 a.m., in room SD–215, Dirksen Senate Office Building, Hon. Max Baucus (chairman of the committee) presiding.

Present: Senators Schumer, Nelson, Carper, Grassley, Snowe, and Crapo.

Also present: Democratic Staff: Bill Dauster, Deputy Staff Director and General Counsel; John Angell, Senior Advisor; and Mary Baker, Detailee. Republican Staff: Emilia DiSanto, Special Counsel and Chief Investigative Counsel; Jason Foster, Senior Investigative Counsel; and Jim Lyons, Tax Counsel.

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The committee will come to order.

The epistle of James says, "See how great a forest a little fire kindles!" The financial crisis of 2008 kindled a fire that spread throughout our entire economy. That fire destroyed more than 8 million jobs. That fire led to more than 6 million foreclosures. And that fire led to 3 million bankruptcies.

The spark for that fire was lit in the financial industry. To generate huge profits and big bonuses, the financial sector was playing with fire. Big banks were providing bad mortgages that they should have known folks were not going to be able to pay. And they would have known it if they had done their homework on the loan applications.

Next, big banks bundled good and bad mortgages together and sold them to investors. They called these bundles collateralized debt obligations, or CDOs, and they called selling them securitization. Then the big banks insured the collateralized debt obligations against failure. They called their insurance policies "credit default swaps." Credit default swaps allowed the banks to protect their risks and make big profits, even if the mortgages that they were writing went bad. Basically, they had to hedge their bets and made a lot of money on the transactions.

Unfortunately, the financial system did not have enough money to cover all of its bets. Now there are charges that big banks may have been both assembling packages of mortgages on one side and betting against them at the same time.

Then the spark kindled the flame, and suddenly our Nation's economy was engulfed in the fire. The Dow plunged, dropping to just above 6,500 in March of 2009. Unemployment rose above 10 percent. Then-Treasury Secretary Paulson knew that he had to act. He came to Congress with a proposal to save the economy. The proposal turned into the emergency law that authorized the Treasury to distribute almost $700 billion through the Troubled Asset Relief Program, otherwise known as TARP.

I knew when we were working on this legislation that we needed to hold the Treasury and TARP recipients accountable for how the money was spent. TARP was spending hard-earned taxpayer dollars to save the big banks, and those big banks had been paying out bonuses worth billions of dollars. Those big banks had sometimes been rewarding excessive risk-taking.

So I proposed that we build right into the law a special unbiased investigator. This investigator would ensure the transparency and accountability of TARP funds. That proposal resulted in the Special Inspector General for the Troubled Asset Relief Program, and that person is sitting before us today, Mr. Neil Barofsky. Welcome, Mr. Barofsky.

Mr. Barofsky is responsible for overseeing the TARP program. He keeps track of where the money goes, how it is spent, and whether it is paid back. That leads us to the purpose of today's hearing. The TARP legislation anticipated that there might be losses. Congress anticipated that the banks might pay back something less than all the TARP money. The most recent estimates anticipate that the Treasury will end up losing about $89 billion. We need to think about how we are going to get that money back on behalf of American taxpayers.

In January, President Obama proposed a bank fee to recover TARP losses. His fee is estimated to raise $90 billion over 10 years. It would apply to the 50 largest financial institutions in the country. This committee is going to take some time, over the course of several hearings, to consider the President's proposal and other options to recover TARP losses. We want to understand the best approach to designing a fee, to whom it should apply, and how it might affect the economy and the markets. We need to learn whether banks will pass it on to consumers and how it might affect lending to small businesses. We need to take into account what European countries might do as they consider similar levies.*

We will begin today with Mr. Barofsky. We will ask who has benefitted from the TARP program, how much they have been repaid, and why some TARP beneficiaries might never be able to pay back the American taxpayers. The financial crisis of 2008 kindled a great fire that spread throughout our entire economy. So let us examine how widely that fire has spread. Let us see who benefitted from our efforts to put out the fire. And let us try to learn what we can to prevent such further economic fires in times to come.

Senator Grassley?

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*For more information, *see also,* "Background and Issues Related to the Administration's Proposed Tax on Financial Institutions," Joint Committee on Taxation staff report, April 16, 2010 (JCX–26–10), *http://www.jct.gov/publications.html?func=startdown&id=3681.*

OPENING STATEMENT OF HON. CHUCK GRASSLEY, A U.S. SENATOR FROM IOWA

Senator GRASSLEY. I welcome you here, Mr. Barofsky. You and I are both big believers in transparency, oversight, and accountability, and I thank you for leading that effort. Even though it is on a very narrow area of government, it sure is an important one, when $700 billion was put out by Congress.

Today, we are discussing what the President calls a “financial crisis responsibility fee.” However, the Assistant Secretary for Tax Policy told the dozens of people in attendance at a briefing for Senate staff on the President’s fiscal year 2011 budget earlier this year that the President’s proposed fee is actually an excise tax.

This is similar to the name game that the administration played with excise taxes in their health care bill. Although they referred to the excise taxes as fees, the legislative text clearly states that they are actually excise taxes. I will refer to it as the TARP tax and not the bank tax, as some call it, because the proposal applies not only to banks, but also to insurance companies, securities brokers, and thrifts, among others.

The statute that created TARP required the President to submit a plan by 2013 to recover any losses under TARP so that the taxpayers are actually repaid for any TARP losses. However, 3 years before it was required the President proposed this excise tax, the TARP tax. One problem that surfaced recently is that congressional Democrats are already reportedly planning ways to spend the money raised by the proposed TARP tax.

One proposal gaining steam among many on the other side lately is to add the TARP tax to the Financial Regulatory Reform bill. The congressional majority is so strapped for money to pay for out-of-control spending, that they are looking to the banks and other financial institutions for money.

This reminds me of the story about a reporter asking Willy Sutton, a notorious bank robber, why he robbed banks. Sutton allegedly said, “Because that’s where the money is.” I cannot emphasize this next point enough: if Congress decides to pass the TARP tax, money should go only towards paying down the deficit. Otherwise, the TARP tax would not even pay for the losses from TARP, it would just enable more taxing and spending by those who want to spend more.

All economists state that corporate entities do not actually bear the burden of taxes—people do. I wanted to know which people would bear the burden of the proposed TARP tax, so I wrote a letter asking the nonpartisan experts at the Congressional Budget Office and Joint Committee on Taxation a series of questions along that line.

The CBO responded to my letter by saying that customers would probably pay higher borrowing rates and other charges. Employees might bear some of the cost, and investors could bear some of the cost. The CBO also said that the TARP tax “would also probably slightly decrease the availability of credit for small businesses.” In addition, the CBO said, “for the most part, the firms paying the fees would not be those that are directly responsible for loss realized by the TARP.”

One other item from the CBO letter worth noting is that the TARP tax would not apply to firms in the automotive industry. That is really odd, since CBO's March 2010 TARP report states that the automotive industry accounts for $34 billion of the program's estimated total cost of $109 billion. Chairman Baucus and I invited GM to testify before our committee at one of the later hearings, but GM representatives said that they did not want to testify. I think it is pretty obvious that the GM silence is deafening.

On another TARP-related matter, I want to thank you, Mr. Barofsky, for investigating the multi-million-dollar severance payments that Treasury is allowing TARP recipients like AIG to pay their departing executives. As you know, I have communicated on several occasions with Treasury and the TARP Special Master for Executive Compensation about this troubling issue, and I have basically run into a stone wall.

I am also pleased that you, Mr. Barofsky, are going to investigate the possible conflicts of interest on the part of key people at Treasury who worked on the TARP executive compensation regulations. Since those regulations helped executives walk away with huge severance payments, we need to find out if they were drafted by people who used to represent the very executives affected by the regulations. Treasury claims that all of the proper recusals were made, but it has provided none of the documentation necessary to verify their claims. So I trust that you will be able to get to the bottom of these important questions and report back to this committee in the near future.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

It is now my honor to introduce you, Mr. Barofsky. Thank you very much for your service to the country. I am very gratified, frankly, that we have named this position, set out this position in the legislation. I can remember thinking how important it was to find somebody to be kind of like an auditor to have the authority and power to see how this money is being spent. We also designed it in a way to give you the powers that you needed, not just housed in, say, some back room at the Department of the Treasury.

But second, I am very happy with your performance. That is, we selected a very good person to do this job, and we thank you very much for your service to the country. I think you have helped restore some confidence of the American people that this program is conducted properly, as much confidence as any one person could. But thank you very much for your service to the country. We would like to hear from you.

Senator GRASSLEY. Mr. Chairman, I want to thank you for saying what you just said, because I think it is so important in the checks and balances of government, and particularly in the oversight that committees have to do—and this committee does a good job of oversight—that they know that you are behind what is being done here and what he is doing. I think it is so important, and I thank you so much for saying that.

The CHAIRMAN. Mr. Barofsky?

STATEMENT OF HON. NEIL BAROFSKY, SPECIAL INSPECTOR GENERAL FOR THE TROUBLED ASSET RELIEF PROGRAM (SIGTARP), DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Mr. BAROFSKY. Chairman Baucus, Ranking Member Grassley, members of the committee, first of all, I would like to thank the chairman and the ranking member for your kind words today and your unwavering support of our office as we have been conducting our oversight for now nearly a year and a half. It is a privilege and an honor for me to appear here today and to release to this committee our most recent quarterly report to Congress.*

We do have some good news to report. Aspects of the financial system, there are clear signs, are on their way to recovery. Many of the larger TARP banks have been able to repay their TARP funds far in advance of what anyone anticipated, and, as a result, the expectations for losses to the TARP, while certainly still substantial, have been trending downwards, with OMB's recent estimate back in February of approximately $127 billion, and the CBO estimating at $109 billion, and both of them estimating that the concentration of losses was in three areas of the TARP: support to AIG, support to the automotive industry, and support to struggling homeowners.

On the other hand, while TARP does appear to be succeeding in its statutory goal of getting Wall Street back on its feet, it is not meeting its goal of getting Main Street back on its feet. Long-term unemployment remains at the highest in recent memory. Smaller and community banks are failing at an alarming rate, with 50 already this year, and the statutory goal of preserving home ownership is falling horribly short: 2.8 million foreclosures last year, with estimates for this year that will even eclipse that.

The Home Affordable Modification Program (HAMP), Treasury's TARP-funded mortgage modification program, was originally intended to help 3 to 4 million homeowners stay in their homes by modifying their mortgages to sustainable levels, but it appears that it may never come close to meeting that goal, with fewer than 230,000 permanent modifications more than a year into the program.

Last month, we issued an audit report on the HAMP program where we detailed some of the failings of the program and made recommendations, addressing areas such as transparency, problems with Treasury's execution of the program, and problems and concerns about the program's very design, which leaves it vulnerable to ultimate failure because of high levels of re-defaults, that is, circumstances when borrowers, even after they receive modifications, are either unable or unwilling to continue making their payments because of the high rate of the payments or because of being hopelessly under water.

In an apparent response, within days of the release of that report, Treasury announced major modifications to the HAMP program, addressing for the first time the issue of negative equity for underwater mortgages, one of the significant indicators of re-

*The SIGTARP Quarterly Report to Congress, dated April 20, 2010, can be found at *http://www.sigtarp.gov/reports/congress/2010/April2010_Quarterly_Report_to_Congress.pdf.*

default. While Treasury's actions have addressed some of the recommendations and issues raised by SIGTARP, they, too, present their own set of concerns.

In our quarterly report, we identify several of those issues and make further recommendations in areas about continuing problems with transparency, problems with the potential vulnerabilities to fraud, and problems with the design of some of these revisions that may lead to them being ineffective or leading to arbitrary results for certain borrowers.

It is important for Treasury to address these issues that we have raised here in this quarterly report, in our audit, and similar concerns raised by the Congressional Oversight Panel in GAO, otherwise it risks that the HAMP program will be remembered not for being the catalyst for recovery in the housing market, but for its bold announcements, modest goals, and meager results.

In our quarterly report, we also review what we have been doing in our Investigative Division. When the chairman and the ranking member insisted upon the creation of SIGTARP, over the objections of many, including those at Treasury and others, they did so in recognition that, in part, with a program of this size, it would inevitably draw those who would seek to profit criminally off of a national crisis. At SIGTARP, we have been building a sophisticated white-collar investigative law enforcement agency to meet that threat.

In this past quarter, as detailed in our quarterly report, we have had some success. Charles Antonucci was indicted or criminally charged up in the Southern District of New York for his fraud as the CEO and president of Park Avenue Bank for trying to steal $11 million from the TARP.

On the civil side, we worked with the New York State Attorney General to secure civil securities fraud charges against Bank of America and its former CEO and CFO for their role in a fraud that affected the TARP, and we supported the SEC in its case that resulted in a $150-million settlement with Bank of America and resulted in important governance changes at the bank.

Out in California, we assisted the U.S. Attorney's Office in the Southern District of California in obtaining criminal charges against Glenn Rosofsky and Michael Trap for their role in a fraud that is alleged to have brought in more than $1 million in a scheme that was designed to take criminal advantage of struggling homeowners by falsely promising them mortgage modifications that never materialized.

Mr. Chairman, Mr. Ranking Member, members of the committee, again, it is a privilege to be here, and I look forward to answering any questions that you may have.

The CHAIRMAN. Thank you, Mr. Barofsky.

[The prepared statement of Mr. Barofsky appears in the appendix.]

The CHAIRMAN. I would like to start off by just asking, at this point, what do you think the losses are and how long will it take to kind of realize definitely what those losses might be? One can argue that over the next few years that the losses will be less, but it would be helpful to the committee if you could say what the

losses are today and say how much that will be reduced over the next several years.

Mr. BAROFSKY. It is very hard to determine. Our role basically is to report what others have done as far as the analysis of these results, what OMB and CBO have done. They see those areas really as concentrated, as I said before, in three areas: AIG, which they estimate being between $36 to $50 billion in loss; in the automotive industry, between $31 to $34 billion in loss; and of course, in the housing program, which will ultimately be an entire loss because, the way the program is designed, it is a subsidy. It is not intended, or there is really no mechanism for any recovery.

Whether those losses will be realized in the longer term really will depend in large amount on what happens with the economy, particularly with the automotive industry. That is going to depend to a certain extent, as the economy recovers, are people going to buy more cars? Are GM and Chrysler and GMAC going to be able to return to profitability?

Because of our interest in those companies, AIG and the automotive industry, it is an equity investment. Our fortunes, and the ability for them to repay, will hinge and depend on how successful they are in rebuilding those companies. It is difficult to determine. I think it will take several years for us to get a sense, a real sense, of what those losses may be, but, if the economy improves, we certainly hope to see that these losses will continue to decrease.

The CHAIRMAN. What is your sense of this proposed bank fee, bank tax, and who it is levied on, and to what degree will that allow the TARP expenditures to be recouped, to be repaid? If you look at whom the tax is levied on, as it is proposed by the President, anyway, to what degree, and how efficiently, will that return dollars back to taxpayers?

Mr. BAROFSKY. Well, I think section 134 of the Emergency Economic Stabilization Act (EESA), of course, is the statutory mechanism that provides for recoupment. There is certainly a lot of flexibility in there in how the recoupment is directed, but there is some flexibility in how it is ultimately designed and who it is targeted for. It is very broad in its language to the financial industry. I think it is borne in a certain way because of the way TARP was originally intended, which was, of course, to be direct purchases of troubled assets, mortgage-backed securities.

I think, as originally envisioned, the government is going to buy up to $700 billion worth of these securities, and then in 5 years make a determination of how those investments are doing. If they are short, it would make sense to make the financial industry, those from whom Treasury would have purchased these assets, come back and levy a fee or a tax in order to recoup those investments.

It becomes more difficult because of the way TARP has morphed now into 13 different programs, a lot of them primarily in capital investments. So those that are more able to repay will have repaid and there would not be a loss associated. Those who are doing poorly, and therefore would not be able to necessarily repay a tax—like if AIG and the automotive industry are short—it would be more difficult to impose a tax on them. So I think that creativity

and flexibility will be important in fashioning the appropriate result.

The CHAIRMAN. Some people suggest, first of all, that TARP money went to banks and that that helped the banks, but it also helped the economy generally. I guess the argument is, if the fee is essentially on banks, it is on those institutions as well that—what, it is appropriate because the benefits of TARP in the first place were not only specifically directed, but also widespread? I do not quite understand the argument. Why should the fee only be on certain institutions and not more widely spread, even though those other institutions got a lot of the benefit from TARP?

Mr. BAROFSKY. Well, I think that certainly there are multiple sides to this argument and this discussion. It really boils down to a policy determination for the Congress and the administration to decide who is appropriate to fulfill section 134's requirement for recoupment, but there are certainly arguments on both sides.

The financial industry and the larger banks certainly benefitted beyond just the dollars that were invested in them, and not just from the TARP, but from, as a whole, the response from the government to the financial crisis, the implicit guarantee that they have of government support. It has been widely reported that they are able to more easily and more cheaply raise money than their smaller counterparts, giving them a competitive advantage and giving them opportunities for high profits. So, it is a very complicated question, Mr. Chairman, for sure.

The CHAIRMAN. Do you have any thoughts on how the fee is structured? As I understand it, it is significantly structured to discourage over-leveraging. Your thoughts on the structures as opposed to, say, a profits tax.

Mr. BAROFSKY. To be honest with you, Mr. Chairman, until we see something hard and in writing as far as a legislative proposal, when it is in this early stage of discussion, we do not really get involved from an oversight perspective. Once it is more fully formed and we are going to be responsible for overseeing it, is sort of when we roll up our sleeves and dig into it. But we really have not had the opportunity to fully analyze the proposal as it has been described in the press.

The CHAIRMAN. Thank you. My time has expired.

Senator Grassley?

Senator GRASSLEY. Thank you, Mr. Chairman.

A year ago, CBO and OMB projected the loss from TARP to be $250 billion. OMB now estimates TARP will lose $127 billion; CBO estimated it at $109 billion. It has been reported recently in a *New York Times* article that I have here that some Treasury officials—I think unnamed, as I recall—expect the bail-out program to "eventually turn from red to black." If Treasury says that eventually there may not be losses, does this excise tax make sense? Before you answer that, would the amount of losses, if any, not be more certain in 2013, the year the TARP law says the President is supposed to propose a plan to recoup taxpayers' losses from TARP?

Mr. BAROFSKY. Certainly with more time there will be more certainty as to the extent of the losses.

Senator GRASSLEY. OMB says that the auto industry is responsible for $31 billion of all TARP losses; CBO says that they are re-

sponsible for $34 billion. Does it make any sense to levy a tax to recover TARP losses and then carve out GM and Chrysler, the companies responsible for 30 percent of the losses?

Mr. BAROFSKY. It is a difficult question, Senator. As I noted, based on the structure of the way section 134 was originally intended as the TARP was envisioned versus how it is now, that is a difficult policy question.

Senator GRASSLEY. In March of 2009, and that is obviously just 13 months ago, the President announced an initiative to use $15 billion in TARP funds to fund what are called SBL (Small Business Lending) loans. However, small business did not actually receive that money, and lending to them has not increased because the initiative was reduced to a $21-million pilot program. So, there is a difference between the $15 billion intended and the actual $21 million that is a pilot program.

In January, the administration proposed taking $30 billion out of the TARP program and setting up a separate, non-TARP program to support small business lending. We do not have actual legislative language yet, but I am concerned about what that would mean for the ability of your office to conduct oversight.

Could you explain why the previous small business lending program never materialized and why you think you should retain jurisdiction to oversee the newly proposed $30-billion program, and also, what are the risks to accountability and transparency if oversight from your office would be blocked by a change of legislative language?

Mr. BAROFSKY. Senator, if I may answer your second question first. We think that this would be tremendously dangerous and wasteful to the taxpayer if this $30-billion program is taken out of the TARP without our oversight continuing.

There is virtually no difference between the newly proposed program and the existing Capital Purchase Program. It involves the same five regulators making decisions on who gets money and who does not. It is the same capital structure. It is the same eligibility criteria. It is the same type of investments. It is actually the same money, TARP money. We estimate that approximately 95 percent of existing TARP recipients, because of the way the program is going to be set up, can just transfer their TARP investments into SBL investments.

So 95 percent of the CPP recipients will not change anything other than moving out of the TARP and into this new program. Meanwhile, at SIGTARP we have grown organically with the Capital Purchase Program. It was there when we were created. A large part of our oversight, on the audit side, the reporting side, and on the investigation side has been built around growing and learning the CPP program, which this Small Business Lending Fund is the mirror image of.

From an audit side, we have done audits into the decision-making process, how it works, and the impact of outside influences. We have made a series of recommendations about transparency and program design. Perhaps most importantly, on the investigation side, we have conducted literally dozens of criminal investigations into those who have tried to criminally profit off of the Capital Purchase Program. We have developed a very sophisticated fo-

rensic team. These are the types of crimes that the SBLF will also be—as I said, it is virtually identical to CPP.

Our complex accounting types of fraud, capital raise issues, the issues that we have already seen that we have spent a significant amount of time learning and training and getting up to speed on—to take this and to throw away the 14 months of expertise and training that we had, from an audit perspective, from a criminal investigative perspective, and taking that out and leaving this program adrift, essentially, with a new oversight body that may or may not have the resources to get up to speed, certainly will be a gear-up process that could take at least a year to get even close to where we are, even if they have the necessary resources and expertise, I think would be a tremendous disservice to the American taxpayer and it would essentially leave a program, which in many ways has a greater vulnerability to being taken advantage of because of the incentive programs, essentially without effective oversight.

I think it would be a tremendous waste of taxpayer dollars, and I would strongly encourage this Congress to include SIGTARP oversight. It is not an expansion of our jurisdiction; it is the continuation of our jurisdiction over the same exact parties with the same exact money. I was very disappointed when the administration changed course on us after initially saying that we were going to be included in the proposed legislation, and then later telling us that we would not.

Senator GRASSLEY. Would it not be more accurate to say that, if we do not do anything, you will be included? Is it your view as a lawyer, if they set this up, we have to transfer what you do now over to that? I thought you would automatically have jurisdiction unless the law was changed to take it away from you.

Mr. BAROFSKY. If they rip this out of the TARP, as they are suggesting doing, we may have jurisdiction to a certain extent on some of the monies, but we would not necessarily have complete jurisdiction over the program.

Senator GRASSLEY. All right. Well, then I think you have answered my question, that you will have jurisdiction unless Congress changes the existing law.

Mr. BAROFSKY. Yes, that is correct.

Senator GRASSLEY. I hope the members of this committee will be aware of that so that we do not let something like that slip through.

I will wait for a second round for other questions.

The CHAIRMAN. All right. Good.

Senator Nelson?

Senator NELSON. Thank you for your service.

A big part of the ultimate losses of TARP is coming from AIG, and a big part of the losses in AIG that will not be paid back is as a result of the credit default swaps being paid off, these insurance policies, at 100 cents on the dollar.

Now, do you think that these derivative counter-parties, such as Goldman Sachs, that received the preferred treatment, put them at the front of the line when the circumstances occurred as they did with AIG? Do you think that they should be put at the front of the line?

Mr. BAROFSKY. I think that, when making these policy considerations, everything should be on the table. The fact is that Goldman Sachs and seven of the eight largest counter-parties refused to negotiate with the Federal Reserve Bank of New York to negotiate concessions, which ultimately did lead them to receiving 100 cents on the dollar.

We issued an audit report on this where we explored the reasons and the justifications for this, but I certainly think it is a relevant policy consideration among the other policy considerations in designing the section 134 EESA recoupment that is contemplated by the statute.

Senator NELSON. Well, what in the world made the Federal Reserve sit there and take that by these counter-parties saying, oh, we are not going to negotiate with you on this? It seems like the Federal Reserve should have been in the driver's seat.

Mr. BAROFSKY. Well, Senator, we agree. When we released our audit report, we went through the reasons that the Federal Reserve gave for what we described as a very ineffective negotiating strategy that was ultimately doomed to fail, as well as what we saw was a simple lack of effort, even within certain limitations they put on themselves with the negotiations—things like requiring that they would not do any deal unless all of the counter-parties agreed, or refusing to put a little pressure on them because of their status as a regulator to sort of encourage the negotiations to move forward instead of saying to them, basically, do not worry, it is just a voluntary negotiation—but the fact is that they did not do what they had done just a couple of weeks earlier with respect to the recipients of TARP funds and the Capital Purchase Program.

In other words, the then-president of the Federal Reserve, now Secretary Geithner, did not get on the phone and call the CEOs or call a meeting of the CEOs of the big banks and the counter-parties and call them together and make a strong emphasis on a negotiation like they did with CPP, telling them that this was important for the country, pointing out the incredible support that the Federal Reserve and the taxpayer had given to AIG, and they would all have suffered, most likely, horrific losses without that support, and using that bully pulpit to try to voluntarily get negotiated fees, even after one of the banks, BBS, actually agreed and said in certain circumstances they would agree to a concession. We have been critical of that, because we think at the very least they should have tried a little bit harder.

Senator NELSON. Of the $89 billion that you think that we are not going to get back, the people, the taxpayers are not going to get back from the bail-out, is most of that attributable to AIG?

Mr. BAROFSKY. To be clear, all we are doing is, we have not done our own analysis. We are just sort of reporting what CBO and what OMB have reported. But it does look like, based on their estimate, that anywhere from $36 to $50 billion of their estimated losses will be attributable to AIG.

Senator NELSON. And, of course, all of those credit default swaps that were paid off with all those firms, like $13 billion just for Goldman Sachs and go on down the line, that would total up to about $50 billion, would it not?

Mr. BAROFSKY. Just on the Maiden Lane facilities alone, which is the portion where the Federal Reserve purchased from those counter-parties at market value the CDOs, the other half of that, the collateral that had been posted, most of that money came from the taxpayer through the Federal Reserve and back-paid. That alone was tens of billions of dollars.

Senator NELSON. This is an outrage.

Let me ask you about HAMP. Would you talk more about your recommendations regarding HAMP's effectiveness and your recommendations on fraud and the voluntary nature of HAMP's principal reduction program?

Mr. BAROFSKY. With respect to fraud, in the new designs of the program it increases incentives in short sales, which are circumstances where Treasury is going to be providing incentives to homeowners, as well as to the servicers, to encourage them to basically turn in the keys to their house and have it being sold to someone for less than what the mortgage is actually worth, so, if a house is worth $100,000 and the mortgage is $150,000, to effect that sale at $100,000, and then for the servicer and the mortgage investor to release the borrower for the difference. It is basically a short sale.

Certainly encouraging those, we have no problem with that as a program design. Short sales are generally regarded as being less expensive to investors. It is not as painful as foreclosure; it is not as expensive as foreclosure. The problem is that these types of sales have historically been vulnerable to a special type of short sale fraud. It is called "flopping," sort of the opposite of flipping. That is based on an artificial deflation of the value of the home.

Say the home is really worth $125,000 in my example, but there is a benefit for the fraudsters, if they could get the investors, the people who own the mortgage, to believe that it is only worth $100,000, so they provide false information. If they do that, then they get the home below market value and could flip the home almost instantly and make a nice, tidy profit.

The problem is the valuation standards that Treasury is anticipating using on this are basically not very robust. It is broker opinions. Even that is not standardized. It is based on the review of the servicer. I am sorry; I see we are running out of time. So our recommendation is simply that, with this program and other programs involving principal reduction, they do what the FHA does, which is require a certified appraiser to make sure there is a good third-party look to prevent those types of fraud.

Senator NELSON. You ought to take a look in Florida where some of this flopping is going on right now.

Mr. BAROFSKY. No. Absolutely. It is a hotbed of that activity in the State of Florida.

The CHAIRMAN. Thank you, Senator.

Senator Carper?

Senator CARPER. Thanks, Mr. Barofsky. Welcome. Thank you for your stewardship and the good work that is being done on this front.

I just want to go back in time a little bit. You said this, but I just want to make sure that it is clear. When the last administration came to the Congress and asked for us to fund the TARP pro-

gram, my recollection was they asked for about $700 billion or so. Is that right?

Mr. BAROFSKY. That is correct.

Senator CARPER. Yes. And the proposed use for the money at that that was to allow for the purchase of illiquid assets that were being held by a variety of entities. Is that correct?

Mr. BAROFSKY. That is correct.

Senator CARPER. For the most part, we did not use the money for that, but we ended up taking a different approach, and we injected a fair amount of that money into large financial institutions and we bought their preferred stock, as I recall. Is that correct?

Mr. BAROFSKY. That is absolutely correct.

Senator CARPER. Yes. What was the size of those institutions, was it $50 billion and above? Help me with that.

Mr. BAROFSKY. It is huge. The initial roll-out, the first $125 billion, went to the largest of the financial institutions. Over time, as the capital purchase program expanded, ultimately it funded more than 700 institutions. We have breakdowns in our quarterly report of the various sizes of them, but they range from investments, even today with the repayments, as low as $300,000 up to Citi, which is still holding onto $25 billion.

Senator CARPER. All right. Thank you.

When we injected capital into those institutions, they had an obligation to us to pay, on our preferred stock, dividends. Is that correct?

Mr. BAROFSKY. That is correct. Five percent.

Senator CARPER. And were there any opportunities for them to lower that 5 percent by lending money that was injected to improve their balance sheet?

Mr. BAROFSKY. To date that has not been part of the TARP program. It is part of the announced proposal for SBLF.

Senator CARPER. How are we doing in terms of collecting the dividend income that is owed to the Treasury?

Mr. BAROFSKY. Generally on a gross level, it is going pretty well. There have been about 104 TARP recipients who have missed dividend payments. Some have caught up. I think perhaps a couple dozen have caught up with those payments, so that leaves a balance that has still not made payments. That also includes a few TARP recipients that have failed, and obviously will never be making future dividend payments.

Senator CARPER. Can you quantify the dividend obligations that sort of have not been fulfilled to the Treasury, just roughly?

Mr. BAROFSKY. We do have it in our quarterly report. I believe it is $100-something million, but I can get you the exact number.

Senator CARPER. One hundred and something million?

Mr. BAROFSKY. I believe so. But as I said, I would be happy to——

Senator CARPER. That is close enough.

Mr. BAROFSKY. All right.

Senator CARPER. That is close enough.

So we have infused all of this capital money. We bought this preferred stock. For the most part, we are receiving the dividend payments that we are supposed to. A good deal of the capital that has

been infused into the balance sheets of these institutions, a lot of it is being repaid.

Mr. BAROFSKY. Absolutely.

Senator CARPER. Being repaid essentially with interest, with the exceptions that you have mentioned.

Explain to us how we are doing on the warrant side. We see that we have been able to exercise or sell our warrants and to realize profits in the billions of dollars. Can you just give us a brief update on that?

Mr. BAROFSKY. The warrant sales have been successful. They brought back—and for the warrant sales, it is pure profit for the American taxpayer. When Congress designed EESA, they put in this requirement for warrants so the taxpayers can share on the upside. It has been successful. Billions of dollars have been returned from the sale of these warrants.

We actually have an audit report that is going to come out on May 11 which will detail our analysis of how Treasury has been doing in administering the warrant process, but it started off, by certain outside estimates including the Congressional Oversight Panel, a little bit rocky as far as the percentage of return, but since that report has come out we have seen that they appear to have been doing better in getting market price for these. Recently, we have had auctions, which again have appeared to bump the prices up. It seems to be a pretty successful program. I will be able to provide a lot more detail on May 11, once we issue that audit report.

Senator CARPER. As you said earlier, there are a number of institutions that have not yet been able to repay their monies, their obligations to the TARP, but that number is decreasing over time.

AIG still owes a fair amount of money. Roughly what is that, now?

Mr. BAROFSKY. It is about $46, $47 billion outstanding.

Senator CARPER. I have been following in the press that they have at least reached agreements to sell certain of their assets. I think one of them is actually headquartered in Delaware, Alico, which is a big insurance company, I think maybe $15 billion. I have seen another one for $35 billion. Is that money that has already been credited to their other obligation to the Treasury or not?

Mr. BAROFSKY. No, that money will not go to Treasury. The way the AIG investment is structured, the Federal Reserve gets paid back every penny before Treasury gets paid back. If those transactions go off as planned, that will help very much in reducing AIG's obligations to the Federal Reserve, but it is not anticipated that they will be nearly enough to accrete to any credit for the debt to the taxpayer through Treasury.

Senator CARPER. On the other hand, the monies that are owed by GM and by Chrysler come back to the Treasury, is that correct?

Mr. BAROFSKY. That is correct.

Senator CARPER. And do I understand that GM recently paid $1 billion of its obligation to the Treasury?

Mr. BAROFSKY. GM has paid $1 billion, and I think they have announced that they are going to be paying back the debt portion—I think there is about $6 billion left—in its entirety very shortly. But we need to be a little bit cautious about that, because the way

that that payment is going to be made is drawing down an equity facility of other TARP money.

So it is good news in that they are reducing their debt, but they are doing it by taking other available TARP money to repay the TARP. It is good news because it means that money, which was going to be available for future problems with GM, that there is a determination that they do not need it. But we should caution that it is not necessarily being generated out of earnings, but out of other TARP funds.

Senator CARPER. When do you think we will have really good news from GM?

Mr. BAROFSKY. I do not have that crystal ball, Senator.

Senator CARPER. All right.

And Chrysler. What is the story with Chrysler's obligation?

Mr. BAROFSKY. Chrysler's obligation is mostly—again, we have an equity interest in Chrysler, so our future ability to recoup taxpayer investment is going to be wholly dependent on how successful Chrysler is and how successful the American automotive industry is.

Senator CARPER. I have some more questions. Maybe we will have a second round.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Senator Schumer?

Senator SCHUMER. Thank you, Mr. Chairman. Being in this room, I immediately get overcome with health care, since we spent so much time here doing that. [Laughter.]

The CHAIRMAN. Well, we are now talking about financial health.

Senator SCHUMER. We are now talking about financial health, right. I want to thank you, Mr. Barofsky, for your testimony and your service in overseeing the implementation of the TARP program.

As unpopular as TARP has become, I think most who would look at it would say it was absolutely necessary to save the economy from complete collapse. I was in the room when Chairman Bernanke and Hank Paulson, President Bush's Treasury Secretary, told members of Congress, some of us, just how serious the situation was. They told us if we failed to enact the TARP we risked another Great Depression. We were staring into the abyss. When we heard it, I think there was a collective gulp in the room. Ben Bernanke talked about it in his very proffesorial, non-exaggerated, non-hyperbolic tones, and you knew how serious it was.

So Congress came together and did the right thing, Republicans and Democrats, and the Bush administration, which had proposed it, signed it into law. So it is important to emphasize that the current financial reform proposal also contains multiple safeguards to make sure taxpayers are never again on the hook for rescuing the financial system. I think that is very important. Any costs incurred in winding down financial institutions would be covered by the industry, sort of the way it is in the banking industry with the FDIC.

We certainly can, and should, work to prevent any more taxpayer bail-outs, but we also need to close the book on the last one and make sure that taxpayers get back every dime they paid to rescue the economy. A key piece of that legislation was a provision requir-

ing the President to assess the costs of the programs and "submit a legislative proposal that recoups from the financial industry an amount equal to the shortfall in order to ensure that the program does not add to the deficit or national debt." That got a lot of people to vote for it. It was a tough vote, even then. I think we have to live up to those words. They should not be ignored.

In keeping with the requirement under TARP to make sure taxpayers are whole, the administration did live up to its responsibility. It proposed a financial crisis responsibility fee to be assessed on financial institutions with over $50 billion in assets. As proposed by the administration, the fee would amount to 0.15 percent of the liabilities of these companies, other than deposits and tier one capital.

There are, to be sure, legitimate questions about the details of the plan, and I salute Chairman Baucus for holding the hearings to try to answer them. But overall, I think the administration's proposal is a common-sense way to make sure that taxpayer money is repaid, and I believe it should be included in the financial reform legislation soon to be debated on the Senate floor. I agree with the administration in this regard.

As the President said when introducing it, "It is our responsibility to ensure that the taxpayer dollars that supported these actions are reimbursed by the financial sector so the deficit is not increased."

So, Mr. Chairman, I want to work with you and all of our colleagues on this committee to get recovery legislation ready in time to be included in the financial reform legislation that will soon be considered on the floor.

Now, my question to you, Mr. Barofsky, is this: you were talking a little bit before about minimizing the losses; the government still holds billions and billions and billions of dollars of these kinds of assets and things. What do you think the administration can do, Congress can do to minimize the potential losses? You indicated earlier it will take years to know exactly what our losses will be, but now we are moving on here, and I think we ought to start looking at how to minimize our losses.

Could you comment on that, please?

Mr. BAROFSKY. I think one of the areas that is near and dear to our role is looking at inefficiencies in the program as they are run, and to fraud vulnerabilities. Those are going to be areas that are very preventable and avoidable losses.

Some of the loss with respect to AIG and the automotive industry, that is going to depend on macroeconomic conditions, whether the economy improves, people buy more cars. There is very little within the TARP program, perhaps, to address those.

But within the TARP program, we try to make recommendations so that the program runs efficiently, that it maximizes each dollar that is spent, and above all, we make sure that the right protections are there against fraud so money is not lost, for example, by providing it to institutions in the new small business program that are defrauding the TARP and getting money that is ultimately going to result in failure to the system or does not carry out its goals. Those are areas where we really have been working hard to

make sure that, when TARP money goes out the door, it goes out efficiently and it is not the result of fraud.

Senator SCHUMER. Thank you, Mr. Chairman. My time has expired.

The CHAIRMAN. Thank you, Senator, very much.

A lot of questions here. One, small business. Generally, small businesses have been unable to take advantage of the funds that have gone into the big banks, whether TARP funds or Federal Reserve assistance, or whatnot. There are some who have suggested that banks make some money by borrowing at very low interest rates from the Federal Reserve and then lend out, I guess, to other banks, rather than lending to small business. Your thoughts on how or what could be done with the TARP program to help small businesses. Just your thoughts. It has been a real problem. How do we get more money to small businesses?

Mr. BAROFSKY. I do think that there is some definite merit in the administration's proposal about the Small Business Lending Fund and the idea to incentivize small business lending—that is, unlike the original outlay of TARP funds in the Capital Purchase Program, where money was sent out without any conditions or incentives or carrots or sticks about what to do with that money; they really had free reign to do with it as they pleased, back then, and really up until now, without really any accountability because of the administration's refusal to require TARP recipients to report on their use of funds.

I think that by incentivizing the banks through lowering their dividend rates to encourage them to increase small business lending—that can help. I think the administration's finally adopting our long-term recommendation of requiring TARP recipients to report on their use of funds so that there is some accountability for the use of TARP funds will also assist, I think, in helping to meet that goal to further incentivize small business lending.

The CHAIRMAN. Now are they reporting how they are using their funds?

Mr. BAROFSKY. Treasury has finally sent out a survey. The responses were due, I think, just this past Friday. They are going to be publishing the results. It is going to be quantitative data as well as qualitative data. For the first time, Treasury is going to sponsor that. We did it ourselves in an audit report back last summer. It was a voluntary audit report, but for the first time Treasury is now going to require it and report on how TARP recipients are saying they are going to use those funds.

The CHAIRMAN. Have you seen those proposed regulations?

Mr. BAROFSKY. I am sorry?

The CHAIRMAN. Have you seen those proposed regulations?

Mr. BAROFSKY. It is actually just a survey that was sent out. We saw the survey, and we had input on the design of the survey.

The CHAIRMAN. All right. So are you satisfied with that design or would you make some suggestions?

Mr. BAROFSKY. We made some suggestions, most of which were adopted, some of which were not. But overall, we were all right with the design and what Treasury's plan was. Now, of course, the question was always in execution. We think that getting the quantitative data and matching it with the qualitative data, the infor-

mation that is received from the regulators as well as from the banks, and putting that together and putting together a comprehensive report will be helpful.

One of the recommendations that we made that they adopted was to make sure that those returning the surveys had a high-level official certify it under penalty of criminal penalty, and we think that will help assure that those people who are signing that are going to have the incentive to be accurate and truthful. But we are going to monitor how Treasury performs under this.

The CHAIRMAN. I appreciate that.

Any other thoughts on small business? A lot of us hear so much from community banks and also small businesses, and a lot of small businesses say they just cannot borrow because banks are not lending.

Mr. BAROFSKY. It is a very difficult problem. I think a lot of it has to do with outside of the contours of the TARP. We have all heard anecdotal information about the push and pull between the regulators who may be tightening certain lending restrictions. There is the possibility that has been discussed, as you mentioned, that the banks are getting the money very, very cheaply, but reportedly a lot of them are just turning around and lending it back to the Federal Government by buying Treasury bills instead of lending it out and taking riskier—lending it out to small businesses.

The CHAIRMAN. Right.

Mr. BAROFSKY. What we try to do in this report as well is do just an overview of small business lending. We do a 5- or 6-page tutorial on some of the issues, what the SBA's role is. One thing that we do come down on: there is no way that we can have lasting economic recovery without a return from small businesses. They are just too important as far as net job growth.

The CHAIRMAN. I agree with that very much. I just hope we can find a better way.

All of this discussion on TARP assumes everything is on the up-and-up. Is there any fraud, waste, and abuse by certain actors in the TARP program generally so far as you can tell?

Mr. BAROFSKY. The TARP is sort of a giant, several hundred billion—multi-hundred billion—dollar pot of honey, and it is going to draw some bees, and it is going to draw some flies. Our job is being very vigilant over this. We have absolutely seen those who are trying to take criminal advantage. As I mentioned in my opening statement, we have secured several criminal charges. We have had, not just in this past quarter, but we are really getting some traction in our Investigative Division.

Now we have 84 ongoing criminal investigations, and they really apply across the TARP, not just into the bank program, although a lot of our resources are structured on those who have tried to steal from the TARP through fraudulent applications in that program. But we are also looking at the housing program, within the public/private investment program, really across the board. So, yes, Mr. Chairman, unfortunately there are those who seek to take criminal advantage.

I think that what we have tried to do is on two fronts. One is through detecting and referring to Department of Justice for pros-

ecution. We have also committed a significant amount of resources in deterring, both through being very public about our being out there—and I think we have had a significant impact with that—but also in helping to design these programs.

If I may—I see my time is up—a great example is in the Term Asset-Backed Securities Loan Facility (TALF) program, the Federal Reserve's program to lend asset-backed securities. When that program was first described to us in early January of last year, it had virtually no protections whatsoever. It was going to rely solely on rating agencies and investor due diligence, basically the two things that got us into this entire mess with the financial crisis in the first place.

I cannot give the Federal Reserve more credit for being willing to work with us. After we initialed our first report last February, a whole team came down from New York. I do believe that this program, as it ultimately became designed, is a very safe program. They followed our recommendation and did not put residential mortgage-backed securities into it, even after it was publicly announced that they were going to do so. So, I think that that is one of the areas where we have had some degree of success.

The CHAIRMAN. Thank you. My time has expired.

Senator Grassley?

Senator GRASSLEY. Thank you, Mr. Chairman.

One of the TARP programs now ramping up at Treasury is the public/private investment program. This is a $40-billion program, and it is the only TARP program designed to buy toxic assets. I understand your office has investigated potential conflicts of interest involving this program and that the investigation might include a Wall Street investment firm named BlackRock.

As I understand it, BlackRock has a deal to work on Maiden Lane for the Federal Reserve Bank of New York as a toxic asset analyst, while a separate BlackRock company has a deal with Treasury to participate in the public/private investment program to buy toxic assets.

Is there a conflict? What can you tell this committee about the results of your investigation? I do not expect you to tell us anything that would violate any investigation you are doing or stall it, but anything you could tell us, I would appreciate it.

Mr. BAROFSKY. Sure. Senator, there are two different areas here. On our audit side, we are doing a number of audits that touch on BlackRock's role, and it is an extensive role throughout this financial crisis. There are actually three different audits that touch on their role. So, for example, we are doing an audit looking at potential conflicts of interest and compliance rules in the Public-Private Investment Program (P–PIP) program. That touches on them. We are doing an audit on the Citibank Asset Guarantee Program, in which they also served a role, an advisory role, which touches on their role. We are looking at the TALF. We have an audit on collateral monitors.

Even in the TALF program, for 2 months, they served in that role. As you said, they have a role beyond just those three programs with the Federal Reserve's $1.25-trillion purchase of agency mortgage-backed securities with respect to Maiden Lane II and Maiden Lane III, two AIG programs, Maiden Lane I, the bail-out

of Bear Stearns, and the list goes on. We are considering doing a more over-arching audit report on their role throughout the financial crisis.

On our investigation side, we do have a pending investigation into one of the P–PIP fund managers. We have not identified who that is because it is a pending investigation, but it is looking very specifically into a conflict of interest issue, specifically some of the data that was provided to us by Treasury—they helped alert us to this—showed that a fund manager who is managing two funds—one is the P–PIP fund and another one is a private fund—sold an asset out of the private fund and then bought it back from an intermediary into the P–PIP fund at a higher price. We are investigating that as a potential conflict of interest.

I have to note that that behavior was made possible because Treasury refused to adopt one of our most important recommendations about strict ethical walls applying to P–PIP fund managers, but that is a separate investigation and we have not identified who the fund manager is.

Senator GRASSLEY. All right.

Now, a little bit on the point you just made. Why does Treasury not just exclude Wall Street investment firms that already work for the Fed? Are there not enough Wall Street investment firms available that do not already work for the Fed that could be doing this work?

Mr. BAROFSKY. It would appear to be so, but based on the repeat performance of certain players in different aspects of the financial recovery, it does appear that from Treasury's and from the Federal Reserve's perspective, that that may not be the case.

Senator GRASSLEY. Would you please conduct a review of any and all conflicts of interest related to BlackRock? I mean, I am making that request of you.

Mr. BAROFSKY. And I will certainly sit down with our team, and we will get back to your staff on how to properly scope out that type of job. But I think it is certainly something that we have considered before, and it is something that needs to be looked at.

Senator GRASSLEY. All right.

On Friday, the Securities and Exchange Commission announced that it was charging Goldman Sachs with civil fraud in connection with selling mortgage-backed securities that were essentially designed to fail. The SEC alleges that Goldman misled investors by telling them that the pools of mortgages were put together by an "independent" advisor when in fact both the hedge fund manager who created the security and Goldman itself were secretly betting that the investment would go bad. If the facts as alleged are true, then it confirms our worst suspicion about how the mega-investment banks could use their position to rig the game in their favor.

As I understand it, the SEC is only looking at one of a series of investments known as "the Abacus securities." Some of the Abacus securities were insured by AIG. Since AIG is a TARP recipient and losses on these securities may have contributed to the need for taxpayers to bail out AIG, I hope that your office will be examining the entire series of transactions in detail.

Has your office been involved in this investigation into Goldman, and if not, will you please investigate these other transactions and provide an independent assessment to us about whether any of AIG's taxpayer-subsidized payments to Goldman can be recovered if they were based on this kind of fraud?

Mr. BAROFSKY. Absolutely. We were not involved in the case that was announced Friday. Ultimately, the insurance that was written off of that was not by AIG; it was ultimately a company that got picked up by RBS. But there are, I believe, seven of these same types of deals that were insurance credit default swaps were written by AIG.

I have been in contact with the SEC. We are going to coordinate with them, but we are going to lead the charge. We are going to review these transactions, working with them, as well as with the Department of Justice if necessary, to give a close review of these transactions and to see if there are allegations, if there are bases of fraud, and if AIG and, as a result, the American taxpayer were victims of any similar types of fraud. But we are absolutely going to do that.

Senator GRASSLEY. I will ask my last question in writing, if you would respond, please.

Mr. BAROFSKY. Absolutely.

The CHAIRMAN. Thank you, Senator.

Senator Snowe?

Senator SNOWE. Thank you, Mr. Chairman.

Thank you, Mr. Barofsky, for your outstanding work in safeguarding the interests of the taxpayer and providing transparency and accountability to this program that, regrettably, Congress had to approve during the financial crisis. So, you are doing great work, I think, on behalf of this country, and I want to thank you.

Mr. BAROFSKY. Thank you.

Senator SNOWE. One of the issues that has arisen with respect to TARP is eligibility for the net operating loss carry-back provision that the chairman and I worked on during the stimulus program, for example, extending it from 2 to 5 years. What emerged in a recent article that appeared in the *Wall Street Journal* was that JP Morgan, which is a former TARP recipient, had repaid its funding to the government, but nevertheless will now benefit from a $1.4-billion net operating carry-back loss due to its purchase price of Washington Mutual. It was clearly and explicitly stated in statute that no TARP recipient, either current or prior, would be eligible to use this net operating carry-back loss.

Now, who is responsible for making this determination, and what should we do to correct this? Because clearly this was not the intent of Congress, so I think we need to go back to the drawing board on this to make sure that this does not repeat itself.

Mr. BAROFSKY. Right. We have been closely monitoring this situation. Right now it is in Bankruptcy Court. The FDIC, as receiver, is in discussions, and there have been discussions about a settlement with JP Morgan that may allocate, as you say, a portion of this tax break to JP Morgan.

We have been in contact with the FDIC, we have been in contact with some of the creditors who have been objecting to this, and we are going to continue to monitor that situation. We have not really

taken any action because we are waiting to sort of see how the settlements break down, but that is where it is right now—it is in Bankruptcy Court. Ultimately, whether there will be a negotiated settlement among the parties or whether the Bankruptcy Court judge will make a ruling, there are complicated legal arguments on all sides that we have been reviewing.

Right now, we have sort of been taking a back seat and watching the process to see what actually happens before making an evaluation, but we have been on top of this, having our Legal Division follow it, but it is certainly a very complex discussion with the intricacies of bankruptcy law. At first our reaction was the same as yours: that this does not seem to be able to make sense. But as you sort of get through the weeds of bankruptcy law, it is a very complicated and complex issue that, frankly, we are still getting our arms wrapped around.

Senator SNOWE. Well, would you provide us with your thinking, once a decision is made? I gather we cannot preempt any decision at this point on this issue, but I will look at it from that standpoint, and so will my staff. We will certainly evaluate it. But it clearly was not the intent, and it was very expressly stated. So, somehow it has gotten wrapped up in allowing this to happen and to providing that to a former TARP recipient. I think that certainly should not be the case. So what we need to do to address it ultimately, certainly, is something we should consider.

Mr. BAROFSKY. Yes, Senator. I would be happy to have my legal team sit down with your staff and sort of discuss the issues.

Senator SNOWE. All right. I appreciate that.

Second, in the non-repayment of dividends—and you have indicated in your testimony that there are $188.9 million worth of dividends that have gone unpaid by 74 institutions—that is disconcerting, when 74 companies have already missed three or more payments. So this obviously could become a significant issue. Why is it, and what are you doing or what is Treasury doing to recover those dividends that are not being paid in a timely fashion?

Mr. BAROFSKY. Well, unfortunately those institutions that are not paying, in most cases it is because their regulator has directed them to stop making dividend payments, basically because they are in trouble. Because the financial institutions are in trouble and their capital is bleeding, taking capital away through dividend payments, it is feared, could lead to the failure of the bank and then a complete loss of the TARP capital investment.

One of the things we are doing—obviously through our Investigations Division—all these banks represented themselves to be healthy and viable before coming into this program, and for those that rapidly digressed from being supposedly healthy and viable to being unable to make quarterly payments of a 5-percent dividend payment, that raises some interesting concerns and some important issues.

So from an investigation point of view, we are looking at some of these institutions and seeing whether there were misrepresentations. The other thing that Treasury is doing for some of these struggling institutions is actually recapitalizing its investment. We detail some of those in the quarterly report, where basically they are taking an up-front loss in certain circumstances by turning

their preferred investment into common or mandatory convertible preferred shares at a discount to par. They are recognizing this loss because basically they have come to the view that, if they do not do these things, the taxpayer investment will be completely wiped out, and better to take a hair cut now in the hope that the bank can recover.

Senator SNOWE. And how many institutions would be in that category?

Mr. BAROFSKY. I think so far there have been five institutions that have announced it. Citi was the first. There, it looks like, at least at current stock prices, we may actually make a profit as a result. Banco Popular down in Puerto Rico was the second. We detail three more smaller banks in the current quarterly report.

Senator SNOWE. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Senator Carper?

Senator CARPER. I would like to go back and just pick up where I left off, if I could. We were drilling down, if you will, on figuring out who still owes money to the TARP and what is maybe our likelihood of collecting what is still out there. I think you mentioned that rather than Chrysler owing money back to the TARP, we have an equity position in Chrysler. Can you just take a minute and talk with us about that equity position, just describe it for us?

Mr. BAROFSKY. Sure. Right now it is about 10 percent. That number can go down if Fiat meets certain performance metrics of introducing a smaller car, a fuel-efficient car, and shares technology. That number may come down to 8 percent. But essentially our ability to recoup that money will depend on how Chrysler does. The goal ultimately for both Chrysler and GM is to get to an IPO, initial public offering, of stock.

That way Treasury will have a method of liquidating its interests through public sales of stock to the public. So the goal is that these companies can get back on their feet, return to profitability so that the shares of their stocks become attractive to the market, and then Treasury will be in a position to sell off its shares and ultimately recoup its investment.

Senator CARPER. This reminds me just a little bit of what happened in 1980, when the Federal Government provided loan guarantees for Chrysler, and Chrysler was able to find funding in the private sector. The Federal Government simply guaranteed the loans, but we did have granted to us warrants which we exercised several years later. When Chrysler stock returned to higher levels, we took the warrants.

I think we had warrants to sell Chrysler stock at about $10 a share, or to buy it at $10 a share, several years after the company had begun to recover. At that point in time we exercised our right to buy at $10 a share, and we turned around a week or two later and sold it for $30 a share and made about a third of a billion dollars for the Treasury. How does the situation with Chrysler resemble that or differ from it in this instance?

Mr. BAROFSKY. I think it is dramatically different because we do have this direct equity investment. As you said before, and I am by no means an expert on the original Chrysler bail-out, but my

understanding is that it is as you described. Here, we are not really guaranteeing debt. We have actually given them money. A lot of the money has been written off.

The investments in Chrysler preceded their bankruptcy and were during their bankruptcy, so it was money that was given, and a good chunk of it was recognized as being lost in bankruptcy. It went to the old institution. There is a bankruptcy plan that is right now pending and has not been approved with money that we have that has been lent to old Chrysler, and there is no real expectation that we are going to get that money back.

Senator CARPER. How much money was that, roughly?

Mr. BAROFSKY. I do not have the precise numbers.

Senator CARPER. Less than $10 billion?

Mr. BAROFSKY. I just do not have those numbers at hand, but I can certainly get them to you.

Senator CARPER. Thank you. Would you, please?

Mr. BAROFSKY. But a good chunk of the amount was there. But because we have an equity investment, if Chrysler outperforms and does really well, we will have a chance of getting a disproportionate amount of the money that was carried over in equity back, assuming the company does well, assuming that they have an IPO, and assuming that the Treasury will be able to liquidate those interests.

Senator CARPER. And the point at which we recover some of the monies that we have invested in Chrysler would come with the IPO?

Mr. BAROFSKY. Yes.

Senator CARPER. And there is probably some stock level, some price level for the stock that above which we would actually break even?

Mr. BAROFSKY. I think that the estimates are that it would have to have very significant market capitalization for us to get to the break-even point. I think that is why CBO and——

Senator CARPER. Let me just ask you a question, if I could, a 2-part question. One, if we could find out the answer to the first question that you said you would have your folks dig up for us, and second, at an IPO, how high the value of the stock would have to go for us to break even?

Mr. BAROFSKY. It is sort of hard to give an exact number because it is not publicly traded right now. So the valuation would have to be equivalent to our investment. But with CBO and OMB, when they make their estimate of more than a $30-billion loss, it is based on the assumption that that price will never get high enough to result in a recouping of any of that.

Senator CARPER. I think somebody is going to try to pass you some information there.

Mr. BAROFSKY. In our quarterly report on page 116, we make reference to the assets and debts that are still in new Chrysler, and it is about a $3.5-billion original loan that was made before the company went into the bankruptcy and a $1.9-billion debtor-in-possession loan that also stayed in bankruptcy. So, those are two pieces that stayed in bankruptcy and will eventually be written off.

Senator CARPER. Mr. Chairman, where I am going with this is to try to better understand how much of this roughly $100 billion

that is still owed is likely to be recovered, likely to be recovered in the next year or two. What is it? 2013 is out there. What is the significance of that date?

Mr. BAROFSKY. Well, first of all, this is the estimate from CBO and OMB of what will never be recovered, other than through the recoupment. Section 134 of EESA, which has the recoupment standards, requires that basically, on the 5-year anniversary of TARP, October of 2013, the Director of OMB and CBO certify and report to Congress at that moment what the estimate of the permanent loss would be, and that triggers the obligation for the administration to submit a legislative proposal to recoup that from the financial industry.

Senator CARPER. So we will hopefully know by that date if Chrysler is going to make it, if this is going to be a successful venture, and they will be able to maybe schedule an IPO. Is that not an unreasonable assumption?

Mr. BAROFSKY. The goal for both Chrysler and GM is to have at least their initial IPOs of a portion of the ownership of the company well before then.

Senator CARPER. Mr. Chairman, can I continue to ask a couple more questions?

The CHAIRMAN. Yes, sure.

Senator CARPER. Thanks.

Can we just sort of turn to GM, if you do not mind, and explain the situation? Do we have an equity position in GM that we need an IPO to be able to recover or to profit from?

Mr. BAROFSKY. It is essentially the same. With the repayment of this debt, which we discussed earlier, there is some preferred share interest, but overwhelmingly the interest is in an equity interest in GM. We have a controlling equity interest in GM. The new CEO, Mr. Whitaker, has announced an intention of having an IPO. It seems to be the intention that it will occur hopefully this year, that there is going to be a return to profit for GM.

At that point—again, I think the initial public offering will not be for 100 percent of the private interest in GM, but it will start returning to becoming a public company, and we will be able to quantify what the government's ownership interest in GM is worth. Then we will see. Basically, if the company continues to profitability, the shares of stock increase, there will be a continued demand in the marketplace for more shares of General Motors that will give the Treasury an opportunity to have subsequent public offerings and to sell off its interest into the market at hopefully what will be an ever-increasing value into their equity interests.

Senator CARPER. All right. Thank you.

We do not have a lot of people here, Mr. Chairman, at least on our side.

The CHAIRMAN. We do not.

Senator CARPER. But this is very interesting testimony. I think it is actually very encouraging testimony.

The CHAIRMAN. It is. But it raises the question of what degree should the tax be? We do not yet know, within a reasonable period of time, how much will be paid back, which I think is a legitimate question to ask. But you are right.

Let me ask one more question, if I might, Mr. Barofsky. What is the status of the corporate governance audit that I requested? I mean, if we own some of these entities, virtually, whether it is GM, Fannie, Freddie, or whatnot, it raises very interesting questions about corporate governance, that is, interaction between, let us say, the Treasury and management of these companies.

Mr. BAROFSKY. Mr. Chairman, in response to your request we, of course, initiated this audit. We are at the stage right now where we split up the responsibilities with GAO. It is a large task, and we frankly did not have jurisdiction over some of the entities, like Fannie and Freddie, because they are not TARP recipients, but GAO, of course, does. We split up the different tasks of this.

I talked to my Chief of Audit just the other day, and right now we are in the process of exchanging drafts of the audit report with GAO. I do not think we have an estimated release date, but we are in the process of getting there. Hopefully within the next couple of months we will be able to release that audit report.

The CHAIRMAN. I appreciate that. I think it is very important, and I thank you for doing that.

How many Fed dollars went to assist distressed companies?

Mr. BAROFSKY. We reported on this number back this past July, and I anticipate we are going to be doing a catch-up on that, on how much money, not just that came from Treasury and the TARP, but overall in the financial system what the level of support was. Back in July it was about $3 trillion all in for the various programs that support the financial industry.

I recently saw an estimate in one of the media outlets, so I do not want to suggest that they do not get everything right, but that estimated the number still at about $3 trillion. We are going to go and revisit that previous report in our quarterly report and give an update on where that number is today, and we will include breakdowns from the Federal Reserve, from Treasury, and from many other entities that have provided support in this financial crisis.

The CHAIRMAN. And when will that report be available?

Mr. BAROFSKY. I think we are going to be doing it as part of our July quarterly report.

The CHAIRMAN. Not until July. What is your best guess of the degree to which the Fed dollars get recouped?

Mr. BAROFSKY. Well, to a certain extent that number will go down in certain categories and up in others, so, for example, when we last did our review, the $1.25-trillion purchase of agency mortgage-backed securities was still in the ramp-up phase, so that is completed now, so that money is now outstanding. Some of the other emergency programs have been shut down, so those numbers will decrease. I am not sure from a net perspective what has changed, but we can probably get you an answer to that just based off of their balance sheet in advance of the July report.

The CHAIRMAN. I appreciate that.

And how many institutions are overlapped, that is, get both TARP dollars and Fed assistance?

Mr. BAROFSKY. I would say a significant number of the large financial institutions would have gotten support, and most certainly did get support from some of the guarantee programs, as well as the TARP.

The CHAIRMAN. Any way you can give us a proportionate amount, on average? I know averages are——

Mr. BAROFSKY. We do not have access to—I should not say we do not have access to. A lot of that Fed information is not publicly available—for example, who benefits from the discount window—so we have not been able to match that up. Frankly, we have not asked for that information, so we have not done that analysis.

The CHAIRMAN. But some TARP recipients have benefitted from the discount window.

Mr. BAROFSKY. One would presume. Not just the discount window, but the array of programs that the Federal Reserve and the FDIC did to support them during the course of this financial crisis. There is no question that the largest financial institutions probably all benefitted from those various programs, so there is debt guarantee, money market guarantee, all the different programs, the sort of alphabet soup of recovery programs. There is no question that the big players all benefitted from multiple programs, TARP and non-TARP.

And look, today their return to massive profitability, in some cases record profitability, and the large pay-outs, executive compensation pay-outs that have accompanied it, are directly attributable to the support that this government has given them through TARP and these related programs. I do not think there can be any questions about that.

The CHAIRMAN. That goes back to an earlier question of, where is small business here? I mean, we help, frankly, large institutions get back on their feet, but I do not think we have done a sufficient job in helping the smaller institutions, including small business.

Mr. BAROFSKY. Ultimately, I think that the decision to provide this money to TARP recipients without any conditions, without any incentives or penalty for not applying it to actually make them go out and lend the money, has resulted in them using this money in ways to maximize their own profits and not necessarily to carry out the government's goal in this program, which was to incentivize and increase lending.

The CHAIRMAN. So it seems.

Senator Carper?

Senator CARPER. Thanks. Thank you, sir.

So coming back to my line of questioning earlier, GM has repaid $1 billion, I think earlier this month, monies from the TARP. They stand to pay another $6 or $7 billion maybe by sometime this summer. But it sounds like they're kind of taking money out of one pocket and putting it into the other to do that. Is that right?

Mr. BAROFSKY. Yes. In fact, they have repaid $2 billion, and the $4.7 billion—I think I read an article this morning that they are getting ready to repay all of that very, very quickly. But yes. The source of that was an equity capital facility that is basically escrow money. Some of the money that was given to GM, it basically was not all given as a lump-sum check, saying, here, all this money is available to you. Some of it was put in what is called an equity capital facility, which they can draw down.

They have to sort of report to the government what they are going to do with the money, the purpose of it. The way it is structured though, if there is any money left in that account after a cer-

tain period of time, it has to be used to repay the debt. Basically what GM is doing is it is pulling that forward, and it is taking the money out of this TARP capital facility to pay off the debt, the $6.7-billion debt that was previously owed. So $2 billion has been paid already, and it is anticipated, I think, very shortly that the remaining $4.7 billion will be paid off.

Senator CARPER. All right. For the Federal Government to realize any additional funds from GM, does an IPO have to occur beyond the $4.7 billion, or are there other additional monies that they need to repay the TARP?

Mr. BAROFSKY. I am trying to think if there is some theoretical or hypothetical way, but I do not think so. I think there has to be a liquidation of its ownership interest. I mean, theoretically, if they could find a private player who would be willing to buy Treasury's equity investment outside of a public offering, that certainly would also accomplish that goal. But I think as a practical matter, given the vast size of the investment, it is most likely going to occur, and it has been identified as the plan to do it, through an initial public offering and then subsequent capital offerings of selling that into the market.

Senator CARPER. And the assumption is that hopefully the value of the stock over time will appreciate as the market and the auto industry recovers in this country, and hopefully GM holds its market share. We will see how that all works.

Did I understand you to say—changing course here just a little bit—with respect to the monies that have gone into this, the HAMP, we are not going to get any of that back, that is money that is gone?

Mr. BAROFSKY. That is exactly right. The design of that program is for a $50-billion subsidy. That is money that is going to be going out. There is absolutely no mechanism for repayment.

Senator CARPER. All right.

Pivoting again, I just want to come back to the administration's proposal. I think they proposed taking another $30 billion from the TARP and using that money for capital infusion into banks of, I think, less than $10 billion in assets. My recollection was that there would be a tiered approach with respect to the institution's obligation to pay dividends on, I presume, the preferred stock we would purchase.

On the money that has gone into the capital infusion already under the TARP, I think the dividend rate was 5 percent. Is the administration proposing that a similar dividend be set for the smaller banks that would be covered in this tranche or this program, but they could lower that obligation to as low as 1 percent? Is that part of their program, if they lend money to, I presume, small businesses?

Mr. BAROFSKY. That is correct. And you have to start with the existing TARP recipients, because the initial participants in SBLF are going to be—approximately 95 percent of the existing CPP participants will be eligible to convert. So those that are currently paying 5 percent will have the option, and not just new applicants to the program, but those that were already in the CPP program, once they convert.

If they can demonstrate that they have increased their lending above 2009 thresholds, they can lower their annual dividend payment incrementally based on how much they can demonstrate that they have increased the lending, from 5 percent all the way down to 1 percent, for a period of up to 8 years.

Senator CARPER. Does the administration have the authority to go ahead and launch this $30-billion program of capital infusion? Do they need our authorization to do that? Do they need something from the Congress?

Mr. BAROFSKY. If they did it within the TARP, they would not have to. Their proposal is to take the money out of the TARP. Their explanation for the reasons why is that the Emergency Economic Stabilization Act that the Congress passed requires Treasury to put on certain restrictions to those institutions that receive TARP money. For example, the executive compensation restrictions, as well as restrictions on certain other things, repurchase of stock and related warrants so the taxpayer can share in the upside.

Treasury has determined that those factors, as well as what they refer to as the stigma of being involved in the TARP, mean that, if they launch this program within the TARP, they will not expect that much additional participation, and that they have to take those sticks away in order to get smaller banks to come to the window and participate. So in order to do that, they absolutely have to take the legislation out of the TARP.

One of the unfortunate things I was discussing earlier with Senator Grassley—originally it was contemplated that our oversight role would come with it, that part of the proposed legislation would take us, along with the $30 billion and the 95 percent potentially of CP recipients, so we can maintain and continue fluidly, without interruption, our oversight. But right now, the current intention is that we would not be included.

Senator CARPER. I think you make a good point.

Mr. Chairman, this is a point we have touched on a couple of times in this hearing, it seems. If we actually do this extra $30 billion, to my mind it seems like the idea of the oversight that you all seem to be doing a pretty good job on, we ought to continue that.

Mr. BAROFSKY. Thank you. I appreciate that. It is very rare I ask for more work to do, but on this one I do not look at it as more work; I look at it as just the continuation of what we have already been doing and put so many resources into building.

Senator CARPER. Great.

The CHAIRMAN. Thank you very much.

Senator CARPER. Thank you.

The CHAIRMAN. You are doing a good job, Mr. Barofsky. We deeply appreciate it. Keep it up.

Mr. BAROFSKY. Thank you very much, Mr. Chairman.

The CHAIRMAN. Thank you.

[Whereupon, at 11:39 a.m., the hearing was concluded.]

PRESIDENT'S PROPOSED FEE ON FINANCIAL INSTITUTIONS REGARDING TARP: PART 2

TUESDAY, MAY 4, 2010

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:09 a.m., in room SD–215, Dirksen Senate Office Building, Hon. Max Baucus (chairman of the committee) presiding.

Present: Senators Bingaman, Kerry, Wyden, Schumer, Stabenow, Cantwell, Nelson, Carper, Grassley, Hatch, Snowe, Bunning, Crapo, Roberts, and Enzi.

Also present: Democratic Staff: Bill Dauster, Deputy Staff Director and General Counsel; Andrew Fishburn, Detailee; and Mary Baker, Detailee. Republican Staff: Emilia DiSanto, Special Counsel and Chief Investigative Counsel; Jason Foster, Senior Investigative Counsel; Jim Lyons, Tax Counsel; and Preston Rutledge, Detailee.

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The hearing will come to order.

Thomas Jefferson may have gone too far when he warned that "banking institutions are more dangerous than standing armies," but in this great recession we have certainly learned that financial institutions can dramatically affect the economy.

Financial institutions have certainly affected each and every American taxpayer. It has been nearly 2 years since the financial crisis hit. The Bush administration responded with the Troubled Asset Relief Program, otherwise known as TARP. Today, we convene the second of our three hearings to consider President Obama's proposal for a tax to recoup the losses from TARP.

TARP helped to keep the financial sector afloat, and there is a decent argument that the financial sector received more benefit from TARP than just the dollars that TARP lent them. Two weeks ago, we heard from Neil Barofsky, the TARP Special Inspector General. He provided an update on TARP. He explained who had received TARP money and who would probably be able to pay the money back.

Today, our first witness, Secretary Geithner, will describe President Obama's proposal. Secretary Geithner will address concerns that the banks are likely to raise, and he can discuss different ways that the bank tax could be structured.

Our second panel includes a cross section from the financial sector. It is no surprise that financial institutions are not enthusiastic

about the proposal. We look forward to learning how they think that a bank tax might affect their business. We are eager to learn their specific concerns. We need to understand the best way to design the tax so that it is fair and achieves its purpose.

We need to understand who should pay the tax, and we need to understand what effect the tax would have on small businesses and the economy. We need to know if banks will be able to pass the cost of the tax onto customers and small businesses, and we need to understand the effects of the bank tax on small business lending.

Small businesses suffered when credit dried up during the financial crisis, so we want to make sure that banks do not harm small businesses. We tried to make the banks pay back the American taxpayer. We want to learn how a bank tax will affect the economy. We need to know how it might affect the ability of financial institutions to compete, and we need to learn what kinds of bank levies other countries are considering.

So let us examine the responsibility of financial institutions to bear some of the fiscal burden created by the financial crisis. Let us try to understand the best way to assess those burdens. And let us try to figure out the way that is best for the American economy.

Senator Grassley?

OPENING STATEMENT OF HON. CHUCK GRASSLEY, A U.S. SENATOR FROM IOWA

Senator GRASSLEY. Thank you, Mr. Chairman, for a very important hearing.

First of all, I want to thank two Iowans who have come here to be on the second panel, John Sorensen, president and CEO of the Iowa Bankers Association, and Pat Baird, chairman of AEGON USA, a Cedar Rapids company. He also happens to be the last chairman of the American Council of Life Insurers.

The statute that created TARP said that the President is supposed to propose a plan in 2013 to repay taxpayers for any losses from TARP. However, earlier this year, 3 years before he was supposed to under the statute, the President proposed what he called the Financial Crisis Responsibility Fee. The President's top tax official, the Assistant Secretary for Tax Policy, admitted that the President's proposal was actually an excise tax and not a fee. Obviously, in 2013 we will have a much better estimate of projected TARP losses than we have right now in 2010.

The President said that one of the purposes of the TARP tax is to repay taxpayers for any losses from TARP. I completely agree that taxpayers should be paid back every penny of TARP losses. Any losses that result from TARP will increase the deficit, which has bloomed under this administration.

Therefore, to pay back taxpayers for any TARP losses, any money raised from the TARP tax would have to be used to pay down the deficit. If a TARP tax is imposed and the money is simply spent, that does not repay taxpayers one cent for any TARP losses. It is just more tax-and-spend, big government, while the taxpayers foot the bill for Washington's out-of-control spending. I have heard that some in the majority are already looking to use the money raised from a TARP tax to spend it under their arbitrary pay-go rules.

These are the same pay-go rules that say expiring spending provisions do not need to be paid for, but expiring tax provisions do need to be paid for. Of course, that is inconsistent until you realize that it leads to more taxing and more spending, which results in bigger government.

I hope that you, Mr. Secretary, will assure us that the President means what he says about repaying taxpayers and that the President would veto any TARP tax that simply spends the TARP tax money without paying down the deficit.

In looking at the President's TARP tax proposal, which I understand the President has already felt the need to change, it is interesting that GM and Chrysler, which are responsible for about $30 billion of projected losses in TARP, are not subject to the President's proposed tax. Also, Fannie and Freddie are not subject to the tax, and hedge funds, like John Paulson's that is involved in the recent Goldman scandal, are not subject to the President's proposed tax.

Meanwhile, companies that did not take any TARP money are subject to a proposed tax, and also companies that were not eligible to take any TARP money are subject to the proposed tax. So, it is a questionable design that has been proposed by the President. When I asked the Congressional Budget Office to tell me who would bear the burden of the TARP tax, they said that one of the groups that would bear the burden of the tax would be consumers.

One of the purposes stated by the President was to reduce risky behavior by financial institutions. However, CBO stated in their letter to me that the TARP tax "would not have a significant impact on the stability of financial institutions or significantly alter the risk that government outlays will be needed to cover future losses."

One area I am concerned about is the effect of the tax on small business lending. CBO stated in that same letter that it will reduce small business lending. This comes at a time when the President, and my friends on the other side of the aisle, are trying to increase tax rates on small businesses at the end of this year.

The nonpartisan Joint Committee on Taxation has written that 47 percent of all flow-through business income will be hit with the President's proposed tax rate hikes. This hits small businesses especially hard because most small businesses are operated as flow-through entities. I have yet to hear administration officials even acknowledge this fact.

Instead, the administration officials choose to use the misleading talking points that the tax increases will only affect 2 to 3 percent of small businesses. I look forward to hearing the testimony today about this proposed TARP tax and its impact on small business.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Secretary Geithner, you know the usual form. Your statement will be included in the record, and just speak informally for about 5 or 6 minutes.

STATEMENT OF HON. TIMOTHY F. GEITHNER, SECRETARY, DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Secretary GEITHNER. Thank you, Mr. Chairman, Ranking Member Grassley, and members of the committee, for giving me a chance to talk to you today about the President's proposed Financial Crisis Responsibility Fee.

The cost of this economic crisis has been, and continues to be, enormous. It has hit Americans harder than any downturn since the Great Depression. Millions have lost their jobs, their businesses, their homes, and their savings. The resulting loss of revenue has added substantially to our national debt.

The purpose of the Financial Crisis Responsibility Fee is to make sure that the direct costs of TARP are paid for by major financial institutions, not by the taxpayer. When you and your colleagues in Congress gave the Treasury Department authority to put out this financial fire, you included in the legislation a requirement that the President forward a plan "that recoups from the financial industry an amount equal to the shortfall in order to ensure that the TARP program does not add to the deficit or the national debt."

This is a simple and fair principle. Banks, not the taxpayers, should pay for bank failures. This is a principle with ample historical precedent. In the aftermath of the S&L crisis, Congress changed the law to require the FDIC to impose a fee on banks to recoup any losses from closing failed banks.

This same principle is adopted in both the Senate and House financial reform bills, which require the financial industry to repay the government for any costs associated with the resolution of a failing financial institution.

So I just want to take a minute now, briefly, to walk you through the key elements of the President's proposed approach. First, the fee would be set at a level to ensure that the costs of TARP do not add to our national debt. A year ago, we estimated those costs could exceed half a trillion dollars; however, we have been successful in repairing the financial system at a fraction of those initial estimates. The administration's last estimate was that the costs could be as high as $117 billion.

Second, we proposed to assess this fee on financial institutions that have over $50 billion in assets and that were eligible for the emergency programs put in place to resolve the crisis. These firms are U.S.-based bank holding companies, thrift holding companies, certain broker/dealers—we call them primary dealers—as well as companies that control insured depositories and certain broker/dealers—again, only those that were eligible for the emergency programs.

Third, we propose that the size of the fee on individual firms be determined by the risk they propose to the financial system. We know, of course, that a combination of high levels of risky assets, high levels of leverage, combined with less stable sources of funding, were key contributors to this financial crisis, so under this proposal firms that take on more risk would pay more than firms that are managed more conservatively.

This framework also has the significant benefit of including derivatives and off-balance sheet items that are not otherwise reflected under conventional accounting. This way the fee targets,

and would therefore help discourage, activities that pose the most risk to the stability of the financial system.

Finally, the fee is designed to limit the risk of any adverse impact on lending. It would be assessed over a period of 10 years. It excludes over 99 percent of U.S. banks; banks, of course, provide the majority of small business loans to businesses and farms across the country.

So I want to just emphasize this point: this fee would not apply to community banks, thrifts, and credit unions. It only applies to the largest firms that were directly eligible for the emergency programs; firms that were not eligible for that assistance are not covered. If covered firms try to pass on the cost of the fee to their borrowers, they will lose market share to other institutions.

The CBO, in its review of our proposal, highlighted these advantages by noting that the proposal "would improve the competitive position of small- and medium-sized banks, probably leading to some increase in their share of the loan market."

Now, we are working with governments around the world who are considering similar efforts so that we can help create a more level playing field for our firms. We believe this fee is an important complement to the financial reforms now under consideration on the Senate floor.

Those reforms will provide better protection for American families and businesses, require stronger limits on risk-taking by large institutions, bring transparency and oversight to the derivatives markets, and enable the government to break apart failing firms with no exposure to the taxpayer.

Enacting this fee now will make it clear to the American people that they will not have to shoulder the direct cost of TARP, and passing the financial reforms now on the Senate floor will help protect the economy from future financial failures.

Now, Mr. Chairman, we recognize that there are a number of possible approaches one could take to protect the taxpayer from the cost of TARP, and we look forward to working with you and your colleagues to design a fair and sensible approach.

Thank you very much.

[The prepared statement of Secretary Geithner appears in the appendix.]

The CHAIRMAN. Thank you, Mr. Secretary.

In designing this fee, to what extent is it designed to recoup the taxpayers' funds, and to what degree is it designed to deter unnecessary risk?

Secretary GEITHNER. The purpose of it is to meet the legal obligation in the law to recoup the funds, and, in deciding how best to do that, we looked at a variety of different forms of fee tax levy. We chose one that would have the additional benefit of falling most heavily on firms that are taking the most risks. So the virtue of this design is, you can think of it as a "too big to fail" tax, a tax on leverage, a tax on risk, but its purpose, of course, primary purpose, is to meet the legal obligation in the law to cover the fiscal costs of TARP.

The CHAIRMAN. How do you define the risk?

Secretary GEITHNER. Well, the way this is designed, you would pay it in proportion to your assets adjusted by risk, minus the cap-

ital you hold and your insured deposits. So again, if you take more risk with more leverage and you fund that risk with more unstable sources of funding, not with insured deposits, for example, then you pay more. If you are more conservatively funded, you take on less leverage, you have more capital, you rely on deposits to fund your lending, like of course banks do across the country, you pay less.

The CHAIRMAN. And who defines risk?

Secretary GEITHNER. The framework we are proposing is to rely on the established framework that U.S. regulators apply to define risk-rated assets. There is a long-established framework for doing that, and our judgment is, it does the best job of capturing risk on the balance sheets of banks.

The CHAIRMAN. And is that Basel?

Secretary GEITHNER. These are U.S. regulations.

The CHAIRMAN. What are the regulations?

Secretary GEITHNER. Yes. These are U.S. regulations imposed under U.S. law. They are, for reasons you understand, related to the importance of providing a level playing field for American institutions that compete around the world. They are negotiated in an international context, but our regulations often differ from, and in many ways are more conservative than, those that are negotiated internationally. But these are U.S. regulations defined by U.S. supervisors under U.S. law.

The CHAIRMAN. All right. So basically the Basel committee determinations are not relevant?

Secretary GEITHNER. No. Well, the framework we use on capital is this. In the United States, we decide what we think makes sense for our country, and then we negotiate with other countries around the world that have institutions that compete with our banks in their markets and around the world to try to bring the world to those standards we apply in the United States. The authority to design those is under U.S. law—regulations under U.S. law designed by U.S. supervisors—but we try to make sure that we are pulling the world to a similar approach on capital.

The CHAIRMAN. But would a banker wonder about the degree to which this tax is going to vary because it would vary according to what the U.S. regulators say constitutes risk for the purposes of this tax?

Secretary GEITHNER. That is a strength, Mr. Chairman, in our view, not a weakness in this proposal. Again, as we have seen, it is difficult to capture risk in a balance sheet of a financial institution, and you want to make sure that you are doing your best job over time at capturing those risks.

So the fact that this framework for measuring risk in banks evolves over time is a strength in this proposal, but again, it is an established framework. There are clear rules. They are publicly available, and firms have to disclose, every quarter, what their risk-rated assets are, as well as their capital and their insured deposits.

The CHAIRMAN. But to what degree might risk change the bottom-line tax that a bank might have to pay?

Secretary GEITHNER. If the bank takes on more risk over time——

The CHAIRMAN. I am talking about the definition, the degree to which the definition might change.

Secretary GEITHNER. Again, if, over time, the responsible authorities in the United States decide that that framework has to be adjusted, do a better job of capturing risk, for example, like in derivatives or in complex financial products, then they would be required to hold more capital against those risks. If the bank continued to take on those risks, then its portion of the fee would be higher than would be the case if it were managed more conservatively.

The CHAIRMAN. What about small business? At least some say the Basel committee regulations or determinations say that small business is risky. So would a small business portfolio be considered risky under this definition?

Secretary GEITHNER. Again, the virtue of this approach is to say that you pay the fee in proportion to the risk in the exposure, so by capturing derivatives, complex financial products, it captures the economic risk in those exposures and it tries to measure those risks alongside other risks banks take, lending to businesses, families, and customers.

But again, the basic principle is, the more risk, the more capital you have to hold, and the higher share of the fee you would have to propose. Again, Mr. Chairman, there are other ways to look at this, but, by measuring it against risk, we think it provides the best balance of approaches.

The CHAIRMAN. I understand what you are trying to do here. But then the question I have is the degree to which banks can game with this. I do not know. I am no banker, but bankers are pretty clever—we have seen that in the last several years—and maybe will put some of this off balance sheets. I do not know. There must be some ways to game this formula.

Secretary GEITHNER. Again, that is what we think is a strength in this approach. This is an established framework that U.S. regulators set and apply with enormous experience over time, and they adapt it over time as firms try to adapt behavior to get around these risks. Again, it is a clearly available published definition. Firms have to report every quarter whether they meet those definitions, what their risk is, how much capital they hold against that, and we think that is a strength in the approach relative to the alternatives. You have to compare these to the alternative approaches, but our judgment, looking at alternatives, is they would be both less effective in providing a disincentive to risk-taking and would have other disadvantages relative to this.

The CHAIRMAN. My time has expired, but one quick question. Why this level of tax? It is, what, 15 basis points? What is the level of the tax?

Secretary GEITHNER. Well, the——

The CHAIRMAN. Why is it not higher?

Secretary GEITHNER. Well, again, the legal obligation——

The CHAIRMAN. Because one of the criticisms is that TARP gave all this money to these banks, and the banks did not go out and loan to small business. They did not make a lot of loans. Instead, they just invested it and bought Treasuries. They could pay the TARP money back because they made a lot of money.

Secretary GEITHNER. Yes.

The CHAIRMAN. And without helping the economy that much.

Secretary GEITHNER. You are exactly right that banks benefitted enormously from the emergency actions Congress authorized to put out this financial fire, but the legal obligation in the law is to make sure we are covering the direct costs of the TARP. So we proposed a fee that, over 10 years, would raise enough money to cover those direct costs.

To answer your direct question about how large it would be, in terms of the size of the fee, it would be roughly the same as the fee now paid by banks for deposit insurance, roughly the same dimensions.

The CHAIRMAN. All right. I will have more questions.

Senator Grassley?

Senator GRASSLEY. Thank you, Mr. Secretary, and thank you, Mr. Chairman.

Regarding the TARP tax, the President stated, "My commitment is to recover every single dime the American people are owed." In addition, there is a statutory requirement that the President propose a plan that recoups all losses from TARP so that TARP does not add to the deficit or debt.

In light of that, would you, Mr. Secretary, assure us today that the President will veto any bill containing a TARP tax that does not go towards paying back the taxpayers, in other words, any bill that does not use the TARP tax to solely pay down the deficit? If you cannot give us those assurances, why won't you?

Secretary GEITHNER. Senator, the President believes very strongly that the resources raised from this fee should go to cover the TARP costs and reduce the deficit. We completely agree with that position. That is the President's position, and he strongly believes that.

Senator GRASSLEY. All right.

The point is, though, let us suppose Congress would say, well, we want this money to be used to offset this program or for offsets to set up a new program. Then it is not being used to pay down the national debt. So then would the President veto a bill where the TARP tax was not used to pay down the national debt and was just being spent?

Secretary GEITHNER. Well, Senator, for the reasons you said, the President believes very strongly that the proceeds from this fee, if adopted, should go to reduce the debt.

Senator GRASSLEY. All right.

Would you suggest to the President that he veto the bill?

Secretary GEITHNER. Well, Senator, I would just repeat it: he feels very strongly about this. I do, too. I agree with him on this, and I think it is the right policy for the country.

Senator GRASSLEY. All right. Let us go on. You did not really answer my question.

The statute that created TARP requires that the President propose a plan in 2013 to recoup TARP losses. Instead of waiting until 2013 when he was supposed to, the President proposed the TARP tax in this year, 2010. Would OMB and CBO not have a better idea in 2013, rather than 2010, what the projected losses from TARP are, if any?

Secretary GEITHNER. Senator, that is a very good question. Let me try to respond. You raised this in your opening comments, too. Why now? Why propose it now? Because you are right: we are still uncertain now what the ultimate cost would be, so we made the judgment to propose it now for the following reasons. This was an expensive financial crisis. It caused a lot of damage to our long-term fiscal position.

We thought it was responsible fiscal policy for the country to make it clear now that we were proposing a way to help dig out of this mess and make a substantial contribution to offsetting the fiscal cost of this crisis. We thought it was responsible to do it now, at a time when people were looking for signals from our country that we have the political will to start to bring down our deficits to a more sustainable position.

We also thought it was helpful to underscore the basic principle in the financial reform legislation that banks should pay for the cost of bank failures, so we thought proposing that now would add credibility to a position I think many people support on both sides of the aisle, that banks should pay for the cost of bank failures, not the taxpayer.

The third reason, Senator, as I said, we think it helps reinforce the broader reforms that are designed to limit risk-taking in the financial system, and by proposing a fee that is in a sense a tax on leverage or a tax on risk, we thought would reinforce that broad objective we all share to help reduce risk in the financial system going forward.

Senator GRASSLEY. But you still, I hope, would have to admit that we are going to know more of what the loss is from TARP in 2013 than we do today, and the purpose of the tax was to recoup that, and only, I assume, to recoup that.

Secretary GEITHNER. That is correct. Yes.

Senator GRASSLEY. For no other purpose.

Secretary GEITHNER. That is correct. But Senator, also as you have acknowledged, the direct costs of TARP do not capture the full damage to our fiscal position caused by the financial crisis, nor, of course, do they really measure the benefit to the financial system provided by emergency programs. So for those reasons, we think it is responsible to propose a way now to start to dig our way out of this hole, part of the hole caused by the crisis.

Senator GRASSLEY. All right.

On another point, after this committee's April 20th hearing, we learned that GM took $4.7 billion out of a TARP escrow account to repay the taxpayer TARP loan. A letter I received from Treasury last week says that, after the loan repayment, $6.6 billion was left over in the escrow account and that this money was available for GM's unrestricted use. It is my understanding that the $6.6 billion has been released to GM.

GM was quoted in the Sunday *New York Times*: "The bottom line is, our strong business performance has put us in a position that we don't need these funds," referring to the cash in the escrow account. In light of GM's statement that it does not need the escrow funds, why should GM not simply return the $6.6 billion to the government? If GM does not need the funds, the taxpayers simply do need them.

Secretary GEITHNER. Senator, you are right to point out that GM is in a much stronger financial position today than any of us expected, and that has enabled GM to repay a portion of the assistance we provided much more quickly than anybody thought. It is also true, though, as I always emphasize, that we still have substantial equity investments left in GM. Those come with risks.

We are going to work very hard, Senator, to make sure that we get that money back and get the government out of GM as quickly as we can, at least ultimate cost to the taxpayer. But because of the strength of the restructuring program GM was forced to undertake through bankruptcy, this firm is emerging stronger, more quickly than any of us expected.

Senator GRASSLEY. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Next, Senator Bingaman.

Senator BINGAMAN. Thank you for being here, Mr. Secretary.

NYU Professor Thomas Cooley argues that we should not only recover bailout costs that we have incurred, we should also create an ongoing charge for insuring against risky behavior. Now, what you have described is a way to pay back the taxpayer for the TARP funds that would have the effect of discouraging risky behavior, but why do we not consider both an ex-post fee, which is what you have proposed to recover TARP outlays, and also a so-called ex-ante levy to deter risk-taking at the expense of taxpayers going forward?

Secretary GEITHNER. There are a lot of proponents of a so-called ex-ante fund financed by a levy on financial institutions as a fund that would go to cover the future cost of bailouts. As you know, Senator, the risk in doing that is it does create the perception that the government might undertake future bailouts, and that perception could undermine the efforts we are undertaking to reduce moral hazard in the system, make it more stable, make it less likely that investors and executives make decisions in the future on the expectation the government is going to come in and save them from their mistakes.

So there are many proponents of an ex-ante fund, but I think the disadvantage in doing it that way is, again, it may create an impression, however designed, that there is a pool of money there to help fund future bailouts, and that, some people have argued, could add to moral hazard rather than reduce it. So that is the argument against.

Senator BINGAMAN. Well, that would assume that the money, this ex-ante levy, be put in a fund which would be specifically for this purpose. You could take the fee you are talking about as a way to pay back the TARP funds and still add to that another fee which would go to the government so that the government would be more capable of doing whatever it had to do in the future, whether it was dealing with an oil spill, dealing with a hurricane, or whatever problems the government encounters down the road.

Secretary GEITHNER. You are exactly right. The general proposal is, since there may be crises in the future that cost money, put money aside today, paid for by banks, to help cover those uncertain future costs. There are a lot of proponents of that approach, too. Again, we are trying to meet the narrow legal requirement in the law to cover the TARP costs, but I understand the merits of that

broader approach. I guess the risk in it, just to do both sides of it, is that, frankly, that money could get spent on other programs, then would not be there to actually protect the government from future financial crises' costs. That would be the risk in doing——

Senator BINGAMAN. But it could go to reduce the deficit.

Secretary GEITHNER. It could.

Senator BINGAMAN. Just as Senator Grassley was asking you what this would be intended to do, you say this is intended, the fee you are now proposing, to reduce the deficit. We are all in favor of reducing the deficit. We can reduce it even more if we have more of a fee, right?

Secretary GEITHNER. That is exactly right. Again, we are trying to meet the narrow requirement in the law to cover the direct TARP costs, but we recognize, of course, that that does not fully capture the cost of this crisis, and of course does not try to capture the cost of future crises.

Senator BINGAMAN. Part of this banking crisis, or part of what has come out as we have tried to understand this banking crisis, is that various of these large financial institutions have off-balance sheet assets and liabilities. Is it your intention that this fee would be part of the taxable base for these large institutions?

Secretary GEITHNER. Yes, and that is one of the virtues of this design. Again, unlike the conventional accounting approach, which does not yet capture all those things, this approach of using the established regulatory definition of risk-rated assets would capture those off-balance sheet exposures, including derivatives.

Senator BINGAMAN. How do you see this applying to insurance companies, particularly an insurance company that has a thrift, that owns a thrift, for example? It would seem that it would make sense to treat insurers differently than banks, since that has always been the approach we have taken in the past. But how would they be treated under this fee?

Secretary GEITHNER. Senator, again, let me just say at the beginning, there are many different ways to do this. The approach we have taken is to apply two simple tests. One is, you have to be larger than $50 billion in assets. A very small number of companies in the country, of course, meet that test.

But in addition to that, you have to have been directly eligible for the emergency programs put in place to put out the financial fire. That means the Treasury's Capital Purchase Program, the FDIC's TLGP, a temporary loan guarantee program, and the Federal Reserve's primary dealer credit facilities.

So, firms that were eligible for those programs—and were above $50 billion—we think benefitted substantially from the emergency programs. Even if they did not take assistance, they had the ability to do that—that provided a benefit to them—and so we think the fee should be limited to those institutions. Now, some insurance companies that were structured as thrift holding companies owned thrifts before the crisis, or who bought thrifts to take advantage of these programs, would be covered by this fee.

Senator BINGAMAN. My time is up, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Senator Hatch?

Senator HATCH. Well, thank you, Mr. Chairman.

Nice to see you here, Mr. Secretary. I finished reading, or am on the brink and I will finish "Too Big To Fail" and a number of other books over the last few weeks. I am just amazed that you look as good as you do after all that you have been through, according to those books.

When this bank tax proposal was unveiled in—and you look well; I do not mean to indicate you do not. When this bank tax proposal was unveiled in January, President Obama scolded the large financial institutions by saying, "We are already hearing a hue and a cry from Wall Street suggesting that this proposed fee is not only unwelcome, but unfair."

He said, "By some twisted logic, it is more appropriate for the American people to bear the cost of the bailout rather than the industry that benefitted from it, even though these executives were out there giving themselves huge bonuses."

Well, let us just talk about fairness for a moment. Is it fair to apply this tax not only to companies that have repaid TARP with interest, but also the companies that did not take TARP money at all? I know that the administration believes that these companies benefitted from TARP in other ways, but really, did every single American not benefit from it as well?

Secretary GEITHNER. Senator, you are exactly right. The American economy benefitted, all Americans benefitted. All financial institutions benefitted. All the customers of banks benefitted. But we thought the fairest way to do this was to apply the fee to the firms that contributed most to the crisis and that were eligible for these emergency programs. And even if you did not apply for the programs, eligibility for them conveyed a substantial financial benefit.

Senator, I agree that it is not going to seem fair to everyone, and there is no perfectly fair approach.

Senator HATCH. Well, it is not fair to everyone. It is not fair to everyone. What many believe to be unfair is that this proposal does not apply to the companies that benefitted the most: Fannie Mae, Freddie Mac, Chrysler, GM. Now, admittedly, all of them have problems. Some of these firms have paid out bonuses to their executives. They have matched some of the bonuses paid by large financial institutions. I do not want to go into those, but you could look at it. There are millions of dollars in compensation and bonuses.

Do you then believe that there should be an exemption? Well, tell me why you do not do this to Fannie Mae, Freddie Mac, GM, and Chrysler?

Secretary GEITHNER. A very good question. Of course, we thought about this very carefully. In the Fannie and Freddie place, it would just be one hand of government paying another. We would be paying the fee.

Senator HATCH. Well, they are quasi-public entities.

Secretary GEITHNER. Of course, unfortunately, as you know, when Congress authorized my predecessor to put them into a form of conservatorship, in effect that put us in the position where their gains are our gains, their losses are our losses. They are the American taxpayers' losses. So, if they were to pay for the fee, we would be paying for the fee.

Senator HATCH. Well, you seem to be saying they are vulnerable.

Secretary GEITHNER. No, I do not think they are. No, I do not think they are, actually. In fact, Congress did the right thing in making sure that we could keep them stable through the crisis before we reform them. The auto companies are a different case, Senator. In the auto companies' case, I think it is fair to say that, despite the many mistakes they made over time in managing those businesses, they did not cause this financial crisis. Their challenges were made substantially worse by this financial crisis.

We are proposing to cover their financial arms, but not the institutions we put through bankruptcy. Since they went through bankruptcy and restructuring, we did not think it was necessary or appropriate for them to be covered by a fee that, as you have seen, is designed to help us make sure that we are reducing risk in the financial system as we cover the potential costs of TARP.

Senator HATCH. But there are a lot of banks out there that did not cause this problem too and will be stung by this fee.

Secretary GEITHNER. That is true. But GM and Chrysler are unique in the sense that we put them through bankruptcy. They did not cause this financial crisis, so it is a slightly different approach. Again, we are not covering 99 percent of financial institutions in the country, so of our 9,000 banks and thrifts, our thousands of credit unions, hundreds and hundreds of other types of financial systems, we are not covering them, although you are right to say they benefitted, and people might argue for a much broader fee. But again, our judgment was, the fair thing to do was to capture those institutions that were the largest that benefitted the most. That seemed fair to us.

Senator HATCH. Let us say that back in my home State of Utah they may be approaching the threshold of $50 billion in assets, so let us assume that they have $49 billion-plus and they are almost there. They are thinking about expanding into under-served areas of Utah or elsewhere. In such a case, would this tax not serve as a disincentive for the bank to want to expand and add new jobs?

Secretary GEITHNER. Senator, you are absolutely right. In defining any threshold, you have to be careful to reduce the risk of having that kind of impact. We would be happy to work with you and your colleagues to design this in a way that the threshold is sensible and reduces that effect. But again, for banks that take deposits to fund loans to their business customers, they would not be bearing any material fee as part of the way we designed this. But we would be happy to work with you on how to design the thresholds so that they seem fair and just and reduce that risk.

Senator HATCH. My time is up, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Next is Senator Stabenow.

Senator STABENOW. Thank you, Mr. Chairman. Mr. Chairman, as you might think, I have thoughts about the discussion about the auto industry. Mr. Secretary, welcome. I wanted to follow up on the discussion because I think it is important, the point you made about the fact that the auto industry did not cause the crisis, it was not their reckless efforts in terms of investing and so on that caused where we are, but actually it was the frozen credit market that affected them, as it affected everyone else.

When we add to the fact that normally in a downturn—and we saw individuals who could not get credit, could not purchase vehicles, so we had almost a 50-percent reduction in vehicle sales, which was huge. Normally, if there is a reduction, they could go into the markets, they could get a line of credit, they could get a loan, and that was not available to them because of the frozen credit market. So, they were in an extremely difficult situation.

Therefore, I think it truly is apples to oranges when we talk about it. Not that other businesses were not in the same situation, but the reality is, in auto manufacturing, for every one job in auto manufacturing there are nine other jobs somewhere in the economy that are impacted, so this is a fundamental part of our economy in terms of middle-class jobs and the economy as a whole, which threatened to undermine jobs and the economy even more.

I also would say that the auto makers are still undergoing a very fragile recovery and are not out of the woods yet, and that part of recovering for us as an economy is to make sure that they are back on their feet. Frankly, that would help us from a taxpayer standpoint as they go into the marketplace to sell their auto stock.

So I wonder if you might expand on your feelings in terms of the negative impact from a taxpayer standpoint of jeopardizing a recovery in the industry at this point when we have yet to be fully repaid, and will not be repaid until they are able to go into the marketplace.

Secretary GEITHNER. Senator, I think you said it very well, that both the initial rationale for excluding them—and I think I would emphasize though that these firms, again, because of the extent of the restructuring that they went through as part of bankruptcy, are in a much stronger position today than any of us expected, and they are emerging stronger, more quickly than any of us would have hoped. Our judgment about whether they should be covered or not had nothing to do with their current financial condition. We just made the judgment that, because they did not cause the crisis and because they went through restructuring, it was neither necessary or fair to ask them to be covered by this fee. It was that simple judgment.

Senator STABENOW. Thank you.

And if I might also just follow on with colleagues who have talked about community banks, because they did not cause this either, and they have been hit on both sides, being told the financial regulatory system is tightening up for them. We are telling them to lend, others are telling them do not lend. I mean, they are caught in a very difficult situation. Therefore, our small businesses, who did not cause this either, are finding themselves in a terrible situation. So I wonder if you might talk a little bit more about whether or not you have run an analysis on the economic impact of the proposal as it relates to community banks and small business lending.

Secretary GEITHNER. Well, as I said in my opening remarks, Senator, we think this proposal is good for community banks. Of course, the fee does not cover community banks, it only covers these 50 institutions that are less than 1 percent of total financial institutions. Therefore, in some sense, if these large institutions try

to pass on this fee—now, they do not need to pass on the fee; they have a choice about whether they pass on the fee.

But if they try to pass on the fee, that would create greater opportunities for other banks not covered by the fee, the vast bulk of the American financial system, to step in and take that business away from them. So as the CBO said, as I quoted in the study, "We think we have designed this in a way that is good for small banks and community banks, and therefore good for their small business customers."

Senator STABENOW. Thank you.

Thanks, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Senator Bunning?

Senator BUNNING. Thank you, Mr. Chairman.

Thank you for coming, Mr. Secretary. I would like to follow up on a question that Senator Grassley had asked you earlier. You said that the TARP law requires the administration to submit a plan to Congress for recouping TARP losses, but you failed to mention that the law said that this plan should come after OMB submits a report on TARP losses on October 4, 2013. Why do you suppose Congress wrote into the law that this plan should be submitted in 2013 rather than 2010?

Secretary GEITHNER. Well, I cannot speak for the authors of it, but I suspect they wanted to be confident that the financial industry was in a stronger position at the point the fee would come into effect. The financial industry of the United States today is in a much stronger position than anybody expected because of actions we took to solve the crisis.

Senator BUNNING. Or could they also want to know more about how much or how big the losses might be after 3 years?

Secretary GEITHNER. Of course, Senator.

Senator BUNNING. Or 4 years?

Secretary GEITHNER. And we are early. We are early because we thought it was the responsible thing to do, because again——

Senator BUNNING. Can you understand why it looks suspicious that the administration is submitting the plan now when the TARP losses are not fully known? Can you understand why this looks like a political stunt to distract the public from the very unpopular TARP program in a transparent attempt to make it look like the administration is not in the back pockets of Wall Street?

Secretary GEITHNER. Senator, I cannot understand. Again, we are doing the responsible thing, which is, in the face of a crisis that caused enormous damage to our fiscal position, we thought it was responsible, prudent, and reassuring to the American people to say to them, we are going to tell you how we are going to protect you from these losses. Now, you are right, we could have waited.

Senator BUNNING. And by waiting, you would have known more exactly what the TARP losses would be.

Secretary GEITHNER. True. But if we had waited, we would have left the world with a lot more uncertainty about whether we would have the will to cover those losses. So again, we thought the responsible——

Senator BUNNING. But the law makes you cover them.

Secretary GEITHNER. It does. But clarity now is responsible and reassuring. Delay is neither necessary nor desirable at a time when people are worried about our political capacity as a country to help dig our way out of the fiscal damage caused by this crisis.

Senator BUNNING. All right.

Concerning the amount of TARP losses, does Treasury expect to experience any losses from the AIG experience?

Secretary GEITHNER. Senator, we publish, twice a year—OMB does separately and CBO does separately—estimates across the full range of investments we take. The latest estimate, I think, is a relatively old estimate done at the end of September, 2009. In that estimate, you will see that we still expect to be exposed to substantial risk of loss on our investments in AIG.

Senator BUNNING. All right.

Secretary GEITHNER. Much less than we thought, but still some risk of loss.

Senator BUNNING. Were you at the New York Fed when AIG derivatives counter-parties were paid off at par? Part of that was cash from AIG which received TARP funds and part was from the Fed. Does it not follow that, if AIG counter-parties had not been paid off at par, then the infusion of taxpayers' money would have been smaller and there would have been fewer TARP losses?

Secretary GEITHNER. No. Senator——

Senator BUNNING. Wait a minute.

Secretary GEITHNER. I am sorry. I apologize.

Senator BUNNING. Let me finish the question.

Secretary GEITHNER. I apologize.

Senator BUNNING. And in that case, does the decision of the New York Fed to pay the full value not lead to a TARP loss?

Secretary GEITHNER. No, Senator. And you and I have had a chance to talk about this many, many times, and I would be happy to talk about it as many times as you would like in the future. If we had not, if the Government of the United States had not stepped in to prevent AIG's failure, the cost——

Senator BUNNING. Well, we have a difference of opinion. You saying one thing is not going to make any difference in what I believe, so let us just pass over that. Answer my questions about the TARP money.

Secretary GEITHNER. The cost to the American taxpayer would have been larger, not smaller, if we had not acted the way we did in AIG. Larger, not smaller, higher burden on the American people, higher losses.

Senator BUNNING. Well, only time will tell that.

Secretary GEITHNER. No, I do not think time will tell. I think that——

Senator BUNNING. Well, right now we are at a loss at AIG.

Secretary GEITHNER. Well, ultimately we do not know how much the loss will be. I think it will actually be a fraction of what these estimates are. But what I can say with complete confidence, Senator, is, if we had not acted the way we acted, those losses would have been dramatically higher.

Senator BUNNING. All right. Last question. Mr. Secretary, your last appearance before this committee was February 2nd. At that time, several members submitted written questions to you for the

hearing record. I understand that we just received the answers to those questions late yesterday.

Do you believe that 3 months is a reasonable period of time for members of this committee to wait for answers to their questions? And, if you had not been testifying today, how much longer would we have had to wait for those answers? Also, if we submit questions based on today's hearing, how long will we expect to wait for an answer?

Secretary GEITHNER. Senator, I believe this is my 33rd time testifying before the committee and Congress in my time in office.

Senator BUNNING. You did not have to take the office.

Secretary GEITHNER. You are right, I did not. But we try to be as responsive as we can. We are trying to meet all those requests as quickly as we can. We will continue to do that. But of course, we are trying to solve a lot of problems we inherited, and we are doing our best job on both those fronts.

But of course, Senator, we will try to be as responsive as we can, as quickly as we can, in response to any questions you have at this hearing, or in the future.

Senator BUNNING. Thank you.

The CHAIRMAN. Senator Cantwell?

Senator CANTWELL. Thank you, Mr. Chairman.

Secretary Geithner, to continue, I guess, on the same lines my colleague was going on, I know that you have been in the press talking about what repayments we have had from TARP and the fact that you view it as somewhat of a profit, $15.6 billion or something like that. This is a proposal today about collecting somewhere between $100 and $115 billion.

But when I look at the Federal assistance program, if you look at everything that has been there, it is somewhere around $10 trillion. I mean, that is what experts are saying. If you look at $2 trillion in FDIC assurances, $1.75 trillion in Federal Reserve commercial paper, that every time we put more paper out it reduces the value of the dollar.

If you look at the $900 billion in term auction facility lending or $600 billion to insure money market funds, or $600 billion for Fannie Mae and Freddie Mac, $550 billion for Federal Reserve loans, $500 billion to insure FDIC deposits, $300 billion for FHA mortgage relief. So the number here is $10 trillion. Ten trillion. I know you are probably going to say, well, we are going to get some of that money back.

The issue is, we still do not know what the Fed is doing. We do not know how many toxic assets the Federal Reserve has purchased. We do not know how many are going to default in the future. So why can we not get access to that information? Without that information, are we not just taking a stab in the dark here about the real cost to the American taxpayer? It is just as dark as the market is.

Secretary GEITHNER. Senator, the TARP program is subjected to independent analysis about potential losses at least twice a year, and, as you saw in my opening statement and you see in the CBO estimates, the direct costs of that program are in the range of $100 billion currently estimated over time. But you are also right that

the government did a whole range of other things as part of putting out this financial fire.

I wrote the leadership of the Congress just a few weeks ago to provide our best sense of updated estimates of losses across those programs, the Fed, the FDIC, the money market guarantee program, that full set of programs. Those losses actually look very small overall, as measured by independent experts. The Federal Reserve programs—I should not be the one testifying on this—are likely to generate tens and tens of billions of dollars to the American taxpayer over the next 5 years, and they already have done so. The FDIC programs will result in——

Senator CANTWELL. I am glad you brought that up. That is great. So, do you think the American taxpayer should deserve access to that information so they can see exactly what is happening at the Federal Reserve?

Secretary GEITHNER. I completely agree, and the Chairman of the Federal Reserve has been very supportive of changes that provide more information about the risks in the Federal Reserve's balance sheet. There is an enormous amount of information available in the public domain today to allow people to make those estimates themselves, but again, I think all those estimates show that the Federal Reserve will provide the American taxpayer tens of billions of dollars on those programs because they were designed carefully to protect the taxpayer.

The Federal Reserve charged a fee for those programs, and they are going to show an enormously substantial positive return to the American taxpayer, as I believe will the FDIC programs, and as did the Treasury's money market guarantee program.

Senator CANTWELL. Well, I think the number is roughly $10 trillion. Without getting access to that information, we do not know whether you are right or not.

Secretary GEITHNER. You do not need to rely on my judgment for that, Senator. Again, the virtue of the fact that this information is in the public domain—and I know the Chairman will be supportive of more disclosure in this area—people can make their independent estimates of that. You do not need to rely on mine; you can rely on other people's for that. I completely agree with you that the American people should have full disclosure and transparency about the commitments still outstanding and the risk in those commitments.

Senator CANTWELL. Well, I do not think that we have that today, and we absolutely need it, so we will hold you to encouraging this information. I think some of my colleagues will just work a legislative process to get access to the information, but otherwise we do not really know what the American taxpayer is going to be on the hook for and what we are going to get repaid for.

I wanted to ask you one other question, if I could, Mr. Secretary. You were here about 90 days ago and I brought up this question about access to capital for small businesses and community banks. At the time, you said we should take swift and deft action to help community banks get credit. Well, it is 90 days later, and we have still not seen a proposal. The, I think, ninth bank in my State just closed last Friday, so small businesses are not getting access to capital. Where is the proposal?

Secretary GEITHNER. Senator, we have been working very closely with the Majority Leader and his colleagues in the Senate and in the House on a very detailed program of tax incentives for small businesses and a small business lending facility to help small banks and to expand SBA programs. That legislation, which has been crafted very carefully over these last 5 months, is, I think, very close now to being brought to consideration, both in the House and the Senate.

I know the Majority Leader is working closely with your colleagues in the Senate to make sure that he can bring that to the floor quickly. I agree with you about the importance of this. At the time we spoke here, we had already provided a broad outline to that proposal, and we have been working very hard on the details with your colleagues to make sure it meets the broad concerns of members of the Senate.

Senator CANTWELL. I would say that swift and deft action has not been taken, and I have not seen this proposal, although we have had various conversations about the challenges. So, I would be very delighted to see the administration's proposal.

Secretary GEITHNER. But again, Senator, I want to make it clear, we provided that proposal early this year. We have been working for 5 months on it. We have shared it. We have taken a lot of consideration of comments made by you and your colleagues on this, and we think we have a very strong package of programs and would be happy to share that with you and talk you through it and see if we can make any adjustments to reflect your concerns.

The CHAIRMAN. Senator Crapo?

Senator CRAPO. Thank you very much, Mr. Chairman.

Secretary Geithner, I want to shift gears with you a little bit. As you know, we have the financial regulatory reform legislation on the Senate floor as we are holding this hearing, and I would like to take this opportunity to ask you a couple of questions about that legislation, as we are dealing with it now on the Senate floor.

It has already been pointed out here in the committee in this hearing that the bank tax that you are proposing here does not apply to Fannie and Freddie, and neither does the bill on the floor of the Senate. My question is this. The public really has focused a lot on taxpayer bailouts, on banks, automakers, and insurance companies.

You can go through the scale of the support that has been provided there, and nowhere has the support been higher than with Fannie and Freddie. I think that right now we are looking at estimates that ultimately will cost the taxpayer about $381 billion, if I am looking at the most recent estimates. That estimate may be too optimistic.

So, of all of the bailouts that we are dealing with, the problem with Fannie and Freddie seems to not only have been at the core of where we started this entire problem, but is also at the height of the cost to the American taxpayer. Yet, last Christmas Eve, Treasury announced that it was lifting the $400-billion cap on losses, and we see basically nothing but the full faith and credit of the U.S. taxpayer there backing Fannie and Freddie, yet it is not included in the legislation that is on the floor of the Senate. Could you tell me why?

Secretary GEITHNER. Senator, you are exactly right. We made a choice, given the complexity of the reform challenge ahead, that we would not move immediately to propose broad reforms of our housing finance system, including the future of Fannie and Freddie. We decided to do this in two stages. We did that because we thought, frankly, we would get a better outcome, a more thoughtful effort, more commitment to reform if we were further ahead in the process of repairing the damage to the housing markets.

But we have begun a process, and we laid out broad principles and objectives. We are conducting congressional hearings, we are soliciting public comment on alternative proposals, and we look forward to working with you on trying to put in place a set of strong reforms that will fix what is broken in our housing finance market. It is not just Fannie and Freddie, of course. As you know, we do a lot of things in the housing market which we need to reassess. Many of those things contributed to making this crisis worse.

Senator CRAPO. Like the mortgage origination process.

Secretary GEITHNER. As you know—and you have made a lot of thoughtful comments on this process in the past—there are a range of things we are going to have to change in that process. This bill does do the necessary essential things to fix not just what caused the crisis, but what would leave us vulnerable in the future, and does include some important changes on the securitization front which are helpful.

But you are absolutely right, it does not, and we did not attempt to take on that broader challenge now because we thought fundamentally we would get a better outcome, more support, more consensus for ambitious reforms, if we were further along in repairing the very damaged housing markets.

Senator CRAPO. I understand your rationale. I do not agree. I believe we should be dealing with it now, and I would love to spend further time with you in terms of how we would approach it when we get to that point.

But let me just ask another couple of quick questions here, still focusing on the financial regulatory reform bill. According to news reports, FDIC Chairman Sheila Bair has urged lawmakers to scrap section 716 of that bill which would force banks to spin off their derivatives businesses. Her argument is that that could destabilize banks and drive risk into unregulated parts of the financial sector.

Her letter echoed fears that were recently raised by Federal Reserve officials as well, who have, in an unsigned memo, indicated that that provision would impair financial stability and be highly disruptive and costly to banks and their customers. Could you comment on whether you agree with Sheila Bair and the Federal Reserve officials who were reported on?

Secretary GEITHNER. Senator, I want to start by emphasizing that the package of reforms that relates to the derivatives market in the bill crafted by Chairman Dodd and Chairman Lincoln is a sweeping, very strong, comprehensive set of reforms.

They would bring standardized products onto clearinghouses. They would force centrally cleared products to be traded on either an exchange or an electronic trading platform. They would provide authority to put capital and margin requirements on major swap participants. They would give transparency and disclosure to a

market that operated largely in the dark. They would give tools to the SEC and the CFTC to police and deter fraud manipulation in these markets.

This is the most comprehensive, sweeping reform. It is a revolution for the derivatives markets, for the country as a whole, and we strongly support a bill that incorporates a comprehensive set of protections and oversight over these markets going forward.

Now, as you know, Senator Dodd and Senator Lincoln are now working through this provision, and they are considering how to deal with concerns raised by Chairman Bair, by Chairman Bernanke, and by members of the Senate, the concerns you expressed in your opening statement. I know they are working carefully on how best to accommodate those concerns.

Senator CRAPO. But you are not expressing your opinion on that today?

Secretary GEITHNER. We have not taken a position on that specific provision now. But Senator, I would like to emphasize the following basic strategy that has underpinned this reform process. To make the system more stable, we need to make sure that we are doing a better job of limiting risk-taking by core institutions that are so important in these markets.

You would not make the system more stable by taking functions that are integral and central to banking and separating and putting them somewhere else. That will create a less stable system, a more unstable system. That basic theory, that basic strategy, underpins the entire approach that Chairman Dodd, Chairman Lincoln, and their counterparts in the House have brought to this important set of reforms.

The CHAIRMAN. Senator Enzi?

Senator ENZI. Thank you, Mr. Chairman.

I appreciate all the comments that you have made. I voted against TARP when it came up because I did not think that it specified what the money was going to go to. We kept hearing an explanation that it was going to go to toxic housing things, and it did not. The money that has been loaned to the banking industry, is that where the money was lost, or was the money that was provided to Chrysler, AIG, GMAC, Fannie Mae, and Freddie Mac where it is lost?

Secretary GEITHNER. No, Senator, you are exactly right. The investments that my predecessor made in the U.S. banking system— and when I came into office, he had made investments in banks representing 75 percent of the American banking system. Those investments, by almost any estimate, are likely to result in a positive return. To put it differently, the American people will make money on those investments.

We have already had about $200 billion of those investments repaid to the taxpayer, replaced with private capital, with a substantial positive return, but we are still exposed to substantial risk of losses on the investments that the previous administration largely made in AIG and the program President Bush initiated in the automobile industry. Those are the most likely source of further risk going forward. But you are also right to point out, as your colleagues have, that in terms of Fannie and Freddie, they are still exposed to substantial risk of loss as well.

Senator ENZI. Well, I appreciate that you are trying to shove that back onto the other administration, but what we are talking about is recouping those losses, and we are talking about recouping them, not from the ones who actually lost the money. That is a little bewildering to me.

In the administration's proposal, the largest, most leveraged are targeted by assessing a tax at $50 billion or more in consolidated assets, excluding the FDIC-assessed deposits and the insurance policy reserves. There are a lot of reasons that have been cited as the impetus for the administration's proposal. Is it your belief that one of the reasons is the need to eliminate risky transactions on the part of those financial institutions?

Secretary GEITHNER. No. The reason for our proposal is to make sure we protect the taxpayer from losses in TARP. That is the legal obligation. That is what motivated the proposal. Now, in doing that, you could do that in lots of different ways, but we decided to recommend to the Congress a form of a fee that would have this additional benefit, which seemed fair to us, of making sure that firms paid it in proportion, effectively, to the risk they take. So, if you are more conservatively managed, you pay less. If you are managed with more leverage, more risk, you pay more. That seemed, to us, a simple, fair proposition.

Senator ENZI. I am told, though, that the riskiest loans are probably those to small business. So does the administration's proposal not kind of force these people to avoid these high-risk loans to small business and——

Secretary GEITHNER. No, I do not think it has that——

Senator ENZI. They create the jobs.

Secretary GEITHNER. I apologize, Senator. I do not think it has that risk, for the reasons I said. What this does is, you pay in proportion to the risks you take. More risky things that are funded in more or less stable ways carry a larger potential burden. But again, this fee only applies to less than 1 percent of American financial institutions, and for that reason I think it is very unlikely to have any impact on the ability of small businesses to get credit at affordable rates from the American financial system.

Senator ENZI. Thank you. I have some serious concerns about the unintended and potentially devastating effects that the Consumer Financial Protection Bureau, the CFPB, will have on consumers, small businesses, and the general health of the economy. In addition to the CFPB, the administration and some members of the Senate are pushing to add another burden to the banks that will punish consumers, and that is the bank tax, which is the topic of today's hearing. Given the push to roll the bank tax into the financial regulatory reform bill, how will this additional tax impact capital reserves for lenders who would also be required to increase capital reserves, reduce leverage, and hold a percentage of all loans on their books?

Secretary GEITHNER. Well, Senator, as I said, I think this would have no effect—no negative effect—on consumers and their access to credit, or small businesses, for the reasons I said. It only applies to less than 1 percent of financial institutions. I think the institutions that we propose be covered by this tax can afford, can handle that burden.

You are right to say, of course, that this cannot substitute for the additional efforts that are part of the reform proposals to make sure that we put in place more conservative capital requirements, leverage requirements, liquidity requirements on these institutions. Those things are important, too, but I do not believe this carries any significant risk of making it harder for Americans to get credit at reasonable rates, again, for the simple reason that it leaves untouched 99 percent of American financial institutions.

Senator ENZI. And with that statement, then, you are sure that it will not negatively impact consumer credit availability for small community banks?

Secretary GEITHNER. Again, I am very confident that it does not have that risk. I quoted CBO in making that judgment and saying that, if large institutions that are covered by this fee try to pass it on to their consumers, then they risk losing that business to other banks that are not covered by the fee. Since, again, more than 99 percent are left out, that is a reasonable judgment. That is why CBO came to that conclusion.

Senator ENZI. I have a question that I will follow up on later in writing.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Kerry?

Senator KERRY. Thank you, Mr. Chairman.

Mr. Secretary, thanks for being here today. There has been some concern expressed about the scope of the proposal and the fact that it covers institutions beyond banks. I want to get parochial, if I can, for a moment.

I have heard from some institutions in Massachusetts that are concerned that they are covered by the fee because a very small percentage of their assets are either in a thrift or in a broker/dealer. For example, there is a very successful property and casualty insurer. It does not own an insured depository. It sells auto, homeowners, worker's compensation, other property and casualty policies. It does, however, have a small broker/dealer in its small life section, and it is limited to product offerings to mutual fund shares, variable annuities, variable life insurance.

The broker/dealer does not provide any kind of investment advice to investment companies or insurance companies. It does not buy or sell securities in its own name or hold customers' securities or funds. Because of the limited activities as a broker/dealer, this particular broker/dealer, it is exempt from the Securities Investor Protection Corporation membership requirements. It generates less than $1 million in revenue per year based on assets that are tied to old retail activity that goes back more than a decade.

So the question is, since you have roughly less than three one-thousandths, I think it is, of 1 percent in the company, would that kind of company be included by the fee or would it not be because the broker/dealer is not a primary dealer?

Secretary GEITHNER. It would not be covered because the broker/dealer is not a primary dealer. Again, we included companies that owned primary dealers because primary dealers were eligible for the Federal Reserve's primary dealer credit facility, which was an exceptional emergency facility, but it would not apply to other in-

stitutions that did not own primary dealers or whose broker/dealer was not a primary dealer.

Senator KERRY. And that will be set forth clearly? That will be a clear delineation?

Secretary GEITHNER. Yes.

Senator KERRY. I will give you another example. A mutual fund company has a thrift and an insured depository. They do not do any banking activities, take no customer deposits, make no loans, but they need to have the thrift because they need it to custody the assets of their 401(k) programs, et cetera. The insured depositories are used solely for trust purposes and not for any commercial activity or investment. Is that institution covered by the fee?

Secretary GEITHNER. Senator, we have not quite figured out how to solve that particular problem. You are right to say there are a limited number of companies that are large enough to be potentially captured who own what we call depository institutions, but they do not take deposits, really, and they have to own that institution really for trust purposes. These emergency programs were not designed to benefit them. I do not think they were ever intended to be eligible for those programs. So, that is something we have to figure out how to solve, but have not figured out how to do it yet.

Senator KERRY. Do you think we need to clarify that, perhaps? I mean, should we, perhaps, prophylactically, exclude non-TARP recipients who have an extremely small amount of assets in a thrift or insured depository?

Secretary GEITHNER. I think there are lots of ways to do it, and we would be happy to work with you and your colleagues to do that. Of course, I think that it should be very clear ultimately in the laws and regulations provided, it should be crystal clear who is covered and who is not.

The simple principle we are trying to hold to is the one I said at the beginning, which is that firms that were above $50 billion—not in their assets under management, we will not touch mutual funds at all—but were above $50 billion and were eligible, directly eligible for these emergency programs, we think, as a matter of principle, they should be covered. But I agree with you that there are some issues we have to clarify still about coverage.

Senator KERRY. Right. That will depend also on what kind of assets you counted in the $50 billion.

Secretary GEITHNER. That is exactly right. Exactly right. And again, to make it clear, you would not count the assets that we call mutual funds in that.

Senator KERRY. I would like to make sure. If we could continue that dialogue. I know we will, and I appreciate your willingness to do that.

Just one last quick question. In response to Ranking Member Grassley, the CBO indicated that the proposal would slightly decrease the availability of credit to small businesses. Can you speak to that for a minute? What impact do you think this is going to have? I am already hearing from a lot of small businesses who think it is tough enough.

Secretary GEITHNER. I do not have, Senator Grassley and Senator Kerry, the report in front of me, so let me describe again what

our intent is and why we think it is designed in a way that would limit that risk.

It only covers, again, a very small fraction of the American financial system and leaves outside most of the institutions who provide most of the credit to small business. So for that reason alone, we think it is designed to have very limited risk of any adverse effect on small businesses.

Now, the firms covered would have a choice about how they pay for these costs. They can reduce compensation to their executives, they can lower their dividend payment, for example, or they could try to pass it on to their customers. But, if they try to pass it on to their customers, then they would face the risk that they would lose that business because the other more than 99 percent of the American financial system that is not covered by that tax would be able to come in then and take that business away.

Senator KERRY. Well, I realize you have already said this. I know my time is up, but you have already said this. I am concerned that, however it works in practice, it may not be that clean-cut, and the result may be that the small businesses may have an impact. I would like to see. I do not know exactly, and I want to analyze how CBO came to that conclusion. But I think it is worth your analysis also to make sure that there is not an inadvertent unintended consequence of a tightening of that credit.

Secretary GEITHNER. I share that objective, and we would be happy to work with you and your colleagues to make sure that it is designed in a way ultimately that gives us all reassurance that it will not carry that risk.

Senator KERRY. I really appreciate that.

The CHAIRMAN. Thank you.

Senator Snowe?

Senator SNOWE. Thank you, Mr. Chairman.

To follow up on that question, Mr. Secretary, that is a concern, and we will hear from panelists who will be testifying subsequent to you who indicate that there clearly could be an effect. Although it applies to only 1 percent of the institutions, they hold a disproportionate amount of the assets. If the FDIC-insured deposits are exempted from the tax, they may try, obviously, to get more FDIC-insured deposits as a way to avoid that tax liability. Obviously, that is going to come into play for competition for those deposits, and that could affect the banks.

So there could be a potential spill-over, not to mention the fact of the overall impact on the economy. I think there is no way to assess that at this point. Is that not true? I mean, so it could invite that competition, it could aggravate the lending supply, the credit supply to small businesses. So albeit maybe 1 percent, it has a true impact because of the size of these institutions that hold the considerable amount of the assets in this country.

Secretary GEITHNER. Well, Senator, of course I agree with the concerns. Because of those concerns, we proposed to design the fee in exactly this way. We are again happy to work with you in making sure that, as we meet this obligation to protect the taxpayer from losses in TARP, we do so in a way that is fair and does not have this effect.

Now, again, you have to look at this against the alternatives. In our judgment, the alternative ways of doing this would carry greater risk of just the kind of problems you are saying. It would not be fair. But we are happy to work with you to make sure we limit this risk, because we all share an interest in making sure we are not making things harder for small banks and for small businesses.

But I quoted in my opening statement the CBO conclusion that said this is likely to increase market share for small- and medium-sized banks. That is not the intent of this proposal, but if that was true that would be a positive effect.

Senator SNOWE. But on what basis do they make that decision?

Secretary GEITHNER. Again, simply on the basis that it only covers a small fraction of the firms in the U.S. financial system. If those firms try to pass on a share of these costs—again, this is a very modest fee. In size, it is going to be like the fee that banks now pay for deposit insurance, so it is a very small, very modest fee.

But, if they try to pass on part of that, then they risk losing business to their competitors. That is the way the market works. That should have beneficial effects against the risks that you cited, which would not encourage more concentration. Again, in putting the fee on risk you help reinforce the broad objectives we have of limiting risk in the system taken by large institutions. I think that is a benefit, a strength, not a weakness, to the proposal.

Senator SNOWE. Well, I think that is certainly something that we will have to be assured of in terms of unintended consequences during this fragile time in our economy, and most especially within the small business sector. If they hold 70 percent of all the assets in this country, that is an issue. I mean, we have to be concerned about the potential for spill-over.

Secretary GEITHNER. Senator, again, I completely agree with you about the important objective of designing this in a way that reduces that risk. I think our proposal does that. Just one thing about our financial system. Banks in our country—and we have 9,000 of them—only provide about half the credit to businesses that businesses rely on, that the economy relies on as a whole. The rest of that is provided by the broader capital markets.

Of the banks that provide that credit, only a very tiny number are covered by this fee. Now, you are right that those large banks account for a large share of assets in the banking system, but a much smaller share of overall credit provided to the American economy.

Senator SNOWE. Also, to follow up on some of the questions that have been raised with respect to small business lending and the availability of credit to small businesses, which clearly is a dire situation from all perspectives—in fact, NFIB released a survey back in mid-April that I think is an indication. If you look at these charts on the optimism, on the outlook in time to expand, these are all 25-year lows. That is significant from the standpoint of job creation.

I know we have had conversations, and we are working with Gene Sperling, working with the chair, and we had a meeting last week representing the majority, minority, both on this committee and among the leadership in your department. The question is,

when? I mean, it has been 5 months. And I know the administration has had initiatives out there.

I just cannot understand why we have not coalesced around an agreement on a small business jobs program. It is really dire. I think the depth of despair within the small business sector, and also among the American people in terms of jobs, when you think of the longevity of unemployment now, it is again the highest in 2 decades, if not more than that, with respect to how long people are now unemployed; 40 percent are unemployed for more than 6 months. I mean, that is significant.

So when I look at these charts, and Mark Zandy testified before this committee as well subsequent to the release of this NFIB survey, indicating confidence is about as low as it has ever been. That is what he said. I think we all concur, from those of us who visit Main Streets in our respective States. I mean, that is a broad indication. So what are we doing about it?

I think that this has just been a very lethargic effort when it comes to small business. Everybody is talking about jobs, everybody is talking about small businesses, but nothing is being done about it. That is why there is a desperation out there across America's landscape, and it most definitely has manifested itself on Main Street, and rightfully so. I just do not see this impetus to get this done.

Secretary GEITHNER. Well, Senator, we feel very strongly about this, as strongly as you. I agree with you: it is time now. We have a good package of tax incentives for small businesses, like zero capital gains rate for investment in small businesses. We have a small business lending facility that would give capital to community banks across the country that prepare to use that capital to expand lending; substantial expanded programs through the SBA, which we think will be very helpful—were part of the Recovery Act—and a special program for States to give them resources to support State programs that are directed exactly to this purpose. I agree with you, it is time. The Senate has been busy. I wish it had not taken this long, but this is something the Senate has to act on. We cannot do it. It requires legislation. But I think we are close to something that should come in with broad bipartisan support, and we think this would be a very helpful package.

Senator SNOWE. Well, can I just ask one follow-up? I hope there is some energizing leadership on all sides here. I mean, I truly do. We can talk about jobs, jobs, jobs, but it is not materializing. That is why you are seeing the 9.7-percent unemployment rate remaining static for 3 consecutive months. That is the problem here, not to mention the people who are out there who have been unemployed for such a significant period of time. It also creates an anxiety and a panic. So, when can we expect some cash flowing from the lending facility, for example? I know that is something you have been arranging at the Treasury Department, lending facilities, for many months now. When will that happen?

Secretary GEITHNER. When enacted with legislation. It requires legislation. When enacted, it would be very quick. I think this is the quickest program to market you could have, because all it requires is banks to come to apply. Again, we think it is the quickest way. It would have the highest return, and the potential costs are

very, very modest. Of course, we will propose ways to cover those costs so it would be fully deficit-neutral. It is a good program, it is time for it, and you are right to emphasize urgency. We would welcome your support.

Senator SNOWE. I appreciate it. Thank you.

The CHAIRMAN. Thank you, Senator. As you well know, we are planning on small business legislation with you and Senator Kerry quickly. It is needed.

Senator Roberts?

Senator ROBERTS. I thank the chair.

Mr. Secretary, thank you for coming. I know you are an extremely busy man. Despite your very vigorous assertions, I still have very serious concerns that have been brought up by all of my colleagues about this bank tax and its potential impact on consumers and small businesses. The reason I am so terribly concerned is that, in a State like Kansas, we have 6,600 small businesses, and they employ over half of our employees, so whatever happens, or whatever could happen, is a big deal.

I understand the tax is targeted at the large financial institutions, and you have certainly stressed that, to quote Willy Sutton, "because that's where the money is," but I am convinced this tax will ultimately harm small businesses through higher costs for borrowing or reduced access to credit, or that the tax will be passed on to, and paid by, consumers.

Now, I am not going to ask you to respond again because you have done that, and I hope your assertions are correct. By some estimates, the bank tax could remove up to $1 trillion in lending. Do you have concerns that removing this capital from the system, reducing lending to consumers and small businesses, will slow the economic recovery?

Secretary GEITHNER. I do not have concerns, and if I did we would not have proposed this tax. And Senator, I just want to make the following observation, which is that I understand why the institutions that do not want to pay this tax do not want to pay it, and I understand that in making arguments against it they will threaten grave economic damage to small businesses if they are forced to pay this tax.

But we have a legal obligation to cover the cost of TARP. We have to propose a way to do that that is fair. We would be open to other suggestions for doing it, but I cannot actually imagine other proposals that would carry less risk of damage to the lending—again, it is only less than 1 percent of institutions.

The vast bulk of institutions that provide businesses to Main Streets across the country are not covered by the tax, and their competitive position, as CBO said, would be improved by this design. If there are other suggestions for how to do it in a way that is more fair, would carry less risk, of course we would be open to them.

Senator ROBERTS. Well, if it does happen in regards to small business, rest assured, this committee will be eager to suggest various ways to you. I do not know about any threats that anybody has been making. If that is the case, that is the subject of another hearing.

What happens down the road for TARP? The TARP program is set to expire this October. Any TARP-related programs that will continue to operate beyond this date?

Secretary GEITHNER. Beyond this date? No. We are putting this program out of its misery as quickly as we can, and we are going to return unused hundreds of billions of dollars of authority to the Congress, unused, much lower cost, saving the American taxpayer hundreds of billions of dollars relative to what people expected, and that will provide resources to help reduce our long-term deficits.

Senator ROBERTS. Well, I have one for you here. There is the Home Affordable Modification Program I keep reading about, $50 billion. If so, what exposure risk do the programs pose to the U.S. taxpayer in regards to the fact that, if we keep going here with HAMP—that is the acronym for the Home Affordable Modification Program; everything has to be an acronym here.

Secretary GEITHNER. It is a terrible acronym, I agree with you, but it is a very good program. It will cost the taxpayer money. If we ultimately commit the $50 billion we have committed, we are prepared to commit to help resolve the housing crisis, then all of that money will be at risk of loss.

Senator ROBERTS. But does that come from the TARP program?

Secretary GEITHNER. Yes, it comes from the TARP program. It does.

Senator ROBERTS. So down the road there is another program, another $50 billion worth of exposure if, in fact, that is a positive decision?

Secretary GEITHNER. No. Again, it is an existing program we put in place more than a year ago, and we said we would not spend more than 50. If we spent up to 50, that money will be at risk of loss. But again, this program, Senator, is providing a very, very substantial benefit in helping stabilize house prices and helping, right now, more than a million Americans stay in their homes with much lower monthly payments.

Senator ROBERTS. All right.

In testimony before the committee April 20, the IG, Neil Barofsky, outlined where the losses in TARP concentrated—you have already talked about this a little bit—$50 billion for AIG; automobiles, $31 billion; housing, $49 billion. Any plans to recover these losses from those TARP recipients? If so, how would that be accomplished? If not, why not?

Secretary GEITHNER. In AIG and the auto companies, again, these companies are going through very wrenching, difficult restructuring plans that are designed to help us recover as much of those investments as possible, and I think ultimately we are going to recover a very substantial fraction of those investments, again, at much lower risk of loss than we anticipated and that are in those estimates. Housing is different. The housing program, these are, in effect, direct expenditures, direct investments, and they have much higher risk of loss.

But Senator, even in pointing out that the ultimate costs are lower than we feared and that we have achieved more stability at lower cost than we had hoped, there is still substantial risk of loss. Every 6 months from now until all the investments are back, we will provide estimates of what the ultimate losses are.

Senator ROBERTS. I think that is why some of our committee members, Mr. Chairman, wanted to wait until 2013. But at any rate, I am over time. I would like to submit a question for the record, however, to the Secretary.

Thank you.

[The question appears in the appendix.]

The CHAIRMAN. Senator Carper?

Senator CARPER. Thanks, Mr. Secretary. Good morning. How are you?

Secretary GEITHNER. Very well, thank you.

Senator CARPER. Good. Nice to see you.

I think I am one of those guys who sees most glasses as half full, sometimes even when they are not. I think there may be an emerging good-news story here. I was at a dinner the other night here in Washington, a lot of people from around the country were there, fire fighters, a bunch of them, and their spouses and families. I remained with the crowd before I spoke, and I said, what do you think I should talk about? A number of people said, just give us some good news. Just give us some good news. We are ready for that.

What I did is, I shared with them a little bit of the good news we have been talking about here today. I just want to go over a little bit, then I have a question or two to follow up with.

I think most people felt when we established the TARP that we just gave money away to banks. Most people have not a clue that what we did is, we infused capital into the banks, we bought their preferred stock, they have an obligation to pay us dividends, and we also got, in a number of those interactions, warrants that we are now being able to execute.

My understanding is that most, but not all, of the banks that have gotten money from the TARP, at least the lion's share, have bought back their preferred stock. They paid their dividends in full, and in a number of instances we are beginning to exercise warrants. Bank of America is one that comes to mind, and I think we have exercised their warrants in a transaction that may have involved maybe $1.5 billion net gain to the Treasury.

Could you just mention a couple of others in terms of the warrants? Maybe take a minute and explain to us how that works.

Secretary GEITHNER. Well, in rough total we have had roughly $200 billion come back from these banks, all the major banks with over $20 billion in both dividends and proceeds from the sale of warrants, and independent analysts look at the total return for the taxpayer in those programs and would show that it is a very, very high return. The taxpayer got a very good deal on these investments because we were so effective in stabilizing the system, and you are right to emphasize that.

Again, when I came into office, my predecessor—and this was the right thing to do, the necessary thing to do—had investments in banks representing 75 percent, three-quarters, of the entire American banking system. We came in and forced banks to go raise private capital to repay the taxpayer, to do that very quickly so we got the money back for the taxpayer at a very substantial positive return.

Senator CARPER. The money that we have not received back, there are some banks that have not, if you will, bought back their preferred stock, and we are not being able to execute our warrants. But have we executed warrants on most of them that we are going to be able to?

Secretary GEITHNER. No. We still have a substantial number of really just small banks across the country that still have preferred stock outstanding, and, in the additional terms of these investments, they had 5 years before the dividend payment went up. So, we have substantial——

Senator CARPER. It goes up from what, 5 percent to what, 9?

Secretary GEITHNER. Yes, from 5 to 9.

Senator CARPER. Right.

Secretary GEITHNER. So we have substantial repayment still ahead of us and substantial dividends ahead of us, and substantial warrants proceeds still ahead of us. But the broad numbers are the most important ones. Instead of a half a trillion in losses, we have around 100, probably lower than 100, with more than $200 billion back already, which is a substantial positive return in dividends and warrants.

And as I said in response to Senator Cantwell's comments, if you look at the FDIC programs, the Fed programs, other Treasury programs not covered by the TARP, those also have this characteristic of showing substantial positive return.

Now, of course the ultimate measure of this is, how quickly do we bring down borrowing costs? In some ways, the best measure of success is not just the financial return but the cost of a loan to buy a house, a car, put your kids through college, help the municipal government build a new school. The cost of credit to businesses across the country is a fraction of what it was in the crisis when we came into office, much lower, much more affordable, even recognizing how tough it still is for small businesses across the country.

Senator CARPER. All right.

Talk to us, if you will, about AIG. AIG sold a number of very large assets, including one in Delaware, Alico—they are an insurance affiliate—for about $15 billion to, I think, MetLife. They also, I think, recently sold one of their foreign units for maybe $35 billion.

Do I understand that money has gone to the Fed to repay an obligation there? Is there a further obligation that AIG has to the Fed? Then, what is their obligation to the TARP?

Secretary GEITHNER. Those transactions you referred to have not yet been concluded, but when they are concluded they will return roughly $50 billion to, in this case, the Federal Reserve, but ultimately to the American taxpayer. Of course, AIG is still undertaking a series of other transactions that will make sure we get as much of those investments back as possible.

But the very important thing as well to emphasize is the part of AIG that some people call their hedge fund, AIG Financial Products, that took on the enormous risks that brought the firm to the edge of collapse. We have been successful in bringing down the risk in that hedge fund very, very dramatically, so it is now a fraction of the level it was. So what we did is to, in a sense, step in, reduce

the risk, sell off the underlying businesses as quickly as we could in a way that maximized potential return to the taxpayer.

The CHAIRMAN. Senator Wyden?

Senator WYDEN. Thank you very much.

Welcome, Mr. Secretary. Of course, we have a major financial reform bill on the floor. It has provisions, obviously, involving taxes and regulation. What I am most interested in is the question of transparency and accountability to American consumers and institutions.

Let me start by asking you whether you believe that a buyer has a right to know that their banker is selling them a product that it is betting against.

Secretary GEITHNER. Senator, I would say this. I think it is very important that we strengthen disclosure requirements across the financial system, that the SEC has the authority, stronger authority, to impose strong disclosure requirements, and stronger obligations, frankly, on institutions that provide financial services and sell products to their customers, whether they are retail investors, individuals, or sophisticated investors across the country. We would be happy to work with you on any proposals to help make sure that we are achieving that objective.

Senator WYDEN. Here is what is going on. I filed an amendment on this, and I am asking this for a reason. You have banks trying to sell products to clients, products that the banks are betting against without telling the client that the bank is betting against the product. Now, we can have a debate about the details of it. I would like you to say "yes" or "no" whether you think the buyer has a right to know that a product is being sold to them that the bank is betting against.

Secretary GEITHNER. Senator, I have an almost perfect record in responding to your questions at hearings, and, even with amendments that I completely agree with, I generally do not endorse them in the context that——

Senator WYDEN. I am not asking——

Secretary GEITHNER [continuing]. Without looking at them first. But I will study your amendment very carefully. And I would say the following: I completely agree that firms should have access to information about not just the risk in the investments, but any conflicts that may apply in that context. I am happy to work with you on that broad objective. I share your objective.

Senator WYDEN. You share the objective that the buyer has a right to know? I am not asking you about whether you support the amendment, but on the question of the buyer having a right to know that a bank is selling them something they are betting against. You think the buyer has a right to know?

Secretary GEITHNER. I do not want to say it exactly that way just because of how difficult this is, and complex. But on the basic principle that the buyer should have access to information they need to make an informed decision about the risk they are taking, absolutely, they should have access to that information.

Senator WYDEN. And clearly, access to that information involves knowing that a bank is actually betting against it. I mean, Mr. Secretary, people are slackjawed on this particular proposition. I happen to think this is pretty complicated stuff, and that is why, under

my amendment, we give the oversight board a lot of discretion in writing the rules.

But I think this is one that is fundamental to passing the smell test in this country with respect to basic fairness, so I hope we can work this out and look forward to working with you. We have done a lot of work together, and I want to work with you on this as well.

One other question on the reform package. I think there is a sense that when you look at the housing bubble, the bad loans, the shoddy oversight, all of the kind of elements of this financial calamity that the country has suffered, there has not been the sense of accountability and oversight that is needed.

Now, under the legislation, you would be chair of the Financial Stability Oversight Council, as I understand it. I would like to ask whether you would be willing to report to the Congress, in effect, and certify each year that the rules of the road on Wall Street are sufficient to protect the financial stability of the economy. It is not completely clear. It strikes me as a very useful council, but I think it would be very helpful to incorporate into it some kind of certification requirement that would come from you annually on this issue.

Secretary GEITHNER. I am happy to work with you, Senator, on crafting that. I agree with you completely that this council should be required to report to the Congress regularly, to testify to Congress on broad conditions in the financial system, including to provide a judgment on whether the protections that exist, that are put in place, are adequate to provide a more stable system with better protections.

Senator WYDEN. One last question with respect to the responsibility fee. I am trying to sort out the way an American bank is going to deal with the taxes relative to foreign banks. Part of this looks to me like it could impose a unilateral kind of fee on some of our financial institutions when banking, of course, is an international industry. So how would you address this question of ensuring fairness for American institutions relative to foreign ones?

Secretary GEITHNER. I just should point out—I should have said this earlier—just one basic fact in design: it is designed in a way that, if you adjust your behavior, you take on less leverage with less risk, the fee diminishes. So it has this benefit of, you can adapt in a way that reduces the incidence of the fee.

But we are working closely with other countries where U.S. firms compete with other foreign banks to encourage them to put in place a similar fee so we have a better chance of a level playing field. As you read in the papers, there is very substantial support for a fee like this from my counterparts in the U.K. and in Europe.

Senator WYDEN. Thank you, Mr. Secretary.

The CHAIRMAN. Senator Schumer?

Senator SCHUMER. Thank you, Mr. Chairman.

I, too, want to talk directly about the financial crisis responsibility fee, which you have named it. Nobody knows better than you how unpopular the TARP has become. The number-one argument against the TARP is, taxpayer money was used to "bail out the banks." So now we are debating comprehensive financial reform to ensure that we are never again faced with the Hobson's choice we all faced, you as chairman of the New York Fed and we as Sen-

ators, to rescue financial institutions on the brink of collapse or risk another Depression. We want to avoid that horrible choice. We sat through it once; once is enough.

We certainly can, and should, work to prevent any more taxpayer bailouts, but we also need to close the book on the last one so people are convinced we mean what we say. We can make sure the taxpayers get every dime they paid into the TARP legislation, which I think will benefit the financial system overall and give more confidence in what we are doing. So I think it is important to do. It is also something we said at the time.

A key piece of the legislation required the President to assess the cost of the programs and "submit a legislative proposal that recoups from the financial industry an amount equal to the shortfall in order to ensure that the program does not add to the deficit or national debt."

Some argue, well, it should be proportionate to what each bank got. That is not what the legislation says. Look, I sat there when many of these major financial companies called up and said, unless you do this, we will be gone. So, just every major financial company should be grateful that this happened, and in my judgment, not quibble that they should do this or they should do that. Everyone benefitted, and the taxpayer did step up to the plate, frankly, under George Bush and Hank Paulson's leadership.

So the financial crisis responsibility fee sends an important message to taxpayers that we mean what we say. When the law requires the financial industry to pick up the tab for rescuing the economy, in part created by the problems of the financial industry, we follow through and get our money back.

There are legitimate details as to the specifics of the plan, and some of those have been debated here. I think those are open to debate. But the first thing, I think it makes common sense to put this in the banking bill, in the regulatory reform bill. I know that is not the majority opinion around here, but I think it makes sense.

What do you think?

Secretary GEITHNER. Senator, first of all, I agree with everything you just said about the rationale for the fee. On the question of how to get it passed, that is really a judgment we leave to the Majority Leader and to Chairman Baucus and to Chairman Dodd, and we are open to any suggestion that meets the legal obligation we have and puts this in place.

Senator SCHUMER. All right. I thought the administration's position was, they prefer it to be in the bill.

Secretary GEITHNER. Well, of course we would like it to become law. As you said, we want to demonstrate to people we mean what we say. We committed to do this, and we want to work with you to make sure that we put it in place with the best design possible as quickly as we can, and we are open to any suggestion for how to do that. We think there is a good case for doing it as part of financial reform, but that is a judgment that we cannot make that we leave to the Majority Leader and his colleagues.

Senator SCHUMER. Thank you. As one of those colleagues, I will weigh in.

Second, as you noted, the current estimates of the TARP losses are going down. They are $109 billion to $117 billion. They may go

down further. I believe the purpose of this is to be repaid, not simply to impose a new tax. My question is, if the losses keep getting lower, as they have been for months, would you recommend that the program end early after every nickel, every dime is repaid?

Secretary GEITHNER. Senator, let me respond to it this way. You are right that the current costs are somewhere between $100——

Senator SCHUMER. When you say that, I know you are not going to respond to it.

Secretary GEITHNER. I am going to respond in just the perfect way. The cost is now estimated between $100 and $117 billion; we proposed a fee that, over 10 years, would raise $90 billion, so we have already built in some recognition these costs may come down over time. But of course, ultimately that is a question we would have to work with you all on to figure out what is fair and just.

Again, since the TARP did not capture the full damage to our fiscal position caused by the crisis nor the benefits to the major banks, as you said, and since we want to reassure people—not just the American people but people around the world—that we are going to be responsible in repairing the fiscal damage, we think it is sensible to say it is $90 billion over 10 years. We can keep it in place longer if we need to to capture higher costs if they materialize.

Senator SCHUMER. But what about the inverse?

Secretary GEITHNER. Well, again, the inverse is a very interesting question we have to work with you on, but our judgment is, because the TARP did not fully capture the fiscal costs, we think that it is responsible to propose this at a level that raises $90 billion over 10 years.

Senator SCHUMER. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Mr. Secretary, I am just glancing at a *Forbes* article from about a week ago or so which outlines that the IMF is suggesting the various countries contribute to what looks to me like some kind of reserve fund, and as much as 2 to 4 percent of the country's GDP, but it seems, as best as I can understand it from the article here, that it would be structured much differently, that is, on income, profits, and bonus payments and so forth, not on risk.

I am just curious. What is our government's position on those IMF negotiations over what kind of a fee makes most sense?

Secretary GEITHNER. Mr. Chairman, the IMF actually, in analyzing a range of possible approaches to cover the fiscal cost of crises, made two recommendations. It proposed a fee very much like ours to cover the cost of this crisis and was very supportive of the broad design we laid out, but it also suggested that governments might also want to consider, as a down payment on the cost of future crises, putting a broader tax on profits against that potential contingency.

But as I have said today, our judgment is that we have an obligation to cover costs of this crisis. We want to meet that obligation. We think this fee, like the IMF recognizes, is the best way to do that. We would be happy to work with you on other ways to do it, but we think this is the fairest way to do it.

In making this judgment, we did look at a broader profits tax, we did look at financial transaction taxes, the full range of those kind of taxes, but we concluded, as I believe the IMF did, that this was the best way to meet that legal obligation. Again, it is the largest institutions paying in proportion to the risk they take. It is like a "too big to fail" type levy, and we think it is better than the alternatives.

The CHAIRMAN. I am a little unclear. Is theirs a risk-based proposal or is it based more on profits——

Secretary GEITHNER. The IMF made two recommendations, for reasons I do not quite understand. They suggested, for the cost of past crises, a fee on risk, like we have proposed is an appropriate approach, but they also suggested countries might want to consider, as a down payment on the cost of future crises, a broader-based tax on profits for financial institutions. That is something that we looked at and did not recommend, do not feel it makes sense. But again, we are trying to meet a more limited objective now, which is to cover the cost of TARP.

The CHAIRMAN. The assumption behind all this, not only this tax but also the financial regulatory reform, is we will be enacting laws that will prevent this catastrophe from happening again. Now, clearly, that is a big assumption. So, when you think about all this, what are some of the areas that we need to focus on to minimize reoccurrence of this kind of financial meltdown?

Secretary GEITHNER. Well, the four essential, necessary things we have to do in these reform plans are to protect consumers against the kind of predation and abuse they faced, to limit risk and leverage by the major institutions—whether they look like AIG, or Wells Fargo, or Citigroup, or Goldman Sachs, or Lehman Brothers, or Bear Sterns. We want to make sure that they are subjected to more conservative constraints on leverage and risk-taking. We want to make sure we bring the derivative markets out of the dark into a framework of oversight and transparency, and we want to make sure that, if in the future these large institutions ever again manage themselves to the point they cannot survive without government assistance, we want to make sure we can put them through a form of bankruptcy without the taxpayer being exposed to loss. We think that combination of reforms is essential to deal with the cause of this crisis and is essential to make our country less vulnerable in future crises.

Now, you are right, and you said this well, that we will face some risk of crisis in the future, but with these reforms we can dramatically reduce that risk and make sure that, if people make mistakes again, that they are not going to cause this kind of catastrophic damage and we can protect the American taxpayer and American businesses and families from the broad damage caused by this crisis.

The CHAIRMAN. Maybe you can help me out on just a question I have. You said that the tax is going to cover, say, derivatives that are off the balance sheet, which I think is a good idea. How much are derivatives currently, according to Generally Accepted Accounting Principles, off balance sheet, or is there a footnote reference to them? How is the investor/public going to know in the future what these derivatives, swaps, and all these exotic instruments and so

forth held by an institution really are, even though they are off the balance sheet?

Secretary GEITHNER. Well, the virtue, again, of these reforms is that firms will have to disclose every quarter the risks they have, whether it is in derivatives or other types of fancy, complex products, whether they are on balance sheet directly or off balance sheet. So where they have risk and exposure to those products, they will have to disclose those risks, hold more capital against those risks. If you adopt this fee as we have designed it, they cover their cost of the financial crisis if——

The CHAIRMAN. I understand if the fee is adopted. But what about those institutions that are not covered by the fee?

Secretary GEITHNER. The reforms that the Senate is considering would require those kind of disclosure requirements and capital requirements across the American financial system, regardless of whether you are covered by this fee.

The CHAIRMAN. So we are not going to see a lot of off-balance sheet problems, like Exxon or Lehman or others that we saw?

Secretary GEITHNER. No, exactly. What happened in our system is people engaged essentially in banking, borrowing money short and taking risk in lending that money, and were able to operate outside the constraints of banking regulation, no capital requirements, no disclosure requirements, nobody in charge, nobody looking at them. This bill will fix that problem, that central problem, and make sure that those institutions, regardless of what they look like or call themselves, if they are engaged in that business of banking and risk-taking, play a critical role in our markets, they will come within a set of constraints to limit the risks they take.

The CHAIRMAN. So how will all these products be shown on the balance sheet?

Secretary GEITHNER. Well, again, they will have to disclose every quarter the economic risks they have in exposure to those products and hold capital against those risks. The reforms on derivatives, we discussed earlier, will bring about this very important set of reforms to make sure that that stuff comes out of the dark and is disclosed publicly, that standardized products are centrally cleared. If they are centrally cleared, they are traded on exchanges where there is transparency and price discovery. That is a huge, sweeping change in transparency and disclosure.

The CHAIRMAN. What about non-standardized products?

Secretary GEITHNER. There is still an important economic benefit in non-standardized, customized hedging products for companies that make things, produce things across the United States. We have preserved the capacity to do that, but you have to provide disclosure transparency on those products, and you have to make sure that the firms that write those commitments hold capital against those commitments. What we cannot do is allow a company like AIG, again, to write hundreds of billions of dollars of commitments to people who are trying to hedge risks without the capital to meet those commitments.

The CHAIRMAN. Again, I do not mean to beat a dead horse here, but how will that be shown on the balance sheet?

Secretary GEITHNER. They will have to disclose to their investors, to their shareholders, to their creditors, every quarter, the risk in

their assets, whether it is on balance sheet or off balance sheet, and the capital they hold against those risks. So, as part of the normal public disclosure requirements for these companies, these firms will have to disclose those exposures.

The CHAIRMAN. All right. As long as there is full disclosure.

Secretary GEITHNER. Full disclosure.

The CHAIRMAN. All right. And in the interest of full disclosure, I meant to say Enron, not Exxon a little earlier, too.

This whole discussion on the bank tax has assumed something along the design of the administration's proposal that is risk-based. There has been virtually no discussion of what I take to be the House proposal, which is based on profits or income. I assume that you summarily dismiss, or at least come close to saying you very much do not favor a tax on banks' income?

Secretary GEITHNER. I definitely would not summarily dismiss. I would say again, and we have said to our colleagues in the House, that we are of course open to suggestions on how best to craft this. We want to work with you to do it in a way that is fair and sensible.

As I said, we did look at a profits tax, as well as a financial transaction tax, and various forms of both of those. But we thought, Mr. Chairman, that this was a better design because it would have the additional benefit, not just of covering the losses in TARP, but in a form that would help reinforce our broader objectives of limiting risk-taking and leverage by the largest firms. A profits tax would not do that. The fee we propose would have that benefit.

The CHAIRMAN. But you are not at all concerned about reducing American competitiveness with this fee?

Secretary GEITHNER. Well, again, we have a legal obligation in the TARP to cover these costs, and we want to find a way to do this that would minimize the risk of any loss of competitiveness.

One way to do that is to do what we have been doing, which is to work with other countries to encourage and put in place a similar fee. I think it is more likely that other countries will join us in the form of a fee designed as a tax on risk than a profits tax. So I think that it is probably true. I cannot be sure that the level playing field objective is best served by a tax on risk.

The CHAIRMAN. Thank you.

Senator Grassley?

Senator GRASSLEY. In regard to that last point, I think New Zealand, Australia, and Canada already torpedoed this effort, so you might as well forget about it from the standpoint of international competitiveness, because they are going to make sure that they stay competitive. I think they see some of the intellectual dishonesty of trying to tax somebody to, let us say, lessen risk. Taxation has nothing to do with that risk. That is just my opinion.

I have two questions I want to ask, and then I guess you will be able to go. GM filings at the SEC state that the taxpayers' TARP loan bore an interest rate of 7 percent and ran until 2015. The SEC's filings also list a $2.5-billion loan GM still owes their auto union health plan that runs until 2017, and bears an interest rate of 9 percent.

In light of GM's statement that it does not need the escrow funds, should GM use some of the $6.6 billion to pay off a high-interest loan from the union health plan so the taxpayers are no longer subsidizing this expensive debt? It seems to me that that would be common sense. Your opinion?

Secretary GEITHNER. I am not quite sure how to respond to that, Senator, but would be happy to talk to you about it in more detail. Again, we are going to be guided by what we think is the best way to recover these investments as quickly as we can with the least risk of loss to the American taxpayer, and we are in a much stronger position today in achieving that objective than any of us hoped because we were so successful in putting these firms through a dramatic restructuring.

Senator Grassley, could I just respond, though, to your first question, your initial comment? The FDIC assessment regime that has been in place now for some time does incorporate this principle of risk-based pricing, so banks now pay a fee for deposit insurance in proportion to a bunch of objective measures of the risk they are taking.

So that basic principle, I think, is a fundamentally sensible principle. It is already imbued in current banking practice in the United States. Many other countries would like to replicate that practice. I think ultimately we have a very good chance of getting support from other countries, but our obligation is to do what is necessary and appropriate for the American taxpayer in a way that is fair and just to them. Again, we are happy to work with you on other ways of achieving this, but we think this does the best job of achieving that objective.

Senator GRASSLEY. On my questions, the point is—and you do not need to respond any more—if you pay off a 7-percent loan and you have a 9-percent loan out there, it is common sense that, if the taxpayers are helping General Motors to keep General Motors viable, they would be better off paying off a 9-percent loan than a 7-percent loan. I mean, you can try to fool other people, but I will tell you how farmers look at interest rates. You have to remember that GM lost over $3 billion last quarter, and that is not great either.

Last question. You testified last week before the Appropriations Committee that you had not seen the GM ad. In that ad, the CEO of GM claims that it has "repaid" its government loan in full. However, as you know, prior to the bankruptcy the taxpayers loaned GM over $19 billion. That loan was certainly not repaid in full.

Have you seen this ad since your testimony last week, and is it not a misleading ad to the average citizen?

Secretary GEITHNER. Senator, I have not seen that ad. I did not see it in advance. We have been very careful to meet our commitment to make sure these companies are running themselves, and we are not in a position of deciding how they run their companies.

But I want to emphasize that we were very careful to make it clear, as we have done all this time, to lay out for the American people the full scope of our investments in these companies. I want to emphasize again, as I did last week, that we still retain a substantial share of equity in these companies, which we hope to re-

duce, and will reduce, very quickly over time, but those investments carry some significant risk of loss.

Now, Senator, I know you know this, but it was President Bush and my predecessor who made the judgment to decide to rescue these companies. Our obligation was to finish the job, and we did it in a way, because we put them through bankruptcy and restructuring, that puts them in a much stronger position today, and we face much lower risk of loss on these investments than any of us expected because these restructuring plans were so ambitious. We are very encouraged by the broad signs of improvement you are seeing, both in these companies and across the American economy.

Senator GRASSLEY. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Thank you, Mr. Secretary. We deeply appreciate all the time that you have taken to be with us today, a little over 2 hours. I know you have testified in many other committees, too. It is sometimes difficult and sometimes frustrating for you, I am sure, but it is very valuable. Thank you very much for taking the time.

Secretary GEITHNER. A pleasure to do it. Happy to be here. Of course, I will respond to any of the questions submitted in writing as quickly as we can.

The CHAIRMAN. You bet. Thank you.

Next panel. Our first witness is Steve Bartlett, president and CEO of the Financial Services Roundtable. Next, John Sorensen, president and CEO of the Iowa Bankers Association. The third witness is James Chessen, chief economist at the American Bankers Association; and finally, Patrick S. Baird, chairman of AEGON USA. Thank you.

You each have 5 minutes to speak, roughly, and your prepared statements will be in the record.

Why don't you proceed first, Mr. Bartlett?

STATEMENT OF HON. STEVE BARTLETT, PRESIDENT AND CEO, FINANCIAL SERVICES ROUNDTABLE, WASHINGTON, DC

Mr. BARTLETT. Chairman Baucus and Ranking Member Grassley, I begin my testimony again by thanking Congress, as we have in the past, and the taxpayers for the capital investments made in the financial firms under the TARP program.

I reaffirm the commitment of the members of the Financial Services Roundtable, and indeed the financial services industry, to repay those investments in full. Let me say that again: we have repaid significant portions of TARP; we are in the process of repaying; and we will repay every dime, as Senator Schumer said earlier, under the TARP program.

That is the law, and we will abide by the law because we support it. TARP, as has been said, was not a popular program, and yet TARP helped stabilize the financial system. It allowed financial firms to maintain the flow of credit to consumers and businesses during the time the economy was in crisis.

However, the tax that the administration has proposed over the last couple of months and here today is another matter entirely. This seems to be a tax in search of a purpose. I have made a list of some of the purposes I heard this morning. It could be an additional tax in addition to what is provided in the law. It could be

an over-tax to over-pay the TARP losses. It is clearly a premature tax, as the law provides that that tax would not even be proposed for an additional 3 years.

It is proposed as a back-door regulatory scheme regarding capital adequacy. Let me say, we support additional and higher capital standards in capital adequacy, but not through a taxing system. It is proposed to be a tax to pay for other programs, including the oil spill in the Gulf, and a tax to shift, indeed, market share from one sector of the banking industry to another.

While the purpose of the tax is not clear, what is clear is that this tax, in its present proposal, is both premature and harmful to the economy. The industry's obligation to pay the cost of TARP was settled when the program was established by law. The Emergency Economic Stabilization Act, which created the TARP program, requires the administration to submit a report to Congress on TARP costs 3 years from now, beginning in 2013.

This recoupment program—and I have included a copy of the statute in my written testimony—is clearly stated. Section 134 says, in part, "Upon the expiration of the 5-year period beginning on the date of the enactment of the Act, the Director of OMB shall submit a report to Congress on the net amount. In any case where there is a shortfall, the President shall submit a legislative proposal that recoups that shortfall from the financial services industry."

Congress delayed the calculation of the TARP program for 5 years for two very obvious reasons. One is, we do not know the total size of the losses, if any. Second, it is counterproductive, for an economy that is just beginning its recovery, to take capital out of the economy now.

In a letter to Congress, Secretary Geithner acknowledged the uncertain nature of any estimates of TARP costs and gains when he said that costs are "highly uncertain and depend on future financial and economic conditions." The estimates of the losses in the last year alone range from $99 billion on the low side to $356 billion on the high side. I have attached to my testimony nine different official estimates that have changed approximately every 6 weeks. One thing is certain, and that is the net losses will be less than they are believed to be now at $117 billion.

The Treasury Department also said, on April 2—and these are their words—"Treasury currently estimates that its programs aimed at stabilizing the banking system will earn a profit, thanks to dividends, interest, and early repayments in the sale of warrants. Total bank investments of $245 billion in fiscal year 2009 that were additionally projected to cost $76 billion are now projected to earn a profit."

The three areas of losses that are in question, roughly one-third, one-third, one-third, are AIG, HAMP, and the automakers. But it is also clear that, even in those three, the size of those losses will likely decline steadily over the next 3 years. So, as I said at the outset, the members of the Financial Services Roundtable have repaid, will repay, and are repaying under the current law.

I would also say, in terms of its economic effect, if you take $900 billion out of the capital system beginning now, particularly in these economic times, you do reduce lending. If you take $90 billion

out, you reduce lending; by rule of thumb, approximately $900 billion would thus further damage the economy.

Mr. Chairman, I have submitted my written testimony and will submit additional suggestions that can, and should, be done for Congress to deal with small business lending. In the Roundtable's opinion, that is the single most urgent action that the Congress should be taking now, to make some way overdue and needed reforms to increase small business lending. I have included some specifics in my testimony.

The CHAIRMAN. Thank you, Mr. Bartlett.

[The prepared statement of Mr. Bartlett appears in the appendix.]

The CHAIRMAN. Next, Mr. Sorensen?

STATEMENT OF JOHN K. SORENSEN, PRESIDENT AND CEO, IOWA BANKERS ASSOCIATION, JOHNSTON, IA

Mr. SORENSEN. Thank you, Chairman Baucus, Ranking Member Grassley, and members of the committee. My name is John Sorensen. I am president and CEO of the Iowa Bankers Association. The IBA exists principally to assist our members in serving their customers and their communities.

The IBA counts 95 percent of 386 banks, with over 1,600 locations, as members. The median size of an Iowa bank is $100 million in assets. Iowa is principally a community banking State, but we also have a regional and money center bank presence, representing 20 percent of the $64 billion in State-wide deposits. Iowa's financial diversity has benefitted both consumers and businesses alike.

One of the local newspapers, the *Dubuque Telegraph Herald*, recently penned an editorial summarizing the importance of their local banks to their community. In it they said, "Healthy financial institutions create and sustain success in all sectors of our community. From their loans towards initiatives vital for economic and civic growth, to their charitable donations, to their leadership in various community endeavors, our local financial institutions play a significant role in our success." Iowa banks in Dubuque, and everywhere, are weathering the economic fallout from the financial crisis which they did not contribute to. The larger question may be whether or not they are able to weather the policy response.

The Senate is working on financial regulatory reform. It is important work, and necessary. Many lessons have been learned from the experience of the last 2 years. We should take steps to close the gaps in financial regulation, better manage risks posed by large systemically important institutions, and develop a government housing policy that does not result in undue risk-taking, but most of all, we should not burden the very institutions who have been responsibly serving their communities.

The Obama administration now proposes an annual financial crisis responsibility fee on banks, thrifts, and their holding companies with consolidated assets of over $50 billion. The purpose is to recoup the cost of the Troubled Asset Relief Program, or TARP. The Iowa Bankers Association opposes any new tax or fees specifically targeting the financial services industry, for two principal reasons.

First of all, the fee will threaten the lending capacity of the banking industry. Much of our industry has been challenged by rising delinquencies, declining profitability, and depleted capital levels. A $117-billion tax or fee, on top of the spiraling costs of recapitalizing the deposit insurance fund, will further deplete resources needed to fuel our Nation's economy and economic recovery.

The Congressional Budget Office, in their March 4 letter to Senator Grassley, confirmed the costs of the proposed fee would ultimately be borne by varying degrees by an institution's customers, employees, and investors. The CBO also predicts the fee would have a negative impact on the availability of credit to small businesses. Small businesses are the engine for job growth in our economy. We should avoid any policy that dampens credit availability and job creation at this critical time.

In addition, setting a tax to target a specific industry, or even a set of firms within that industry, sets a very bad precedent. Our industry would be much better protected, and we believe consumers better served, when bad actors are addressed through adequate regulation rather than through tax policy.

Second, it is clear the American taxpayers will not incur loss in their bank investments through TARP. Rather, Treasury projects a double-digit return on bank investments. Although losses are projected in non-bank TARP investments in AIG and the automobile industry, even these may subside as the economy improves and we approach the loss assessment date of 2013 as contemplated by the Emergency Economic Stabilization Act.

To charge banks for losses generated by non-banks and other administration programs would be unfair, and I believe inconsistent with the spirit of section 134 of the Emergency Economic Stabilization Act.

In conclusion, the proposed fee accomplishes little in the way of altering behavior that caused the financial crisis. The country would be much better served by focusing on how we maintain a dynamic and responsible financial sector where the rules of the game are consistently applied to all players.

Thank you for your invitation to testify today.

The CHAIRMAN. Thank you, Mr. Sorensen, very much.

[The prepared statement of Mr. Sorensen appears in the appendix.]

The CHAIRMAN. Next, Mr. Chessen?

STATEMENT OF JAMES CHESSEN, CHIEF ECONOMIST, AMERICAN BANKERS ASSOCIATION, WASHINGTON, DC

Mr. CHESSEN. Thank you, Chairman Baucus, Ranking Member Grassley. My name is James Chessen, and I do appreciate the opportunity to be here on behalf of the ABA.

There is no question that the banking industry—indeed, the entire country—benefitted from the extraordinary actions taken in the fall of 2008. It was a time of considerable stress and required decisive action to stop the growing anxiety and uncertainty in markets worldwide.

The programs implemented in this crisis, however, were not well-articulated and often changed as issues arose. This was particularly true of TARP, which was originally, as the name implied, for

the purchase of troubled assets. In a matter of days after enactment, everything changed, and the policy shifted to putting capital in healthy, viable banks under the Capital Purchase Program.

The fact that this was a program for generally healthy banks and one that promised a significant return to the government was lost on the public and often mischaracterized. As the economic recession took hold, the use of TARP funds extended well beyond providing capital to the banking industry and became a ready source of funds for dealing with the bankruptcies of non-banks, including General Motors, Chrysler, and AIG. It is the non-banking part of TARP where the losses are concentrated.

The CBO, in response to your question, Senator Grassley, acknowledged that for the most part the firms paying the fee would not be those that were directly responsible for losses realized by the TARP. Had the TARP been limited to the banking industry, there would be no losses on that program. President Obama acknowledged this last December when he said, "Assistance to banks, once thought to cost taxpayers untold billions, is on track to actually reap billions in profits for the taxpaying public."

Treasury has already received, as Secretary Geithner said today, over $20 billion in dividends and warrants and has earned over an 8.5-percent return already, a very good return, as the Secretary acknowledged, by any measure.

Besides the unfairness of paying for losses outside of the banking industry, the tax would have significant unintended consequences. The proposed tax of $90 billion to $117 billion means that $90 billion to $117 billion cannot be used directly for lending, but that does not even begin to capture the impact on lending, as $1 of capital supports up to $10 of new loans. Thus, the total impact could be nearly $1 trillion in foregone credit over the next 10 years.

Large banks, of course, are directly impacted by this tax, but it has a much broader impact on smaller banks as well. Because the proposed tax affects how small businesses fund themselves, it will inevitably alter all the economics of every way banks fund themselves, including the deposit market, the Federal funds market, the pricing of home loan bank advances, and the short-term repo market. All raised the cost of funding loans for community banks. Ultimately, it is the owners and borrowers, particularly small business borrowers, who often finance by local community banks, and also finance by large banks, who end up paying for the tax.

There is a broader issue that worries community banks. Many small banks believe that, once the precedent is set to assess an additional tax on large banks, it is only a matter of time before the tax is spread to other smaller banks.

Finally, it is worth noting that the estimates of losses on TARP continue to decline. That is the reason the law required the TARP losses to be reported in 2013, so there could be a clearer picture of the magnitude of those losses and the sources of those losses. It is too soon to know the extent of the losses from AIG and the auto companies.

Given the continual downward revisions in expected losses, a discussion of repayment is premature. In fact, implementing such a tax now would likely lead to a greater withdrawal of resources in a shorter period of time than is appropriate or prudent, particu-

larly given the anemic state of this economy. It is counter to the efforts to getting this economy going and to lending to small businesses.

Thank you, Mr. Chairman, Senator Grassley, for the opportunity to present ABA's views. I would be happy to answer any questions.

The CHAIRMAN. Well, thank you, Mr. Chessen. That was very interesting.

[The prepared statement of Mr. Chessen appears in the appendix.]

The CHAIRMAN. Mr. Baird?

STATEMENT OF PATRICK S. BAIRD, AEGON USA, LLC, CEDAR RAPIDS, IA

Mr. BAIRD. Mr. Chairman and Senator Grassley, thank you. My name is Pat Baird. I am chairman of AEGON USA, and I live and work in Cedar Rapids, IA. I have spent over 32 years at my company and in the life insurance industry.

I am here today on behalf of the American Council of Life Insurers, or ACLI. The ACLI represents more than 300 legal reserve life insurers and fraternal benefit society member companies in the U.S. These member companies represent over 90 percent of the assets in premiums of the U.S. life insurance and annuity industry.

You should know, as Senator Grassley noted, I was chairman of the ACLI from October of 2008 until October of 2009, which I believe is generally acknowledged as the most difficult of times in the history of the life insurance industry, so that experience, whether it is wisdom or baggage, I do not know, but I have it.

I appreciate the opportunity to appear before you today to share our views about the administration's proposal entitled "Financial Crisis Responsibility Fee." At the outset, it is important for you to know that, while I intend to be very responsive and very open, there is still a lack of clarity in this bill as regards how it impacts the life insurance industry.

To that end, some of that clarity, I think, was provided with Secretary Geithner's comments earlier. Had we had the benefit of those comments earlier, I think my remarks today probably would have been different. So I still intend to make this responsive to you, but it may be a little bit by the seat of the pants, so you will have to give me a little bit of give on that.

Before any new tax is imposed, it is important to know and identify what the goal of that tax is. In January, the administration released its first description of that proposal. At that time, the proposal cited two reasons for the tax. First, to reimburse the Federal Government for the expected shortfalls in the TARP program. It has been suggested that life insurers benefitted generally and/or indirectly from the government's policies that assisted the economy, and we agree that this industry did benefit from the government's extraordinary action that stabilized the economy.

That argument, though, can be said about many companies, businesses, individuals, and industries within this country. However, our industry did not cause this crisis. As Secretary Geithner emphasized, those causing the crisis should pay and not those who did not. We all benefitted from having a stabilized financial system, but we do not believe that life insurers should be identified as an

industry that inordinately benefitted, and therefore needs to be taxed to recoup government funds. Like most of Main Street America, our industry was more of a victim than a perpetrator.

A second reason given is to limit risk-taking or excess leveraging among large financial firms. Since insurers are prohibited by State law from engaging in excessive risk-taking, investing, or excessive leveraging, we do not believe this is justification to impose a tax on our industry. State investment laws are very clear, and they are uniform throughout the country. They impose strict limitations on the types of investments insurers can make.

Given the stated reasons for the tax by the administration, it is unclear why the life insurance industry has been included. We have been told by members of Congress and their staff that life insurers are included in this proposal because AIG played a significant role in the economic downturn and financial crisis. We do not disagree with that assessment.

However, AIG is a very unique, multi-faceted financial group with many different financial businesses, including, in part, regulated life insurance companies. These businesses other than life insurance constituted a large part of the total AIG, much more so than any other life insurance group in the U.S. It was primarily these other financial activities which fell outside regulated life insurance companies that resulted in AIG's role in the financial crisis. For these reasons, we strongly feel that AIG should not, and cannot, be used as the benchmark for the life insurance industry.

I also have a question as to the fundamental fairness to life insurers within the life insurance industry. In this proposal, insurers are to be included only if consolidated assets exceed $50 billion, and if within the consolidated group there is an owned bank, thrift, or broker/dealer. While some insurers may own a bank, thrift, or broker/dealer, as Secretary Geithner noted, most often they are very small parts of their total business and are ancillary to their core business of life insurance.

For example, in my own company of AEGON USA, while we do not own a bank or a thrift, we do employ broker/dealers as distribution vehicles for our variable insurance products. For our company, the total assets of our broker/dealer are one-tenth of 1 percent of the total U.S. consolidated assets, and much less of our worldwide assets.

Yet, given our understanding of the proposal, the entire AEGON USA, not one-tenth of 1 percent, would be subject to this tax. Like you, I heard from Secretary Geithner that perhaps certain broker/dealers are now to be excluded from this, and that was new to us today, so please take that into consideration.

Other life insurers may own thrifts to carry out trust services which are ancillary to the primary nature of our business. To Senator Kerry's point, if those are immaterial and, again, ancillary to the core business of life insurance, we think that should be noted.

It should also be noted that we are concerned this bank tax could cause competitive distortions among life insurers by imposing a tax on either those who own a thrift bank or broker/dealer or meet the $50-billion size requirement. These companies will be competing with companies who are not subject to the tax, but sell the same products. We are in a very competitive business. I have not seen

a tax that picks apart an industry and does not have unintended consequences.

The Joint Committee on Taxation's background document on the tax recognizes these differences between the regulation of insurers and other financial institutions and notes, among other things, that those life insurers who are assessed the tax will be at a competitive disadvantage in their sector of financial services as a result. We do not believe shifting the competitive field domestically or globally within an industry, in the manner that the Joint Committee itself indicated seemed ambiguous or arbitrary, would be the intent of Congress.

The critical actions taken by the administration and Congress in 2008 and 2009 responded to one of the most precarious economic situations in our country's history. The crisis called for precipitous actions. We all understand and appreciate—and we really do—that the extraordinary actions taken brought stability and improvement to all aspects of the economy, including the various segments of financial services.

As the Senate reviews the Treasury's proposal or considers other proposals, as Secretary Geithner invited you to do, you really need to understand that the life insurance business is fundamentally different than banking. What is a risky practice within a bank may be a risk mitigator within a life insurance company. They are totally different businesses.

We urge you to carefully consider whether it is appropriate to impose this tax on our industry; whether our industry benefitted from TARP disproportionately to other industries; whether it is worth the potential competitive disruption and resulting unintended consequences within the industry; and finally, whether a tax designed for the banking industry can be applied at all to the very different business of life insurance.

Thank you for the opportunity to be here.

The CHAIRMAN. Thank you, Mr. Baird.

[The prepared statement of Mr. Baird appears in the appendix.]

The CHAIRMAN. Senator Grassley?

Senator GRASSLEY. I think, Mr. Baird, the question that I was going to ask, but I will ask it anyway, you just answered. The President proposes to tax insurance companies based on the riskiness of their assets. Your comment on that? I think I expressed my view to the Secretary, that I think this is just a way of raising money, that it is not going to deal with the riskiness of one business versus another at all, or discipline whatsoever. But let us hear your comment precisely on my question about taxing insurance companies based on the riskiness of their assets.

Mr. BAIRD. Senator Grassley, I think it is no doubt possible to find some way of measuring risk of assets relative to our liabilities. It is impossible to divorce risk in our business without considering assets and liabilities together because we match the two together. I think it is possible, but in no way can you use a bank model to go after an insurance company and actually tax it based upon its risk profile. They do not work together.

Senator GRASSLEY. Mr. Sorensen, you heard me express in my opening comments, and you heard several members of the committee talk to Secretary Geithner about the possible impact of the

TARP tax affecting small business lending. Answer how you see it affecting small business lending from the standpoint of Iowa banks.

Mr. SORENSEN. Yes, Senator. Obviously, in Iowa we have a number of community banks, so a number of those would not be directly impacted. But that said, we also have a large bank presence, and you heard some of the percentages mentioned earlier, about 70-some percent of the overall national marketplace of assets of larger institutions that would be impacted by this tax. So, anything that would take those dollars out of the lending community at this point in time I think could be detrimental to small business lending.

In addition, the industry, as you know, Senator, is recapitalizing the deposit insurance fund through a risk-based deposit insurance methodology, and so in addition to any potential additional tax burden, we would have the recapitalization of the deposit insurance fund, which also takes dollars, potentially, out of those local communities that would be available for lending. So, again, the combination of the two may be problematic.

Senator GRASSLEY. All right. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

How can we help small business? I think everybody on this committee wants to figure out some way to give small businesses a break. We have been talking so far about the potential negative consequences of this bank tax, such as it is. Do you have any thoughts on how maybe it could be restructured to give incentive to banks to make small business loans? What if they got a portion of it that was a credit for business loans?

I am just trying to think out loud here. Everything is an opportunity, and I am just trying to see if any of the four of you see an opportunity here to not just prevent harm to small business, but maybe affirmatively, positively figure out a way to help small business.

Mr. Bartlett? Yes, go ahead.

Mr. BARTLETT. Our group believes that taking action to increase small business lending is the most important thing that Congress should be doing today and this summer, and we regret that there has not been the sense of urgency from the administration to cause that to happen. We hope to rekindle that urgency.

We have worked both with the Treasury and with Senator Warner in particular, as well as other Senators, on a capital assistance plan that would provide for an enhanced reserve. It is an extra reserve to enhance small business lending that we believe, with a fairly small amount of money, $1 billion or so—each billion dollars could provide up to $50 billion of additional small business lending. As Secretary Geithner said, it could be run through the States that have these funds in place, but they are unfunded, or have very small funding.

Second is, we have provided to Treasury, SBA, and the Congress 11 specific recommendations of steps that could be taken today by the SBA to increase SBA involvement in small business lending.

Then third, I must say, Mr. Chairman, many of our companies have taken steps unilaterally to increase their small business lending. Bank of America announced an increase of $5 billion in 2010 over 2009; JP Morgan Chase, $4 billion. U.S. Bank is committed

to a second, third, and fourth look at every small business loan to try to get it right, and we have also teamed up with some organizations to send small business owners to places, to incubators, where they can find ways to obtain additional lending. So we think it is the number-one issue facing the economy today and needs to be done.

The CHAIRMAN. I look forward to seeing that list.

Mr. Sorensen or Mr. Chessen, any ideas here?

Mr. SORENSEN. Well, one thing, Senator. Certainly an improving economy certainly helps the small business environment, and we are starting to see that happen. Consumers are more confident. Also, businesses are buying from other businesses, which is an important step. Probably the programs that our members use the most would be the SBA programs, and the enhancements you made to the guarantee, and also the fee reduction changes to the SBA programs have been very helpful.

The CHAIRMAN. Right. I hear a lot of that in Montana, too. That is a big difference.

Mr. SORENSEN. Yes. There are also some things being done at the State level to provide funding in cooperation with lenders to try to get more small business credit available.

Mr. CHESSEN. And I would say, Mr. Chairman, that a continuing frustration continues to be the regulatory burden and the pressure not to make loans. We see added pressure to have greater capital. We see proposals like this tax that adds an extra cost. We see a lot of regulatory burden coming, even with the financial package that is before the Senate now, where we have identified more than two dozen regulatory burdens for community banks.

All those things add to the cost and uncertainty and end up making it more difficult to meet the needs of local businesses and small businesses everywhere. That is our frustration, particularly with this tax that is being proposed. Think of all the small business loans that are not made with a $9-billion yearly tax, not even counting the consequences of what that means for capital.

The CHAIRMAN. Well, that sort of assumes how banks handle the tax. I mean, it is hard to know what they are going to do with it. There is a whole range of possible actions they could take, including cutting back on loans, especially to small business. You think it will all go to cut back on loans?

Mr. CHESSEN. No, I do not think so. You are absolutely right. Also, with the CBO, to Ranking Member Grassley's comments, I think there are many things. I think the first is, investors are likely to take losses. These stocks that are held are widely held. They are in a lot of people's pension plans.

I was shocked to know that in the day that this was announced by the administration, the largest six banks lost $18 billion in market capitalization. Investors moved money very quickly. That affected every pension plan that holds these loans. That is the first impact. It will affect personnel. It could mean staff layoffs in these banks as a consequence of what happens.

We already have unemployment—banks and other businesses have already laid off people. It is naive to believe that it does not get translated into a higher cost of credit or less availability. All those are possible consequences, and frankly none of those are good

for all of us as either stockholders or small businesses in this country.

The CHAIRMAN. Well, you make some good points. The major effort of this committee in the next month or so is robust small business assistance, and I very much hope we can get that passed.

Thank you very much. You all have been very, very helpful. Thank you.

[Whereupon, at 12:41 p.m., the hearing was concluded.]

PRESIDENT'S PROPOSED FEE ON FINANCIAL INSTITUTIONS REGARDING TARP: PART 3

TUESDAY, MAY 11, 2010

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:10 a.m., in room SD–215, Dirksen Senate Office Building, Hon. Max Baucus (chairman of the committee) presiding.

Present: Senators Conrad, Grassley, and Bunning.

Also present: Democratic Staff: Bill Dauster, Deputy Staff Director and General Counsel; Gabriel Adler, Senior International Trade and Economic Advisor; Blaise Cote, Research Assistant; Andrew Fishburn, Detailee; and Mary Baker, Detailee. Republican Staff: Jim Lyons, Tax Counsel.

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The hearing will come to order.

Criticism of the big Wall Street banks is nothing new. Nearly a century ago, Louis Brandeis wrote, "The goose that lays the golden eggs has been considered a most valuable possession, but even more profitable is the privilege of taking the golden eggs laid by someone else's goose. Investment bankers and their associates now enjoy that privilege." Justice Louis Brandeis.

Ninety-four years later, with the financial crisis of 2008, much remained the same. Wall Street bankers still took the golden eggs, and the American taxpayers' goose got cooked.

The financial crisis of 2008 led to the Great Recession, and the financial crisis led to President Bush's bank bailout, the Troubled Asset Relief Program, otherwise known as TARP.

Today we convene our third and final hearing to consider President Obama's proposal for a tax to recoup the losses from TARP. Three weeks ago, we heard from Neil Barofsky, TARP's Special Inspector General. He provided an update on TARP. He explained who had received TARP money and who would probably be able to pay the money back.

Last week, we heard from Treasury Secretary Geithner. He gave us details about how the bank tax would be calculated, he told us to whom it would apply, and he made the case for the tax. We also heard from a panel of financial industry experts. They outlined their concerns with paying the tax.

Today's hearing will help us to address many questions. Who should pay the tax? What is the best way to structure the tax? How

can we best ensure that the tax is fair? How can we minimize unintended consequences?

Our hearings have demonstrated that the financial crisis had effects much wider than the direct costs of the TARP program. The financial crisis resulted in Federal spending to rescue the financial industry, and it resulted in increases in spending for unemployment insurance and assistance to help keep folks in their homes.

Today, we hope to further our understanding of the extent of the economic effects of the financial crisis, and today we hope to learn the true costs of weathering the economic storm. We also delve more deeply into the economics of the bank tax, and we will examine its effects on consumers, on our Nation's economy, and on our financial system.

Douglas Elliott, from Brookings, and David John, from The Heritage Foundation, will discuss the policy and economic implications of a bank tax. Edward DeMarco from the Federal Housing Finance Agency, the overseer of Fannie Mae and Freddie Mac, will give us an update on the status of these two enterprises. We can ask him whether the bank tax should apply to Fannie or Freddie. And Nancy McLernon, from the Organization for International Investment, will tell us how she thinks a domestic bank tax will affect U.S. subsidiaries of foreign financial institutions, and she will give us an update on what the G–20 countries are doing.

When we close our series of hearings today, we will have established a solid foundation to build on as we move forward on the bank tax. There will always be Wall Street bankers taking golden eggs laid by somebody else's goose, but let us consider today whether we can get some of the bounty back for the American taxpayer.

Senator Grassley?

OPENING STATEMENT OF HON. CHUCK GRASSLEY, A U.S. SENATOR FROM IOWA

Senator GRASSLEY. Thank you, Mr. Chairman.

To repeat something that I think I said at each of the other two hearings on this tax issue, I want to make crystal clear that taxpayers should be paid back every penny of TARP losses. The statute that created TARP said that the President is supposed to propose a plan in 2013 to repay taxpayers for any losses from TARP.

However, earlier this year, 3 years before he was supposed to under the statute, the President proposed what he called the Financial Crisis Responsibility Fee. Obviously, in 2013 we will have a much better estimate of the projected TARP losses than we have now this year, 2010.

The President said that one of the purposes of the TARP tax is to repay taxpayers for any losses from TARP. I want to make sure that this actually happens and that it is not just empty rhetoric. Any losses that result from TARP will increase the deficit, which has ballooned under President Obama. Therefore, to pay back taxpayers for any TARP losses, any money raised from the TARP tax would have to be used to pay down the deficit.

If a TARP tax is imposed and the money is simply spent, that does not repay the taxpayers one cent of any TARP losses. It is like getting a raise and saying that you are going to pay down your credit card with the extra money, but then choosing to spend the

money instead of paying down the credit card. It should not be any surprise to learn that your credit card balance did not go down. Saying you are going to pay down your credit card—in this case, the deficit—does not do any good. You have to actually do it.

Many people in the Congress—I think primarily of the Democratic party—are already looking to use the money raised from the TARP tax for spending under the arbitrary pay-as-you-go rules. When I tried to get a commitment from Secretary Geithner on this point, he would not give me one. To me, that was very disappointing. However, I was encouraged that it sounds like the chairman of the Ways and Means Committee and I see the TARP tax the same way.

Martin Vaughan wrote, on May 5th, a *Dow Jones Newswires* column titled, "House Panel Chairman: Bank Tax Plan Not Ready for Prime Time." The column states, "Levin signaled he doesn't favor pairing the bank tax with legislation already pending in Congress, such as the financial overhaul bill or a separate bill to extend expired tax breaks. First, he said, the tax should be used for deficit reduction and not to pay for new spending. 'At this point, I don't think the bank tax is ready to be a pay-for,' Levin said."

Now, in looking at the President's TARP tax proposal, which I understand the President has already felt the need to change, it is interesting that GM and Chrysler, which are responsible for about $30 billion of the projected losses of TARP, are not subject to the President's proposed tax.

Secretary Geithner said that GM and Chrysler were simply victims of the financial crisis and therefore should not be subject to the President's tax. However, Ford did not take any tax money, and they survived just fine. In addition, with GM and Chrysler responsible for such large amounts of tax losses, it seems only fair that they should be subject to the TARP tax to pay back some of those losses.

GM and Chrysler were both invited by Chairman Baucus and me to testify at this hearing and make their case regarding why they should not be subject to the tax, and both declined. Their silence, then, is deafening.

Also, Fannie and Freddie are not subject to the tax. We will explore whether that makes sense at today's hearing. And hedge funds are not subject to the President's proposed tax. Meanwhile, companies that did not take any TARP money are subject to the proposed tax.

The President's proposed tax is so lacking in detail that members of Congress who are being asked to support it are having a very difficult time figuring out how it would apply and who would be subject to the tax.

When I asked CBO to tell me who would bear the burden of the TARP tax, they said that one of the groups that would bear the burden of the tax would be consumers. CBO stated in their letter to me that the President's tax would reduce small business lending.

Under the new version of the tax proposed by the President, small business loans would be considered the riskiest assets held by a bank, and therefore subject to the highest taxes. Considering the 9.9-percent unemployment rate, the trouble small businesses

are having getting credit, and the proposed tax hikes on small businesses, I am very concerned with that aspect of the proposal.

One of the purposes of the tax stated by the President is to reduce risky behavior by financial institutions. However, CBO stated in their letter to me that the TARP tax "would not have a significant impact on the stability of financial institutions or significantly alter the risk that government outlays will be needed to cover future losses."

That is not just me saying it. I hope you all know that the Congressional Budget Office is a nonpartisan organization, and they have come to that conclusion. If the United States imposes a TARP tax and other countries do not, it will make our financial institutions less competitive than their foreign competitors. Of the G–20 countries, Australia, Canada, Japan, Russia, and Brazil are opposed to a bank tax, and South Africa does not want its banks taxed either.

So I look forward to today's testimony, and maybe we can come to some conclusions. But I guess I am looking for a conclusion that, if you want to make sure the TARP bailout is paid back, you have to know exactly how much is owed before you collect it.

The CHAIRMAN. Thank you, Senator.

I would now like to introduce the panel. Our first witness is David John, who is a senior research fellow at The Heritage Foundation. Thank you, Mr. John, for being here. Next, Mr. Elliott. Douglas Elliott, economic studies fellow at the Brookings Institution. Third, Edward DeMarco, Acting Director of the Federal Housing Finance Agency. Finally, we have Nancy McLernon, president and CEO of the Organization for International Investment.

As is our regular practice, your prepared statements will automatically be included in the record, and I urge each of you to summarize your statements in about 5 minutes, 5 to 6. We are kind of easy around here.

So, Mr. John, why don't you go ahead?

STATEMENT OF DAVID C. JOHN, SENIOR RESEARCH FELLOW, THE HERITAGE FOUNDATION, WASHINGTON, DC

Mr. JOHN. Thank you for having me. I am not used to going first. Actually, it is a little overwhelming.

First off——

The CHAIRMAN. Well, do you want the other guy to go first?

Mr. JOHN. No, that is all right, actually. I will take it. I appreciate that. [Laughter.]

Mr. JOHN. First off, let me clarify a little bit of my own terminology. You will find that I use "tax" and "fee" interchangeably, and I do that for a reason, because I thoroughly believe that this is not really a fee, this is a tax. In a sense, what the administration is proposing to do here is to get some of the chairman's golden eggs and move them over to the use of the administration and the government rather than returning them to the consumers where they might have originated.

To a large extent, I think Willie Sutton would be very pleased with this tax because, faced with a situation where the government is running massive deficits already, the administration has gone for its first effort in raising taxes where the money is. Willie Sutton,

of course, was a bank robber, and when asked why he robbed a bank, he is supposed to have said—he used to deny it—that that was why he robbed the banks. I think that taxpayers can be very justifiably angry with banks, and they can be justifiably angry with bankers. I know I personally was furious when the 2008 crisis hit.

However, I am not sure that this proposed tax is an appropriate way to deal with the issue. For one thing, I think, as I say, this is more raising revenue than it is recouping losses, and I say that, to repeat what former Chairman Grassley said about the timing. If this had been proposed in 2013, then I would readily agree that this was a matter of recouping losses because we would know what those losses were.

Second, what concerns me much more is that, while I agree that a 15 basis point tax is not going to be the difference between profitability and non-profitability of any financial institution, the way the administration has proposed to change it concerns me quite a bit.

First off, as has been noted, loans—commercial loans, and that is both small business loans and regular commercial loans—do carry the highest risk-weighting under capital standards. The new way of doing this tax appears to be tracking the bank capital standards as a way of applying it.

What is very concerning to me is that this new tax, if you are trying to recoup the same amount of money, roughly $9 billion a year for 10 years, is going to be divided very differently according to financial institutions based on their risk assets.

You cannot simply say it is going to be 15 basis points across the board after subtracting a few items out. It is likely that the higher-risk items, which include the commercial loans, may be subject to 30 basis points, may be subject to 25 basis points. We do not have that information. Until we have that information, I think it would be irresponsible to make a decision.

There is also an interesting question that in the future there is an international agreement that we are going to change capital standards for all financial institutions. This is a rather crucial move because, the higher the capital standards, the more likely a financial institution can absorb its own losses and therefore not be subject to a bailout in the future.

However, is this fee, whatever level it is going to be, going to be assessed by the bank regulators, which of course is the responsibility of the Banking Committee? Is it going to be assessed by Treasury? Is there going to be consultation? Will the fee be subtracted from the capital standards? This is especially true if, as the administration has said, they want to focus most of the money coming from the top six financial institutions. So, I am very concerned about the way this is structured.

It is also structured in a way that does not apply to insurance companies and certain other types of financial institutions because the terminology and the regulatory technology is different. The whole setup is different.

Finally, there is the question of Fannie Mae and Freddie Mac. Now, I would love nothing more than to privatize Fannie Mae and Freddie Mac and reduce their size to as small as possible, but, until that happens, applying a tax to them is really nothing more

than one arm of the government taxing another arm of the government, so maybe that should be a secondary level.

Now, I listed a couple of other things in this testimony, pointing out, as has already been said, that if this were a recoupment fee it would apply to Chrysler and GM. I find it interesting, since they clearly qualified as financial institutions to come under the TARP program in the first place, then clearly they should be subject to the tax also.

Then there is the question, of course, we are not going to assess it on the HAMP program, the Housing Affordable Mortgage Program, since those people cannot pay their mortgages in the first place, and therefore we certainly should not apply a fee to them. But we need to recognize that that is a significant source of losses, according to CBO, to the overall TARP program.

So, when it comes right down to it, this is an interesting idea, but it is an unformed idea, and it is a policy mistake. There need to be an awful lot of questions that are answered, and answered in significant detail, before this committee or any other should really give it too much serious consideration.

And then last, but not least, there is a question as to whether this tax actually is needed at this point or whether it should be looked at in 2013, as was originally said under the legislation.

Thank you.

The CHAIRMAN. Thank you very much, Mr. John.

[The prepared statement of Mr. John appears in the appendix.]

The CHAIRMAN. Mr. Elliott?

STATEMENT OF DOUGLAS ELLIOTT, FELLOW, ECONOMIC STUDIES, BROOKINGS INSTITUTION, NEW YORK, NY

Mr. ELLIOTT. Thank you for the opportunity to talk about this important topic. As was mentioned, I am a fellow at the Brookings Institution, but I should also mention, before that I spent roughly 2 decades as an investment banker, mostly at JP Morgan, with my clients being financial institutions. At Brookings, I have focused principally on financial institutions, markets, and their regulation, and I have several dozen papers on the financial crisis and financial regulation available.

I strongly support the idea of recovering from the financial industry the losses on the TARP so that taxpayers do not bear the ultimate cost. It sounds like there may be substantial agreement on that here.

It is difficult to see why it would be more appropriate for the taxpayers to bear the cost than the industry, barring some substantial negative effect of imposing the fee. As I will explain, I firmly believe that the financial industry and the economy could absorb this relatively small fee without significant negative effects.

I am less wedded to a particular way of imposing the fee, although I do like the general approach the administration has proposed, since it would help in a modest way to achieve other public policy objectives at the same time. In particular, it is structured to fall most heavily on the firms that represent the most risk to taxpayers going forward and that represented the greatest danger during the crisis.

It is also tilted away from the core lending activities, which are generally supported by deposit money which is exempted. It is, therefore, tilted towards the riskier activities that are less central to economic growth. These are worthwhile goals, although I do view them as secondary to the overall objective of repaying the taxpayers.

Now, opponents legitimately point out that imposing a fee on a bank is likely to cause some of the costs to be passed through to the bank's customers. In particular, they suggest that loans could become more expensive and harder to obtain. They are right directionally, but a review of the facts shows that any effect should be quite small, given the immense size of the financial industry.

The administration is proposing to collect $9 billion a year for a minimum of 10 years. This compares to a core earnings power for the banking industry in basically normal times of approximately $200 billion a year after tax. In addition, non-interest expense, which is mostly compensation, is another $300 billion a year after tax.

So, if you add these two together, you would see that the fee would be less than 2 percent of the $500 billion a year of after-tax income, plus after-tax expenses, again, which is mostly compensation. Two percent appears extremely reasonable, given the scale of aid that we taxpayers have provided the industry. I do, by the way, see this as a repayment mechanism, not a tax, though I do not care too much which particular word we use for it.

Now, comparing this on another dimension, banks and thrifts reported $13 trillion of assets to the FDIC. Thus, the industry could cover the $9 billion fee by charging less than an additional 0.1 percent on each dollar of assets.

Now, in practice, the industry might well absorb, say, half of this by taking what would be a 1-percent hit to income plus expenses, and then pass the other half on to customers. If they do that, they would need to charge approximately 0.05 percent, or 5 basis points, per dollar of assets as an additional charge. For comparison, the Fed would never bother with an interest rate move as small as 5 basis points because the effect on the overall economy would be minor. It usually moves in increments of a minimum of at least 5 times this size.

Now, I notice that industry lobbyists are magnifying the reported effect by aggregating the 10 years of fees into a total of $90 billion as a hit to capital, and then indicating that this $90 billion could have supported $900 billion of lending at a 10:1 ratio of lending-to-capital.

Now, they are broadly correct; however, they could just as easily have indicated that the industry could voluntarily support an additional $900 billion of lending simply by cutting non-interest expense by 3 to 4 percent for the next 10 years, principally by cutting compensation. I notice they have not volunteered to do this.

In addition, $9 billion a year for 10 years has a significantly lower value in today's dollars than simply multiplying 9 by 10 years. Discounting at a 12.5-percent cost of equity would bring this figure down to under $50 billion, making the necessary adjustments even smaller.

In my written testimony, I explain why I believe it is fair for the banks and the other financial institutions that would be in this to pay this fee, even though, on a very narrow definition, the taxpayer will roughly break even on their support of the industry.

The key point is that the government, appropriately, charged much less for its support than the value that this represented to the industry, this unprecedented level of assistance. Simply paying as promised does not automatically wipe the slate clean from a moral point of view. Making sure that taxpayers do not lose money from the TARP, taken as a whole, seems only fair and comes at a very modest cost to the industry in relation to the level of assistance we taxpayers provided. Further, as was noted, Congress has already specified that the costs should be borne by the industry.

I also addressed some of the specifics of the fee in my written testimony, but I will leave that for the Q&A period in the interest of time.

Thank you.

The CHAIRMAN. Very interesting. Thank you, Mr. Elliott.

[The prepared statement of Mr. Elliott appears in the appendix.]

The CHAIRMAN. Mr. DeMarco, you are next.

STATEMENT OF EDWARD DeMARCO, ACTING DIRECTOR, FEDERAL HOUSING FINANCE AGENCY (FHFA), WASHINGTON, DC

Mr. DEMARCO. Good morning. Thank you, Mr. Chairman, Ranking Member Grassley, members of the committee. Thanks for the opportunity to testify on the Financial Crisis Responsibility Fee and the Nation's housing and government-sponsored enterprises, Fannie Mae and Freddie Mac, which I will refer to as "the Enterprises," and the Federal Home Loan Banks.

As this is the Federal Housing Finance Agency's first appearance and my own first appearance before this committee, let me begin by introducing FHFA and myself.

The CHAIRMAN. Well, welcome to your inauguration.

Mr. DEMARCO. Thank you, Mr. Chairman.

FHFA was created on July 30, 2008, upon enactment of the Housing and Economic Recovery Act of 2008, or HERA. This long-sought legislation to reform the oversight of the housing GSEs resulted in the joining together of two separate regulators and the transfer of certain responsibilities and staff from HUD to the new agency. Just 6 weeks into its existence, FHFA put the Enterprises in conservatorship. The financial support provided by the Treasury for the companies in conservatorship came from the HERA statute.

As for myself, I am a 24-year career civil servant. During that time I have worked at GAO, Treasury, and the Social Security Administration, before joining one of FHFA's predecessor agencies late in 2006, just as the housing bubble was beginning to burst. I became FHFA's Acting Director last September.

You have asked me to comment on the President's Financial Crisis Responsibility Fee, and in particular whether this fee should be applied to Fannie Mae and Freddie Mac. We understand that the administration does not intend for Fannie Mae and Freddie Mac to be covered by the proposal and, given the Enterprises' current financial condition and financial support from the Treasury Depart-

ment, I would agree with that view. Subjecting the Enterprises to the fee would not increase revenue to the Federal Government.

FHFA placed Fannie and Freddie into conservatorship in September 2008, before the creation of TARP. In conjunction with the conservatorship action, the Treasury Department provided financial support to the Enterprises through the Senior Preferred Stock Purchase Agreements (Senior Preferred). The Senior Preferred is an ongoing, explicit, and irreversible contractual commitment by the Federal Government to ensure that Fannie Mae and Freddie Mac can meet their obligations by ensuring the Enterprises maintain a positive net worth. Fannie and Freddie have received no TARP funds. Funding authority for the Senior Preferred, as I said, has come from HERA.

The Senior Preferred has worked as intended. Investors have confidence in the Federal Government's commitment to honor these obligations, and investors have continued to support U.S. housing finance through investment in Enterprise securities. As a result, roughly three out of every four mortgages originated last year were guaranteed by the Enterprises.

From July 2007 through the end of 2009, combined losses at the Enterprises totaled $207 billion. During 2009 alone, the Enterprises reported net losses of $94 billion. Their financial performance continues to be dominated by credit-related expenses and losses stemming principally from purchases and guarantees of mortgages originated in 2006 and 2007.

Since the establishment of the conservatorships, the combined losses at the two Enterprises depleted all their capital and required them to draw over $125 billion from the Treasury Department through the Senior Preferred. With the first quarter results now reported by the Enterprises, their combined draws will be roughly $145 billion.

With continuing uncertainty regarding economic conditions, employment, house prices, and mortgage delinquency rates, the short-term outlook for the Enterprises remains uncertain, and they are likely to require additional draws under the Senior Preferred.

The Enterprises already have the obligation to pay a 10-percent dividend to Treasury on draws made under the Senior Preferred. Today, this quarterly obligation exceeds $1 billion for each company, and those dividends are effectively being paid by further draws on Treasury's Senior Preferred, so we are already moving money from one government account to another.

In conclusion, the financial state of the Enterprises today makes them poor candidates for inclusion in a fee proposal because the Enterprises are projected to have continuing losses that will be funded by the Senior Preferred. Any additional fee assessments will add to those losses, resulting in increased draws from Treasury. Applying the fee to the Enterprises would be an exercise in moving money between government accounts.

Thank you for the opportunity to appear today, and I would be glad to answer questions.

The CHAIRMAN. Thank you, Mr. DeMarco. Good beginning.

[The prepared statement of Mr. DeMarco appears in the appendix.]

The CHAIRMAN. Next, Nancy McLernon.

STATEMENT OF NANCY McLERNON, PRESIDENT AND CEO, ORGANIZATION FOR INTERNATIONAL INVESTMENT (OFII), WASHINGTON, DC

Ms. MCLERNON. Good morning.

The CHAIRMAN. Good morning.

Ms. MCLERNON. Chairman Baucus, Ranking Member Grassley, and members of the Finance Committee, thank you for your invitation to testify this morning.

The Organization for International Investment represents the U.S. subsidiaries of many of the world's largest international companies, or in-sourcing companies. In-sourcing companies—these are firms based abroad but investing in the United States—directly employ over 5 million Americans and support an annual payroll in the U.S. of over $400 billion. These American businesses generate 6 percent of U.S. GDP, produce almost 20 percent of total U.S. exports, and pay 12 percent of total corporate taxes.

While OFII member companies include a number of financial institutions, OFII represents a broad cross-section of industries. On behalf of these companies, OFII advocates for the fair, non-discriminatory treatment of U.S. subsidiaries. We undertake these efforts with the goal of making the U.S. an increasingly attractive market for foreign investment and the economic benefits it brings.

The global coordination of a financial institution tax is critical to OFII member companies because they operate across borders. To that end, ensuring that any fee is structured within agreed-upon principles with other developed nations and the G–20 is of great importance and will be the focus of my testimony this morning.

I would like to emphasize four key points. First, the G–20 has not yet achieved consensus on the form, purpose, or use of a financial institution tax. Is the purpose to recoup funds? Should it be used to deter high-risk behavior? Or should the prime focus be on building a fund to be used for future financial crises?

According to an IMF report sent to the G–20 last month, even among the G–20 countries that do support a tax there is no consensus about the type. There is also disagreement about which entities should be taxed, whether all banks, large diversified financial institutions, or insurance companies should be included. In fact, the G–20 is conflicted on whether such a tax is an appropriate element of regulatory reform in the first place.

It is noteworthy, and I think mentioned earlier, that Canada, Australia, Japan, and other major developed countries do not support a targeted tax at all and do not intend to adopt one. Likewise, major emerging markets like China, India, and Brazil are firmly opposed to burdening their financial institutions with a new systemic tax.

Which leads me to my second point. Before adopting a tax, the U.S. and its G–20 counterparts need to understand better how the tax would interact with financial reform initiatives, such as new capital and liquidity rules.

That is why the leaders of the Financial Stability Board and the Basel Committee on Banking Supervision have encouraged the G–20 to undertake further study of these rules before considering a tax. Thus, the G–20 recently directed the IMF to study the poten-

tial effects of a tax, and in particular to closely examine the interlinkages between a tax and proposed regulatory reforms.

Third, an uncoordinated approach would hamper recovery efforts. While recovery efforts have been effective to date, we are not yet clear of this crisis. Introducing a new, uncoordinated tax would create a headwind in the face of our economic recovery and discourage investment.

The G–20 has recognized at each of its summits that uncoordinated, unilateral action encourages arbitrage. Given that financial markets are global, institutions may respond to a U.S.-only tax simply by offshoring activities to markets that do not impose the tax. This would remove significant amounts of capital from the U.S., which would materially diminish lending and could slow U.S. economic recovery.

Additionally, if the U.S. moves alone on a tax it would tilt the competitive playing field against institutions located in the United States, including U.S. subsidiaries of companies headquartered abroad.

Finally, if the U.S. nevertheless decides to impose a tax unilaterally, it should be structured so that it does not discourage worldwide investment in the U.S. In particular, a tax on in-sourcing financial groups should not be based on their worldwide operations.

Historically, the United States has taxed all in-sourcing companies on income derived from the U.S. An in-sourcing financial company's liability for a financial tax should be similarly limited in order not to fail a standard of fundamental fairness.

For example, if a U.S. subsidiary of a German-headquartered financial institution was taxed in the U.S. on its worldwide operations, it would face significant double taxation should Germany decide to tax its own financial institutions. In response, Germany may decide to even retaliate against U.S. institutions. And what if France decides to get in the game? You can see how an uncoordinated approach can have a multiplier effect on global institutions.

The threat of double tax on in-sourcing financial institutions would discourage their investment in the U.S. and impact available capital. What is at stake? According to government statistics, the U.S. operations of international companies hold almost 30 percent of total U.S. commercial and industry loans.

In conclusion, given the possibilities of arbitrage, contradictory regulations, and adverse competitive impacts, OFII believes the U.S. should only implement a tax when other major financial centers are prepared also to adopt comparable measures. Going alone is not in the United States' interests in this globally interconnected economy.

Thank you. I welcome any questions.

The CHAIRMAN. Thank you very much.

[The prepared statement of Ms. McLernon appears in the appendix.]

The CHAIRMAN. Mr. Elliott, I think you hinted, and I would just like more precise testimony, on how much benefit the banks have received, given all the assistance that they have been given, whether it is TARP money that they received, even support for Fannie and Freddie, which is expected to be about $400 billion.

The first stimulus bill was about $125 billion. The Recovery Act authorized $800 billion over 10 years. Add to that the Federal Reserve, which put in place a number of emergency credit programs, which offered up to $1 trillion in assistance at the peak of the crisis. Add to that how much the Federal economy contracted. The figure I have is by about 2 percent of GDP, or $300 billion, in 2009. Automatic stabilizers are expected to add about 2.5 percent of GDP to the Federal Government in both 2010 and 2011.

So in all, is it not true that trillions of dollars, Americans' tax dollars, were put on the line to reverse the damage caused largely through the risky investment and lending practices of the financial institutions? Therefore, the direct cost of the proposed tax is much less than the cost to the entire economy given the financial collapse.

Mr. ELLIOTT. Yes, I do agree with that. First of all, there is more in my written testimony, but to answer your question here, it is difficult to be precise. However, there were trillions of dollars of taxpayer money put on the line. First of all, guaranteeing Fannie and Freddie is a guarantee of over $5 trillion of mortgage assets, just that alone. The Federal Reserve is backing up the securitization market. We put hundreds of billions of dollars directly into the banking industry, as you know, and did that at a below-market price, appropriately and deliberately.

We have provided guarantees of hundreds of billions of dollars of additional debt taken on by the banks under the Temporary Liquidity Guarantee Program. We have guaranteed money market fund assets. I cannot even, in the time we have here, go through all the programs. It is many trillions of dollars.

It is difficult to know what the value of that was for the industry, but I have to believe it was well over $1 trillion because, if we had not taken those actions, the meltdown that was bad enough that we experienced would have been significantly worse. It would have come through in securities prices and the values of loans, and these are very predominantly held by the organizations we are talking about imposing the fee on.

The CHAIRMAN. And is the same principle true even after, say, GM pays back some of its TARP money, and even though AIG pays back some, and I presume that Fannie and Freddie are going to finally get out of that hole. Given all that, is it true that the bank tax of roughly $9 billion a year is much less than the benefit that the banks have received generally because of U.S. taxpayer assistance given to the economy, even after some of those institutions have repaid those funds back to Uncle Sam?

Mr. ELLIOTT. Absolutely. The likely loss on the TARP is something in the neighborhood of $90 billion. I think the size of this fee is roughly appropriate. The value to the institutions we are talking about imposing the fee on, again, it is difficult to quantify, but I am confident it was well over $1 trillion if you compare it to the alternative if we had not taken those actions.

The CHAIRMAN. What do you say to Ms. McLernon's point, that my gosh, if we impose this now we are going to be shooting ourselves in the foot because other countries are not imposing the same fee?

Mr. ELLIOTT. Well, I would say two things. First of all, as I am sure came through in my general testimony, many of the theoretical concerns that have been raised are not, to my mind, significant practical concerns because the size of this fee is so small compared to the size of the industry.

Second of all—and I have talked to officials of many of these countries—the countries that are opposed to the tax are the ones that did not have to rescue their industries or that had to do very little. To my mind, this is a recoupment mechanism. This is the same type of thing that is being proposed for the resolution mechanism on the financial reform bill. That is, we will not require any prefunding, but we will agree that the industry will be charged to recoup it afterwards. To my mind, that is all that is happening here, and it was made explicit when Congress passed the Emergency Economic Stabilization Act that established TARP.

So, clearly there are many details to be worked out, there are legitimate arguments on both sides, but the general principle of recouping this money starting soon, I think, is a very strong one.

The CHAIRMAN. All right.

Senator Grassley?

Senator GRASSLEY. None of you addressed something that the President proposed about the tax on the insurance companies. He is proposing to tax insurance companies based on the riskiness of their assets. Although the concept of risk-weighting of assets is common in the banking world, it is not common in the insurance world. So, I want your opinion of whether or not you agree with that proposal or if it is misguided.

Mr. ELLIOTT. May I, Senator?

Senator GRASSLEY. Yes, you can.

Mr. ELLIOTT. Risk-weighting of assets is actually quite common in the insurance industry. When you look at the regulatory structure, they have a risk-based capital structure that is particularly relevant for the life insurers, but also applied to property/casualty insurers, so this is actually not an alien concept to the insurance industry.

Mr. JOHN. I am going to slightly disagree, in that I agree with Doug's general statement, as I usually agree with his general statements. I just do not always agree with his conclusions. But the application in the banking industry is very explicit. There is a very detailed form that financial institutions, regulated by the bank regulators, must fill out that dictates to them how each asset class must be treated, et cetera.

You cannot simply lift that out and drop it into the insurance industry, because they use different accounting methods, they use different regulatory methods, et cetera. So while I agree with Doug's general statement, I think the actual application would be very difficult and very confusing.

Senator GRASSLEY. All right.

I will ask Mr. John and Mr. DeMarco about what you have talked about a lot, but I want to get something specific on the record. The Congressional Budget Office estimates that the Federal taxpayer bailout of Fannie and Freddie will cost $389 billion by 2019. What responsibility do Fannie and Freddie bear for the financial crisis? Since the President's proposal is meant to target

those responsible for the financial crisis, should Fannie and Freddie not be subject to the President's proposed tax, and I would say by the year 2013, not right now?

Mr. DEMARCO. Senator, clearly, the collapse of Fannie Mae and Freddie Mac, their being placed in conservatorship, the Senior Preferred agreements that Treasury has put in place that have provided substantial financial support to the companies, have come at a cost to the taxpayer, and it is clearly a key part—a part—of the story of the country's financial crisis of the last few years.

That being said, the recoupment of those expenses, I believe, is something that needs to be considered in a larger context. I certainly, as the conservator of Fannie and Freddie, am very much looking forward to the administration and the Congress getting together and working on a comprehensive approach to housing finance reform.

If, in that context, Congress and the administration think it is appropriate for the country that there be some consideration of the taxpayer expenses that supported housing finance in the last few years, I believe that is the context in which to consider that question.

As I set forth in my opening statement, to assess this particular fee at this time to Fannie and Freddie would not accomplish anything in terms of increase in revenue to the government.

Mr. JOHN. I also agree that Fannie and Freddie had a significant role in causing the 2008 financial crisis. I think, however, that many other types of institutions that are not subject to this fee, ranging from the credit rating agencies to, frankly, some of the monetary policy actions of the Federal Reserve, to a wide variety of other entities that are out there, had equal roles in causing the 2008 crisis.

That points out to me even further that what this is is not really anything that is aimed at recouping the cost of the 2008 financial crisis. This is really nothing more than a tax on significant financial institutions. I am very concerned that, once the principle has been established, whether it is 15 basis points across the board or whether it is risk-weighted, as the administration now proposes, that it is going to be frightfully easy to raise that to ever-higher levels in an effort to close an already staggering budget deficit.

Senator GRASSLEY. Does anyone on the panel disagree with what Ms. McLernon said? I think you said this: if the United States imposes a TARP tax and other countries do not, it is going to make our institutions uncompetitive with foreign competitors. That is your position, right?

Ms. MCLERNON. Well, that it would make the companies that are invested in this country, including U.S. subsidiaries of foreign companies, uncompetitive with others around the world.

Senator GRASSLEY. All right. And is there any disagreement by anybody on the panel on that point?

Mr. ELLIOTT. Yes, I do. Not because of the direction, but simply the magnitude of this is so small compared to the industry that I do not think it will significantly affect competitiveness.

Senator GRASSLEY. All right. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Grassley.

Next, Senator Conrad?

Senator CONRAD. Thank you, Mr. Chairman, and thank you for holding this series of hearings. I think they are very important, and you have had really excellent witnesses.

As I look back on what happened, it seems to me that it was a confluence of factors that led to the collapse: an overly loose monetary policy under the control of the Federal Reserve, abnormally low interest rates from 9/11 going forward, an overly loose fiscal policy under the control of the Congress and the administration, massive Federal deficits even in good economic times, coupled with an air of deregulation that meant there was nobody watching the store with respect to AIG and derivatives. In addition to that, subprime loans being made. By the way, Fannie Mae did not make those loans. Fannie Mae bought them, as did Freddie. In a way, they were victims of this collapse as much as anything.

That is not to say that there were not serious policy errors that were made with respect to Fannie and Freddie, because clearly they did have an implicit Federal guarantee that became explicit. Really, to hear how big the hole is with respect to all of these elements is sobering, indeed, and ought to be for all of us.

As I look at it, this overly loose fiscal policy, overly loose monetary policy created the seed bed for bubbles to form. What we got were a series of bubbles. It was not just a housing bubble. We got an energy bubble, with oil prices over $100 a barrel. We got a commodity bubble, with wheat prices over $20 a bushel, virtually unheard of. So you had a series of bubbles form, and when bubbles burst there is economic wreckage, and we have it in spades.

So the question now is unwinding it all. First of all, we had to provide enormous liquidity to the system to prevent a global financial collapse. We came perilously close to that, I believe, but it was averted. That is something the Federal Reserve deserves some credit for, the previous administration deserves some credit for, the current administration deserves some credit for, Congress deserves some credit for. But we are not out of these woods yet.

So, what more needs to be done? Well, clearly, given the fact that one in every six workers is either unemployed or under-employed, we have to continue to provide liquidity, but very soon we have to pivot and we have to focus on the growing deficit and debt like a laser.

That takes me to the question of, what are the funding sources necessary, combined with spending cuts, because both are going to be necessary? There is going to need to be additional revenue; there is going to need to be spending cuts. That is going to be tough medicine, but it has to be done in the interest of this country, otherwise we will be Greece sometime in the future.

Mr. DeMarco, Fannie and Freddie continue to make draws, as I hear it, $145 billion through this quarter? Is that the correct number?

Mr. DEMARCO. That is correct, Senator, with the first quarter financials that Fannie reported yesterday and Freddie last week. When the draws made based on that are done, it will be about $145 billion combined.

Senator CONRAD. So, if this fee were imposed on Fannie and Freddie, it might feel good to us—I am kind of attracted to that part of it—but it is just money going out of one pocket of the gov-

ernment into the other pocket of the government. Is that not the case?

Mr. DEMARCO. That is correct, Senator. It might sort of be akin to rocking in a rocking chair. It does feel good, but it does not get you anywhere.

Senator CONRAD. Yes. It does have a certain, I do not know, rough justice to it that they pay, along with everybody else who has benefitted by this set of policies, but you do not actually move anything. I mean, you are stationary. You are moving money around, but it is from one government pocket to another.

Mr. DEMARCO. I mean, certainly, Senator, the shareholders in both companies have taken their loss in the collapse of the companies. The executives at the companies have absorbed their losses. Most of the senior executives at each company are no longer there. Much of their compensation was in the form of company stock, which is now not worth much. Frankly, the employees at the companies have taken a hit as well, and for them some of their retirement has also been in company stock.

Senator CONRAD. So, from your standpoint, what does make sense in terms of filling the hole? Because on the TARP, $700 billion was authorized. We now know we are going to get over $600 billion of that back. That is the current estimate by CBO, that we are going to get more than $600 of the $700 billion authorized back. It leaves a hole of about $90 billion. What do you think would be the appropriate burden sharing here?

Mr. DEMARCO. Senator, with respect to the broad recoupment of TARP, I really do feel like that is beyond both my responsibility and expertise, but I have reviewed not just the statements of the panelists here with me today, but prior testimony, and I think that the committee has been given a pretty balanced set of perspectives on both the pros and cons of this particular fee, the potential unintended consequences.

I would add only that I do think that the actual costs—I mean, you focused on this $600 billion out of $700 billion being repaid. I think that the actual cost really is still to be determined, and that the component parts that make up this $90- or $100-billion projected gap still are left to be determined. The HAMP program, the Home Affordable Modification Program, makes up about half of that, and it is too early to know what the actual ultimate cost of that will be.

Senator CONRAD. All right. My time has expired.

The CHAIRMAN. Senator Bunning?

Senator BUNNING. Thank you, Mr. Chairman.

Mr. DeMarco, your testimony states that, in the first 2 years of the housing crisis, losses from Fannie and Freddie totaled $207 billion. Since that figure only covers losses through 2009, I assume it does not include the $10 billion recently given to Freddie and the over $8 billion that was just requested by Fannie Mae.

Mr. DEMARCO. That is correct, Senator. My testimony was required by the committee before Fannie Mae had filed its first quarter financial statements, so I was not able to provide that in my written statement.

Senator BUNNING. Do you have any idea when the open-ended taxpayer bailout of these GSEs will stop, and will Fannie and Freddie ever be able to repay the taxpayer?

Mr. DEMARCO. Senator, I do not know what the ultimate cost of this will be. As I said in my opening remarks, the dividend that each company owes to the Treasury on a quarterly basis, the amount of money drawn, already exceeds $1 billion a quarter. So for this quarter, Freddie owed $1.3 billion in dividend payment, Fannie owed about $1.5 billion.

Now their draw is about to go up again, so those dividend payments will go up next quarter. The ability to make those dividend payments is itself challenging and, as I said in my opening remarks, is effectively being paid by taking down yet more money. So they are struggling to make the dividend payments, and that says nothing about principal payment to pay down on the approximately $145 billion that has been drawn.

Frankly, Senator, I think we are all looking forward to the administration and the Congress coming to a final resolution about the future of the country's housing finance system, and in that context an ultimate resolution of Fannie Mae and Freddie Mac that will be the final determinant of the kind of question you asked.

Senator BUNNING. In other words, you do not know.

Mr. DEMARCO. Senator, the actual cost, I do not know.

Senator BUNNING. Nor do we. That is why I asked.

Mr. DEMARCO. Senator, I would like to add, though, because I do think that this is important for both the committee and the public to understand, that with the two companies in conservatorship, FHFA, as conservator, is focused on a daily basis on doing everything we can, and working with the companies, to minimize the losses that are going to be incurred.

A lot of that goes to efforts on foreclosure mitigation to try to find ways of working through these seriously delinquent loans in a way that minimizes the cost to the company, and hence to the taxpayer. But these losses are the realization of losses on mortgages that were made earlier in this decade.

Senator BUNNING. When you appeared before the Banking Committee some time ago, I asked you whether an Inspector General had been appointed for Fannie and Freddie. At that time you stated that the White House had not responded to your repeated requests for an Inspector General. Is there any ongoing progress you could report from the White House on this very urgent issue?

Mr. DEMARCO. Senator, I am actually very pleased to report positive progress on that point. Recently, the White House, in fact, nominated an individual, a career official at the Justice Department by the name of Steve Linick, to be the Inspector General for the Federal Housing Finance Agency. Mr. Linick's nomination has been forwarded to the Banking Committee, and I am looking forward to the Banking Committee acting upon that nomination.

Senator BUNNING. Last week, the *Wall Street Journal* reported that 96.5 percent of American mortgages are now government-backed through GSEs, FHA, or the Veterans Administration. Is that an accurate number, 96.5?

Mr. DEMARCO. It seems a little high for the current flow of mortgages, Senator, but it is clearly quite substantial. So, if it is off, I

do not suspect it is off by much. That is for new flow. We are talking about new production.

Senator BUNNING. With the way government-backed mortgages dominate the market, is there any hope of having a private sector secondary mortgage market in the United States in the near future?

Mr. DEMARCO. I believe that there certainly is the prospect of getting there, Senator. By the near future, I think that what this requires is, it requires the administration and the Congress to assess, what is the government's proper role in the housing finance system going forward?

Once we know the government objectives and government role, including the extent to which the Federal Government wants to be in a credit loss position with respect to mortgages, then we need to figure out, what are the going-forward institutional arrangements to most efficiently and effectively assure liquidity and stability in the Nation's mortgage market.

I personally, Senator, believe that this can be done with private companies and with private risk equity, but, before we get there, policymakers do need to make some fundamental determinations about the appropriate role of the government and the objectives of the government, the public policy objectives of the government with respect to housing finance. From there, I believe that we can then legislate changes that will get us a housing finance system that will take us into the future.

In the meantime, what we have today, including the FHA, Fannie Mae, and Freddie Mac, is essentially the country's housing finance system, and to ensure stability for our economy, to ensure our citizens are able to continue to buy homes, sell homes, refinance their mortgages, what we have right now needs to continue to function in order to provide that stability to our economy.

Senator BUNNING. I have just a couple more questions, Mr. Chairman, if that is all right with you.

The CHAIRMAN. Go right ahead.

Senator BUNNING. Thank you.

To Mr. John, according to the testimony this committee received, the administration's plan to use TARP for mortgage modification will result in almost a total loss to the Treasury. Would it have made more sense to consider this program part of fiscal spending policy rather than part of TARP?

Mr. JOHN. Well, probably it should have. When it comes right down to it, the TARP program was not really set up to deal with either the auto industry or individual mortgage modifications. The House and Senate Banking Committees have tried, on any number of occasions, to set up ways to modify mortgages, all of which have been rather stunning in their lack of success. This was just one more opportunity to give it a try, and it has been about equally successful.

Senator BUNNING. Ms. McLernon, will international finance firms be less likely to create jobs in the United States if the administration's bank tax is enacted, especially if our trading partners do not do the same? Are you aware of countries that have already rejected the idea of a bank tax?

Ms. MCLERNON. Yes. Thank you, Senator. There are several countries that have already rejected a bank tax, and I do think that having the U.S. act alone will encourage a couple of different things. Number one, it will encourage offshoring of activities to a market that does not impose such a tax.

Despite what Mr. Elliott said earlier, regardless of how small it is, nobody wants to leave themselves vulnerable to double taxation. No one wants to pay their tax bill twice. If the U.S. acts alone without seeing the full scope of what G–20 countries can agree to on underlying principles of a tax, I do think that it will reduce investment from financial institutions based abroad in the U.S. They would have a disincentive to invest here

Moreover, many in-sourcing companies among my membership are within the U.S. to fund their activities here, so it could have a multiplier effect on the economy overall by reducing the amount of capital in our market.

Senator BUNNING. And other countries rejecting the idea of taxes, bank taxes?

Ms. MCLERNON. Yes. Canada, Australia, Japan, and the BRIC countries, including Brazil, Russia, and India, have expressed strong reservations about a tax. In addition, Singapore and Switzerland, two non-G–20 countries with major attractive financial centers, have also voiced concerns.

Senator BUNNING. Thank you, Mr. Chairman, very much.

The CHAIRMAN. Thank you. Thank you, Senator.

It just strikes me that there is just something that does not connect here. If you look at the amount of funds that banks received and paid back on their losses and compare that with the bonuses that those same companies paid in those years, they are a little out of whack.

For example—this is according to a report by New York Attorney General Andrew Cuomo—in 2008, the nine original TARP recipients received $225 billion in the first tranche of TARP funds, and lost a combined $81 billion, and paid $32 billion in bonuses. So in the same year that these nine institutions lost $81 billion, they still found a way to give more than 800 employees bonuses exceeding $3 million each, and almost 4,800 employees bonuses exceeding $1 million each.

So, if in the worst year our economy faced since the Depression, the financial industry can create a bonus pool of over $32 billion, do you believe that the industry would have trouble absorbing a $9-billion annual tax to pay back the American taxpayer, to pass along the cost to individuals and small businesses? Mr. Elliott?

Mr. ELLIOTT. No, I do not believe they would have significant trouble. As I was pointing out, if you look at total compensation just on commercial banks, that does not include investment banks as part of that. It does not have investment banking arms of commercial bank operations like JP Morgan. You are talking about $300 billion, even on an after-tax basis, of non-interest expense, of which about $200 billion is compensation.

The CHAIRMAN. What about Fannie and Freddie, Mr. DeMarco? I am a little concerned about the bonuses paid to Fannie and Freddie executives, current and prior. Was there any recoupment there?

Mr. DEMARCO. Mr. Chairman, when the CEOs of each company left the companies at the time of conservatorship, and the senior officers with them left, they took nothing with them. We used authority Congress had given us with respect to golden parachutes. There, as I mentioned earlier, much of their compensation prior to conservatorship had been in the form of company stock, and the stock prices have collapsed, so there has been cost there.

With respect to the current employees, a couple of things I would point out. The first is that, for the senior officers of the company, total compensation is down 40 percent from pre-conservatorship levels. One of the single biggest risks that I deal with, Mr. Chairman, with respect to overseeing the companies in conservatorship, is ensuring that we are able to attract and retain capable talent to be able to run these two institutions with $5.5-trillion worth of obligations while we work through the country's housing crisis and we consider the future of these companies and the housing finance system.

The folks who are working at these companies now have a great deal of uncertainty about the future of their employer, because it is in the hands of Congress to determine what the post-conservatorship outcomes will be. In the meantime, there is a great deal of stress working through the problems of the housing crisis and the substantial delinquencies that we have.

We have tried very hard as conservator to strike an appropriate balance, to see substantial reductions in compensation, to restructure compensation in a much more appropriate way. We have worked very closely with the Special Master for TARP compensation in doing that, but we are also working to make sure that we have appropriate talent still at the companies to be able to operate them during this time of great uncertainty.

The CHAIRMAN. What about prior executives, 2 or 3 years preceding the collapse? They paid themselves a lot of money, and that is also the time when there were some accounting irregularities.

Mr. DEMARCO. Yes, Mr. Chairman, that is correct. Now, with respect to going back to the accounting debacles, one of the predecessor agencies for the Finance Agency, the Office of Federal Housing Enterprise Oversight, took administrative action with respect to the CEOs and several of the senior executives at each of those companies and reached settlements with each of them that did involve the repayment of millions of dollars.

The CHAIRMAN. Frankly, I thought it was an outrage, what they were paying themselves, given what they were doing at the time, and as a GSE at the same time.

Mr. DEMARCO. Mr. Chairman, I am not going to disagree. I think that that is quite true.

The CHAIRMAN. Thank you.

Some raise the question that this fee might impede small business loans. I would like one of you to address that. Maybe you, Mr. Elliott, Mr. John, or somebody, the degree to which this is going to.

Mr. ELLIOTT. Sure. Probably we each should, since I think we have somewhat opposing views on this one.

The CHAIRMAN. All right. Why don't we get both then? Both of you, then.

Mr. ELLIOTT. From my point of view, again, we are talking about such a small figure when you look at what is likely to be passed through, because I do believe some will be absorbed in terms of a hit to the shareholders, and very modest compensation reductions. I think, on average, you are looking at maybe a 5 basis point pass-through. That is so small, even if it did flow through directly to small business, they are not going to notice that in terms of, they are paying 8, 10 percent anyway, possibly higher.

So, there has to be some effect if there is any pass-through; I do not think it is large. If this were a sufficiently large concern for you, even though I do not personally believe it needs to be, it is certainly possible to exempt small business loans or reduce it by 50 percent or something.

The CHAIRMAN. All right.

Mr. John?

Mr. JOHN. I would point out that it is one thing to apply 15 basis points across the entire banking industry, but the administration says that they want to focus it on 50 financial institutions and to get most of the revenue from 6. Among those six, you have some of the larger commercial lenders.

To the extent that this fee is divided off according to risk levels using the standard banking capital guidelines, you are going to find that it is most completely applied, whether that is 15 basis points, as I said, or 25, or 30, or whatever, to the commercial loans of all size of those particular financial institutions.

Now, those financial institutions do a substantial amount of direct lending, and in certain cases they will find that specific products are no longer profitable, and therefore they will not offer them. They are not required to, after all.

But on the other hand, they also provide loans to smaller financial institutions, and the cost of that, as Doug has said, is going to likely be passed on to them, so you can expect that there will be some effect. We do not know precisely what the effect is until we examine the balance sheets of, in particular, those six major financial institutions and get more data from the administration on precisely how they mean to apply that. But I think it would be a mistake to just simply assume that there will be no effect whatsoever.

The CHAIRMAN. I do not know if anybody is expecting no effect. Why could they not take some of it out of their bonuses?

Mr. JOHN. Well, the problem with the bonuses is—and I am not defending the bonuses; I was just as appalled as anyone else—it is important to remember that in 2008, especially among the initial TARP recipients, the numbers that you cited there, that a significant amount of those bonuses were required by contracts, so it was not quite the same as most of us have a view of bonuses as something that is strictly discretionary according to the employer. In many cases, in financial institutions it is not necessarily discretionary, it is in the contract in some form or another.

Yes, you can move from one thing to another, but that is not the way financial institutions work. What they will do is to price particular products. If you increase the marginal cost of a particular product, which is the way that the administration's new version of

this bank tax would be applied, that is going to mean that certain products are going to be offered less than others.

You cannot just simply say to them, well, what we are going to do is to tax a certain portion of your compensation. Of course, if that is your goal, then that would be one way that you could structure such a tax, but that is not the way this one is being set up.

The CHAIRMAN. Yes. I just wonder sometimes if the way financial institutions, especially investment banks and large banks, structure their compensation plans, partly, leads to some of the unnecessarily risky bets and decisions that some of those institutions make.

Mr. JOHN. Oh, I am sure it does.

The CHAIRMAN. Just to fatten up their bonuses.

Mr. ELLIOTT. If I might say one thing in that regard, just quickly. A good thing is, given that what the banks usually do is to take their revenue pool and divide it up between the shareholders and the employees roughly 50–50, anything that reduces their revenues net of this fee is almost automatically going to be split to some extent, with employees taking a substantial portion of it.

The CHAIRMAN. All right. Go ahead.

Ms. MCLERNON. Mr. Chairman, I just wanted to add the point that, again, despite how small a tax may be in the U.S., we are in a global market, and companies will be subject, or could be subject, to tax all over the world if things are not structured in some sort of coordinated way, which, as I explained earlier, could lead to a multiplier effect.

So, I do not see how it would not impact small business loans, the capital markets in general, if things are not done in a coordinated way so that each individual country can act independently, but within agreed-upon guidelines. The G–20 is set to meet again in June in Toronto. They have asked the IMF to study this issue, and I expect some sort of draft report back from them in June.

Given that we do have until 2013, by law, to recoup the funds, it seems worth it to take the time to see what the IMF says, to see what the G–20 says, and for the U.S. to show leadership in this regard. If it acts alone, and then other major countries start to act alone, we could have a multiplier effect that would affect all business loans, not, of course, just small business.

The CHAIRMAN. Well, the U.S. could show more leadership by leading, by acting. If we sit around and wait for all these other countries to agree, my guess is, not much is going to happen. A lot of countries look to the United States for leadership. If the United States does something, it is reasonable and leads, I think, to a good chance that other countries will take note of that and try to figure out a way to do something that is similar, if not exactly the same. So sometimes you have to step up and lead, but you have to talk while you are leading and listen while you are leading, but you have to take some action, too. One could make that argument, it seems to me.

Ms. MCLERNON. Right. I certainly see your point, but there are different ways to lead. If the U.S. decides unilaterally what piece of the pie that they want, and other countries want a similar piece, then that will have an effect on the capital markets that I do not think that we are looking to have occur. Once again, companies, no

matter how small, given that we live in a global economy, may just decide to offshore certain activities out of the U.S.

The CHAIRMAN. Well, if they are small, they are not going to get hit. They are not going to get hit by this tax.

Ms. MCLERNON. Well, I am saying no matter how small the tax.

The CHAIRMAN. But I am talking about, it only hits the largest companies. It only hits a few companies, not very many. Not very many. All right.

Mr. DeMarco?

Mr. DEMARCO. Mr. Chairman, thank you. Just one other, somewhat related, observation. This last set of exchanges has really gotten to the incidence of the tax, if you will, on certain assets or activities that a bank would take if subject to the tax. I would observe that we are still waiting to see the actual details of the assessment base, but there is another set of institutions FHFA oversees, and that is the Federal Home Loan Banks.

The Federal Home Loan Banks provide funding to institutions that may be subject to this fee, and since the assessment base appears to be risk-weighted assets minus some specific liabilities (including deposits), there is a question about—15 basis points does not sound like much, and it is not in many contexts, but it certainly could have an important impact on the relative cost of different types of liabilities on a bank's balance sheet that might cause it to alter its funding.

The CHAIRMAN. That is a good point. Also, I think the question I think either Senator Bunning or Senator Grassley raised about the effect on insurance companies too, they are different institutions that are affected differently. We have to do the best we can to make sure that this is tailored and designed the right way that is fair to everybody.

All right. This has been very helpful. Thank you very much for the hearing.

The committee is adjourned.

[Whereupon, at 11:28 a.m., the hearing was concluded.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Statement of

Patrick S. Baird

Chairman, AEGON USA, LLC

On Behalf Of

The American Council of Life Insurers

Before The

Committee on Finance

United States Senate

May 4, 2010

Mr. Chairman, Ranking Member Grassley and members of the Committee, my name is Patrick Baird and I am Chairman of the Board of AEGON USA and Immediate Past Chairman of the American Council of Life Insurers (ACLI). I am here today on behalf of ACLI, the trade association for U.S. life insurance companies. The ACLI represents more than 300 legal reserve life insurer and fraternal benefit society member companies operating in the United States. These member companies represent over 90% of the assets and premiums of the U.S life insurance and annuity industry.

I appreciate the opportunity to appear before you today to share our views about the Administration's proposal entitled, Financial Crisis Responsibility Fee. The Administration's description of the proposal is brief, but as I understand it, the proposed tax would apply to banks, thrifts, bank and thrift holding companies, brokers and securities dealers, as well as US companies owning or controlling these types of entities on January 14, 2010. It is not applicable to those entities with consolidated assets of less than $50 billion. The fee or tax is applied to liabilities with an exclusion for certain liabilities at the rate of 15 basis points.

The proposal cites two reasons for the tax: First, to repay the costs incurred by the Federal government to inject funds into the financial system, guarantee certain types of securities and purchase securities from weakened financial institutions and second, to deter excess leverage for the largest financial firms, many of whom were primarily responsible for the economic meltdown.

Given the stated reasons for the tax by the Administration, it is unclear why the life insurance industry has been included. Generally the answer we get when we ask the question why insurers are included in this tax is that AIG played a very significant role in the economic downturn and financial crisis. We don't disagree with that assessment. However, it is important to emphasize that while AIG is an insurance company, AIG is/was actually a multi-faceted entity with many business units in addition to its insurance business, and its life insurance and property casualty business was and remains highly regulated by the states. Therefore, AIG should not be used as the benchmark for the life insurance industry.

Life insurers' primary purpose is to accept and spread risk from policyholders and to fulfill promises made to policyholders. To meet these obligations, we maintain reserves and surpluses through conservative and careful investments in full compliance with existing state laws regulating the industry. This is why during the near meltdown of the economy, while our industry was negatively impacted like every other in the U.S., life insurers paid their claims and obligations, and remained stable despite the investment behavior of others within the financial services community.

As formulated, the tax would apply to those life insurers with assets over $50 billion who happen to own banks, thrifts or broker-dealers, whether they received Federal assistance or not. Regardless of the size of their bank, thrift or broker-dealer, the overall assets of a company would be taken into account on a global basis when determining the amount of the tax. Because their reserves and statutory surpluses can be very large, a significant

number of life insurers – not only publicly traded companies, but mutuals, fraternals, and reciprocals – would be swept into the tax.

As previously stated, life insurers invest carefully in order to have the funds in the future to pay policyholder obligations. While some insurers may own a bank, thrift or broker-dealer, these are generally small parts of their business operations. For example, life insurers engaged in the variable annuity or variable life insurance business often own a broker-dealer to facilitate the distribution of these contracts, and some life insurers own thrifts to carry out trust services. We believe these operations are ancillary to the nature of our business, especially when compared to our primary purpose of insurance, and therefore are not sufficient basis to lump us together with companies whose primary purpose is banking. This tax would penalize those companies who have chosen a certain business model in which to best serve their policyholders.

Life insurers provide a service that sets us apart from all other sectors of the financial services industry. Life insurers make long-term commitments to their customers to provide life insurance, disability insurance, long-term care and annuities. Each of these commitments is substantially different than the obligations undertaken by banks or other financial institutions. To ensure that insurers have the ability to pay those claims decades out, life insurers are subject to a system of state regulation that focuses on protecting consumers through asset-liability matching, cash flow testing, solvency regulation and state guarantee funds.

The imposition of the tax will create a competitive imbalance within the industry by imposing a tax on those insurers who have a bank, thrift or broker-dealer. These companies will be competing with companies who are not subject to the tax but sell the same products. The Joint Committee on Taxation background document on the tax recognizes these differences between the regulation of insurers and other financial institutions and notes, among others things, that those life insurers who are assessed the tax will be at a competitive disadvantage in their sector of financial services as a result. We do not believe shifting the competitive field within an industry, in a manner that the Joint Committee itself indicated seemed ambiguous and arbitrary, would be the intent of Congress.

When announcing the tax proposal in January, the Administration stated that it sought to impose the tax to discourage risky financial behavior and speculative leveraging activities. Since insurers are prohibited by state law from engaging in excess or risky leveraging, we do not believe this is justification to impose a tax on our industry. State investment laws are very clear and uniform throughout the country. They impose strict limitations on the type of investments an insurer can make.

It could be argued that life insurers benefitted generally and indirectly from the government's policies that assisted the economy. That argument, though, can be said about every company and business in the country. We all benefitted from having a stabilized financial system. We do not believe that insurers should be identified as an industry that inordinately benefitted and therefore needs to be taxed to recoup

government funds. Like most of main street America, our industry was a victim of the recession, not a perpetrator.

The regulatory accounting for life insurers is different than accounting for banks. The Joint Committee on Tax background document also noted that applying concepts designed for depository institutions to non-depository institutions would be complicated and bring significant uncertainty. It stated, "For example, nondepository institutions do not have a concept of insured deposits or Tier 1 capital. Specifying equivalent concepts for other financial institutions may be complicated and adversely affect the ease and cost of administration."

The critical actions taken by the Administration and Congress in 2008 and 2009 responded to one of the most precarious economic situations that ever faced the country. The crisis called for precipitous actions. We understand that the extraordinary actions brought stability and improvement to all aspects of the economy including the various segments of financial services; however, it is important to note that these benefits were not evenly distributed within the financial services industries.

In raising these fundamental concerns, we acknowledge that, in addition to AIG, a few of our members did receive financial support from the federal government during the crisis. We fully understand the desire of the federal government to recoup taxpayer funds in the TARP program as provided in the Emergency Economic Stabilization Act (EESA) which calls for recoupment by 2013. In fact, these companies have either repaid or will have repaid well in advance of the 2013 statutory date.

As the Senate reviews this proposal, we urge you to carefully consider whether it is appropriate to impose this new tax on our industry.

Thank you.

Senate Finance Committee Hearing
"The President's Proposed Fee on Financial Institutions Regarding TARP: Part 2"
May 4, 2010
Response to a Question for Patrick S. Baird, Chairman, AEGON USA, LLC

Question from Senator Bingaman

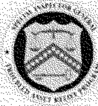
1. As I understand, you argue that it is arbitrary to apply the fee to a life insurance company that happens to own a small bank or thrift, but to exempt an otherwise similarly situated life insurer that does not have a bank or thrift subsidiary. To be certain, I am sympathetic to that claim. But are you asking us to ignore the fact that certain life insurance companies did, in fact, receive direct benefits from TARP? For instance, one of your peer companies acquired a thrift for the express purpose of qualifying for TARP – and then received $3.4 billion in TARP monies. How would you square your call not to include life insurance companies owning a bank or thrift in the fee with this fact? And given that the level of TARP assistance was presumably based on these recipient life insurance companies' total assets, rather than just assets of their associated bank or thrift, how would you justify levying any such fee solely based on bank or thrift assets?

Response to Question by Patrick S. Baird

It's important to remember that the purpose of the CPP program was to provide liquidity into stressed financial services companies on a temporary basis. Because the federal government does not regulate the insurance industry, Treasury concluded, despite explicit congressional authority, that the only way it could provide our industry with needed funds and yet maintain oversight into the use of those funds, was to require life insurers to acquire a bank or thrift. Even with this additional requirement, approximately 25% of the life insurance market in the U.S., represented by foreign owned life insurers, were excluded from the CPP.

As I stated in my testimony, we fully understand the desire of the Federal government to recoup taxpayer funds in the TARP program as provided in the Emergency Economic Stabilization Act (EESA) which calls for recoupment by 2013. In addition to AIG, a few of our member companies did receive financial support during the crisis and these companies have either repaid or will have repaid well in advance of the 2013 statutory date. If the reason for the proposed tax is repayment, we urge Congress to delay consideration of the use of a tax for repayment until 2013.

Another stated reason for the tax is to deter excess leverage for the largest financial firms. Since insurers are prohibited by state law from engaging in excess or risky leveraging we do not believe a tax intended to discourage such leveraging should be imposed on the industry. While some insurers may own a bank or thrift, these entities are generally small parts of their business operations and such banking operations are ancillary to the nature of the insurance business. During the hearing, Secretary Geithner himself confirmed that the tax should not be imposed on insurers solely because of their ownership of a bank or thrift ancillary to its business. The ownership of these entities should not subject these life insurance firms to a tax designed for banks. Given the structural differences between banks and insurers, it is difficult to understand how the tax could be imposed on insurers.



SIGTARP OFFICE OF THE SPECIAL INSPECTOR GENERAL FOR THE TROUBLED ASSET RELIEF PROGRAM

ADVANCING ECONOMIC STABILITY THROUGH TRANSPARENCY, COORDINATED OVERSIGHT AND ROBUST ENFORCEMENT

STATEMENT OF NEIL BAROFSKY

SPECIAL INSPECTOR GENERAL
FOR THE TROUBLED ASSET RELIEF PROGRAM

BEFORE THE
SENATE COMMITTEE ON FINANCE

April 20, 2010

Chairman Baucus, Ranking Member Grassley, and Members of the Committee, I am honored to appear before you today to discuss SIGTARP's Quarterly Report to Congress.

There are clear signs that some aspects of the financial system may well be on the path to recovery. Many of the large banks and Wall Street firms propped up by unprecedented taxpayer support in the fall of 2008 — including massive infusions under the Troubled Asset Relief Program ("TARP") — have returned to profitability, attracted private-sector capital, and enjoyed substantially rebounded stock prices. Many of those firms have been able to repay TARP far sooner than anyone reasonably would have anticipated, resulting in a profit on those particular investments for the Treasury Department ("Treasury"), and thus the American taxpayer. Even Citigroup Inc. ("Citigroup") and Bank of America Corporation ("Bank of America"), firms that appear to have survived only with extraordinary TARP assistance, have rebounded, with Bank of America repaying its TARP bailouts in full and Citigroup on the verge of doing the same. All told, as of March 31, 2010, $205.9 billion has come back to the taxpayer through repayment of principal, interest, dividends, cancellation of guarantees, and warrant sales. As a result, although TARP is still expected to result in a large loss to taxpayers ($127 billion according to the Office of Management and Budget, as of February 2010), the expected loss is far lower than previous estimates, and is concentrated in the programs designed to support American International Group, Inc. ("AIG") ($50 billion), the automotive industry ($31 billion), and housing ($49 billion).

Even as Wall Street regains its footing, however, signs of distress on Main Street remain disturbingly persistent. Although unemployment has eased slightly in recent months, it still remains much higher than at any time since 1983. In addition, the long-term nature of unemployment is unprecedented in recent history — the March 2010 figure for the average duration of unemployment, 31.21 weeks, is the highest since such measurement began in 1948. Meanwhile, smaller and regional banks continue to struggle (with 50 closed so far in 2010), small-business lending remains substantially depressed from pre-recession levels, and the real estate markets, both residential and commercial, continue to suffer at crisis proportions in many areas of the country. Questions remain as to whether the real estate markets have truly found bottom or are headed for further decline. In sum, notwithstanding that the financial system appears to be stabilizing and record profits are returning to Wall Street, the plain fact is that too many Americans on Main Street are still in imminent danger of losing their businesses, their jobs, and their homes.

In light of these circumstances, Treasury has shifted much of TARP's focus to initiatives intended to offer economic relief to the broader public. A year ago this March, Treasury introduced the Making Home Affordable ("MHA") initiative, which was designed to address the growing wave of home foreclosures ravaging many areas of the country. The centerpiece of MHA is the Home Affordable Modification Program ("HAMP"), which was intended to result in millions of sustainable mortgage modifications that would allow homeowners to remain in their homes by reducing their monthly payments to affordable levels. The Administration has allocated $75 billion to HAMP, including $50 billion of TARP funds.

Despite Treasury's efforts, however, the home foreclosure crisis has not abated; indeed, the situation has continued to deteriorate since HAMP's rollout. Nearly 2.8 million foreclosures

were initiated in 2009. More ominously, 2010 is on pace to be even worse: there were more than 932,000 foreclosure filings during the first three months — a 16% increase from the already staggering rate for the first quarter of 2009. Similarly, for the first quarter of 2010, actual bank repossessions rose 35% from 2009 levels to nearly 258,000. Unfortunately, HAMP has made very little progress in stemming this onslaught, resulting in only 230,000 permanent modifications initiated over the approximately 12 months of the program's existence. That figure represents only 8.2% of the foreclosures initiated in 2009 and fewer than just the most recent quarter's actual bank repossessions.

A SIGTARP audit report published on March 25, 2010, examined the design and operation of HAMP in detail. The audit first found that Treasury's publicly touted measure of success, the number of short-term trial modification *offers* that have been made to struggling homeowners, was largely meaningless, and that Treasury needs to clearly identify the total number of homeowners it actually intends to help stay in their homes through sustainable permanent mortgage modifications. The audit also found that the limited results to date stemmed from, among other things, flaws in HAMP's design, rollout, and marketing that diminished the program's effectiveness in providing sustainable relief to at-risk homeowners. In its original version, HAMP involved frequent and time-consuming revisions of guidelines that created confusion and delay; permitted reliance on unverified verbal borrower data that slowed down conversions to permanent modifications; suffered from insufficient outreach to the American public about eligibility and benefits; and did not fully address risk factors for re-defaults among participating borrowers, including negative equity and high total debt levels even after modification. Without addressing the dangers of re-default, HAMP risks merely spreading out the foreclosure crisis at significant taxpayer expense. While this may benefit financial institutions that would not have to recognize the losses from immediate foreclosures, it would do little to accomplish the Emergency Economic Stabilization Act's explicit purpose to "help families keep their homes."

Although Treasury was initially reluctant to address the issues raised in the audit report regarding re-default, including a suggestion that only modest changes would be made to the program to address negative equity, just days after the publication of SIGTARP's audit report and a subsequent Congressional hearing discussing the report's findings, Treasury changed course and introduced major revisions to HAMP, including new provisions designed to address the plight of unemployed homeowners and to require consideration of principal write-downs for borrowers with negative equity. To Treasury's credit, the program changes appear intended to expand HAMP participation and improve the rate of permanent modifications, as well as to address the significant re-default risk driven by homeowners' negative equity. On the whole, the revisions to HAMP constitute a potentially important step forward in addressing some of the flaws identified in SIGTARP's audit report.

However, the program changes, as announced, also raise several issues that could impede HAMP's effectiveness and efficiency. Treasury's urgency in rolling out the new initiatives, laudable as it is, risks significant costs in the form of ill-defined goals, incomplete program guidelines, increased vulnerability to fraud, incentives that may prove ineffective, and the potential for arbitrary treatment of participating borrowers. SIGTARP has made a series of recommendations designed to address these issues:

• Treasury should identify its participation goals and anticipated costs for each HAMP program and subprogram and measure success against those expectations in its monthly reports.

• Treasury should launch a broader based fraud awareness campaign for HAMP and include fraud warnings when it makes program announcements.

• To protect against fraud, Treasury should abandon its differing valuation standards across HAMP and adopt the Federal Housing Authority's appraisal standard for all HAMP principal reduction and short sale programs.

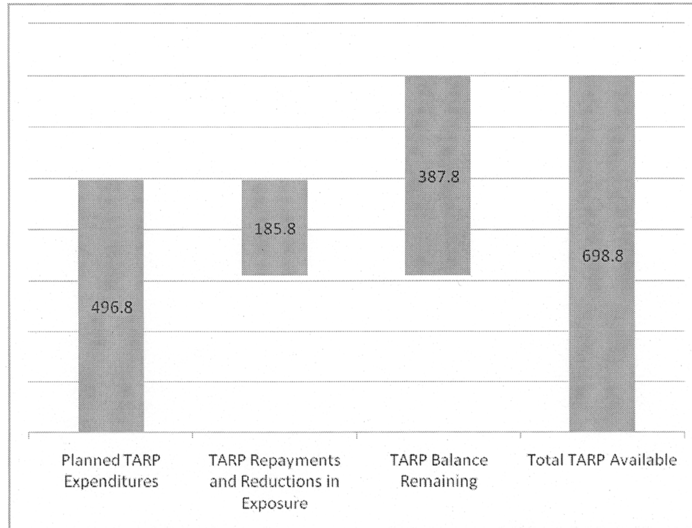
• Treasury should reevaluate the voluntary nature of its principal reduction program, considering changes to maximize effectiveness, to ensure to the greatest extent possible consistent treatment of similarly situated borrowers, and to address potential servicer conflicts of interest.

• Treasury should reconsider the length of the three-month minimum term of its unemployment forbearance program.

In sum, until Treasury fulfills its commitment to provide a thoughtfully designed, consistently administered, and fully transparent program, HAMP risks being remembered not for catalyzing a recovery from our current housing crisis, but rather for bold announcements, modest goals, and meager results.

PROGRAM UPDATES AND FINANCIAL OVERVIEW

TARP consists of 13 announced programs, all of which have been implemented. Six are closing or have already been wound down. As of March 31, 2010, Treasury had announced programs involving potential spending of $537.1 billion of the $698.8 billion maximum available for the purchase of troubled assets under TARP as authorized by Congress. Of this amount, Treasury had expended or committed to expend approximately $496.8 billion through the 13 implemented programs to provide support for U.S. financial institutions, the automobile industry, the markets in certain types of asset-backed securities ("ABS"), and homeowners. As of March 31, 2010, 77 TARP recipients had paid back all or a portion of their principal or repurchased shares for an aggregate total of $180.8 billion of repayments and a $5 billion reduction in exposure to possible further liabilities, leaving $387.8 billion, or 55.5%, of TARP's allocated $698.8 billion available. In addition to the principal repayments, Treasury has received interest and dividend payments on its investments, as well as revenue from the sale of its warrants. As of March 31, 2010, $14.5 billion in interest, dividends, and other income had been received by the Government, and $5.6 billion in sales proceeds had been received from the sale of warrants and preferred stock received as a result of exercised warrants. At the same time, some TARP participants have missed dividend payments: among participants in the Capital Purchase Program ("CPP"), 104 have missed dividend payments to the Government, although some of them made the payments on a later date. As of March 31, 2010, there was $188.9 million in outstanding unpaid CPP dividends. In addition, three TARP recipients have failed and several others have restructured their agreements with Treasury, increasing the potential for further losses.



Notes: Numbers affected by rounding. The "planned expenditures" referenced throughout this report represent the funds Treasury currently plans to expend for each program, and a majority of those are committed funds (e.g., signed agreements with TARP fund recipients).
a Repayments include $135.8 billion for CPP, $40 billion for TIP, $4.6 billion for Auto Programs, and a $5 billion reduction in exposure under AGP.
b Treasury experienced a $2.3 billion loss on some investments under the CPP program

Sources: Treasury, "Transactions Report," 4/2/2010; Treasury, response to SIGTARP data call, 4/12/2010.

OVERSIGHT ACTIVITIES OF SIGTARP

Since SIGTARP's Quarterly Report to Congress dated January 30, 2010, SIGTARP has actively sought to fulfill its vital investigative and audit functions. SIGTARP's Investigations Division continues to develop into a sophisticated white-collar investigative agency. Through March 31, 2010, SIGTARP has 84 ongoing criminal and civil investigations. Highlights from the last quarter include important developments in several cases that have been brought as the result of SIGTARP's investigations.

The Park Avenue Bank

On March 15, 2010, Charles Antonucci, the former President and Chief Executive Officer of The Park Avenue Bank, was charged by the United States Attorney's Office for the Southern District of New York with offenses including self-dealing, bank bribery, embezzlement of bank funds, and bank, mail and wire fraud, among others. In particular, Antonucci allegedly attempted to steal $11 million of TARP funds by, among other things, making fraudulent claims about the bank's capital position. These charges mark the first time an individual has been criminally charged with attempting to steal TARP funds.

According to the allegations, Antonucci falsely represented that he had personally invested $6.5 million in The Park Avenue Bank to improve its capital position. As set forth in the charges, however, the funds were actually borrowed from the Park Avenue Bank itself and reinvested as part of an undisclosed "round-trip" transaction. The complaint further alleges that this fraudulent transaction was touted by The Park Avenue Bank in support of its application for TARP funds as evidence of its supposedly improving capital position.

Bank of America
On February 4, 2010, the New York Attorney General charged Bank of America, its former Chief Executive Officer Kenneth D. Lewis, and its former Chief Financial Officer Joseph L. Price with civil securities fraud. According to the allegations, in order to complete a merger between Bank of America and Merrill Lynch & Co., Inc. ("Merrill Lynch"), the defendants failed to disclose to shareholders spiraling losses at Merrill Lynch. Additionally, after the merger was approved, it is alleged that Bank of America made misrepresentations to the Federal Government in order to obtain tens of billions of dollars in TARP funds. The investigation was conducted jointly by the New York Attorney General's Office and SIGTARP, and the case remains pending in New York state court.

SIGTARP also assisted the Securities and Exchange Commission ("SEC") with its Bank of America investigation. On February 22, 2010, the Honorable Jed S. Rakoff, United States District Judge for the Southern District of New York, approved a $150 million civil settlement between the SEC and Bank of America to settle all outstanding SEC actions against the firm.

Nations Housing Modification Center
On March 19, 2010, Glenn Steven Rosofsky was arrested by agents from SIGTARP and the Internal Revenue Service, Criminal Investigation Division and charged by the U.S. Attorney's Office for the Southern District of California with one count of conspiracy to commit wire fraud and money laundering and one count of money laundering. A separate information the same day charged Michael Trap with conspiracy to commit fraud and money laundering. As set forth in the charges, Rosofsky, Trap, and others operated a telemarketing firm, ostensibly to assist delinquent homeowners with loan modification services. Operating under the names "Nations Housing Modification Center" and "Federal Housing Modification Department," Rosofsky and Trap took advantage of the publicity surrounding the Administration's mortgage modification efforts under the TARP-supported MHA program and are alleged to have used fraudulent statements to induce customers to pay $2,500 – $3,000 each to purchase loan modification services that were not actually provided. It is alleged in court documents that the fraud grossed more than $1 million. Trap pled guilty to the charges listed in his March 19 information the following day. The case against Rosofsky remains pending.

On the audit side, SIGTARP released its latest audit report on March 25, 2010, which examined the "Factors Affecting Implementation of the Home Affordable Modification Program." SIGTARP has 12 other ongoing audit projects, including 2 new audits that have been initiated over the past quarter:

• **Application of the HAMP Net Present Value ("NPV") Test:** This audit, which will be conducted in response to a request from Senator Jeff Merkley and eight other Senators, will

assess: whether the participating loan servicers are correctly applying the NPV test under the program; the extent to which Treasury ensures that servicers are appropriately applying the NPV test per HAMP guidelines when assessing borrowers for program eligibility; and the procedures servicers follow to communicate to borrowers the reasons for NPV test failure, as well as to identify the full range of loss mitigation options available to such borrowers.

• **Material Loss Review of United Commercial Bank:** SIGTARP is participating in a Material Loss Review of United Commercial Bank, based in San Francisco, with the Office of the Inspector General of the Federal Deposit Insurance Corporation ("FDIC OIG"). In November 2008, United Commercial Bank received $298.7 million of TARP funds through CPP. On November 6, 2009, the California Department of Financial Institutions closed the bank and appointed FDIC as receiver. The objectives of the audit are to (1) determining the causes of the financial institution's failure and resulting material loss to the Deposit Insurance Fund; (2) evaluating FDIC's supervision of the institution; and (3) determining whether FDIC and Treasury followed applicable procedures in recommending the bank for CPP funding and in monitoring its compliance with the securities purchase agreement.

SIGTARP RECOMMENDATIONS ON THE OPERATION OF TARP

One of SIGTARP's oversight responsibilities is to provide recommendations to Treasury so that TARP programs can be designed or modified to facilitate effective oversight and transparency and to prevent fraud, waste, and abuse. In this quarter's report, we provide updates on existing recommendations and summarize implementation measures for previous recommendations. We make a series of recommendations concerning the new HAMP initiatives. We also discuss Treasury's introduction, on February 3, 2010, of the Community Development Capital Initiative ("CDCI"), a new TARP initiative designed to provide up to $1 billion in additional capital to Community Development Financial Institutions to incentivize lending. In addition to reviewing CDCI's provisions in detail, our report details a number of SIGTARP recommendations designed to improve the transparency of CDCI investments and better safeguard them against fraud or the failure of participating institutions.

Over the past quarter, Treasury has also announced another new initiative designed to spur small-business lending, the Small Business Lending Fund ("SBLF"). As announced, although SBLF will be funded with $30 billion that will be rescinded from TARP, SBLF will not be part of TARP, but rather will be operated outside of TARP and thus will not be subject to the executive compensation restrictions and perceived stigma associated with TARP. However, many of the characteristics of SBLF are the same or very similar to the TARP's CPP and CDCI: the economic structure is basically the same, with Treasury providing capital in the form of preferred equity, and, like CPP and CDCI, the maximum amount of capital available under SBLF will be a percentage of the institution's risk-weighted assets. It would also appear that the application and approval process for new participants will be similar and will involve the same primary regulators. Even many of the same banks will be participants — SBLF is expressly being designed so that many CPP participants will be able to convert their CPP capital into SBLF capital. SIGTARP has estimated that up to 95% of CPP participants could be eligible to convert to SBLF. In sum, the funds being utilized, the core mechanics, the economic terms of the program and even many of the participants all stem from TARP's CPP. Because SIGTARP has

developed considerable experience and expertise in its oversight of the very similar (and similarly complex) CPP, particularly in reporting, monitoring, deterring, and investigating fraud, SIGTARP has strongly encouraged that SIGTARP be included in the oversight provisions of Treasury's legislative proposal concerning SBLF. SIGTARP has sent a letter to Treasury, attached to our quarterly report, objecting to its stated intent not to include SIGTARP in the proposed legislation.

Chairman Baucus, Ranking Member Grassley and Members of the Committee, I want to thank you again for this opportunity to appear before you, and I would be pleased to respond to any questions that you may have.

If you are aware of fraud, waste, abuse, mismanagement or misrepresentations affiliated with the troubled asset relief program, please contact the SIGTARP Hotline.

Via Online: WWW.SIGTARP.GOV
Via Toll Free Phone: 877-SIG-2009
Via Fax: 202-622-4559

Via Mail: Hotline, Office of the SIGTARP
1500 Pennsylvania Ave., N.W. Suite 1064
Washington, D.C., 20220

QUESTIONS FOR THE RECORD FROM NEIL BAROFSKY

SPECIAL INSPECTOR GENERAL

FOR THE TROUBLED ASSET RELIEF PROGRAM

BEFORE THE

SENATE COMMITTEE ON FINANCE

May 26, 2010

Questions for Mr. Barofsky

Questions from Senator Baucus

1. ***Which companies have received the most TARP funds? Which of them have paid back the money? Which of them will never repay the money, and why?***

Response: In SIGTARP's April 20, 2010, Quarterly Report to Congress (the "April Quarterly Report")[1], Tables 2.3 and 2.4 (pages 44-47) identify the debt and equity investments in private sector firms made under TARP. Those tables provide aggregate figures for participants in the Capital Purchase Program ("CPP") and the Public-Private Investment Program ("PPIP"). Listings of individual participants in those programs may be found for CPP in Appendix D, Table D.1 (pages 174-201) and for PPIP in Table 2.27 (page 100). Table 3.2 of the April Quarterly Report (pages 124 to 127) identifies all private sector vendors retained by Treasury for assistance with various aspects of TARP administration.

With respect to companies that have repaid their TARP investments, for your convenience, we have attached a file, drawn from Treasury's most recent publicly available TARP Transaction Report, detailing TARP participants that have repaid some or all of their public investment as of May 14, 2010.[2]

With respect to which companies will never repay their TARP investments, whether a given participant will repay Treasury in the future depends on many factors (some at the macroeconomic level, and some specific to each industry and firm) and are impossible to predict with certainty. The most recent estimates of TARP costs put out by the Office of Management and Budget and the Congressional Budget Office, however, anticipate losses resulting from the AIG and auto company investments and thus assume that those investments will not be fully repaid. With respect to CPP, four participating banks (UCBH Holdings, Inc., Pacific Coast National Bancorp, Midwest Bank and Trust Co., and CIT Group, Inc.) have failed, and the taxpayer investment in those institutions is not likely to be recovered. In addition, according to recent news reports another CPP participant, South Financial Group Inc., was acquired recently by Toronto-Dominion Bank. As part of that transaction, Toronto-Dominion Bank will pay Treasury $130.6 million for its CPP preferred share investment in South Financial Group, which was originally valued at $347 million.[3]

2. ***a. At the time President Obama made his proposal he estimated the TARP losses could be $117 billion. CBO estimates TARP losses will be $109 billion. Do you think the Treasury and CBO estimates are accurate? Do you think there will be any losses when the final accounting is done? When will we know the full extent of TARP losses?***

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[1] For a copy please see http://www.sigtarp.gov/reports/congress/2010/April2010_Quarterly_Report_to_Congress.pdf
[2] The original data may be found at http://www.financialstability.gov/latest/reportsanddocs.html.
[3] For example, http://online.wsj.com/article/BT-CO-20100517-712033.html

Response: In addition to the estimates you cite, we note Treasury's May 21, 2010 release of an updated TARP cost estimate of $105.4 billion.[4] All of these estimates are just that — estimates — that are driven principally by underlying assumptions about future events (*e.g.*, the likelihood of strong profits at TARP participants or prevailing interest rate trends) that cannot be predicted with certainty. It is thus impossible to say definitively at this point how accurate they will ultimately prove.

TARP will certainly incur some significant costs because not all TARP outlays provide for later repayment. The most prominent example of this is the Home Affordable Modification Program ("HAMP"), for which $50 billion of TARP funding has been allocated. The key terms of that program provide for payments to loan servicers, investors and homeowners, with no provision for repayment thereof. With respect to losses on TARP programs that provide for repayment of public investment, we reiterate that participants' ability to fulfill those obligations in the future depends on a range of factors that are impossible to predict with certainty.

The full extent of TARP losses is not likely to be known with any degree of certainty for several years. Several of the TARP programs are designed to last for years into the future, and whether and to what extent TARP suffers losses on the AIG and auto company investments, for example, will depend on whether and how long those companies take to recover.

b. The April 2010 SIGTARP report states that three sectors are leading to the projected losses in TARP – AIG, the automotive industry and housing. What losses are expected in each sector and why are the losses expected? What other businesses or sectors will likely result in losses and what will the expected amount of these losses be?

Response: The CBO report (published in March of this year) and the Administration estimates for TARP costs (published by OMB in February and by Treasury in May) cite three principal drivers of costs to the public under TARP: first, assistance to AIG under the Systemically Significant Failing Institutions program; second, assistance to automobile manufacturers; and third, the Home Affordable Modification Program. These figures, drawn from Table 1 on page 3 of the CBO report, are listed below:[5]

All figures in $ billions	Cost/(Gain) per CBO	Cost/(Gain) per OMB	Cost/(Gain) per Treasury
Assistance to AIG	36	50	45
Assistance to the Automotive Industry	34	31	25
Home Affordable Modification Program	22	49	49
Remaining TARP Funds	23	3	-
Cumulative Other	(6)	(6)	(14)
Total	**109**	**127**	**105**

As noted above, disbursements under HAMP are not designed to be repaid. With respect to the AIG and auto company investments, which are held in the form of equity investments, the

[4] http://www.financialstability.gov/latest/pr_05212010b.html.
[5] http://www.cbo.gov/ftpdocs/112xx/doc11227/03-17-TARP.pdf, with the addition of corresponding Treasury data from their May 21 press release.

Administration and CBO estimates assume that the Government will not be able to recover full value from those investments over time.

c. Do you think all businesses receiving TARP funds should be required to repay TARP funds? Should some businesses be exempted from repaying TARP funds? Please explain your position.

Response: As a general matter, all businesses receiving TARP funds should abide by their TARP commitments. To the extent that Treasury has designed a program, consistent with its statutory authority, in which repayment is not contemplated, SIGTARP takes no position on such a policy decision.

3. a. Have the benefits of the TARP program been limited to the banks, insurance companies and businesses directly receiving TARP funds?

b. What has been the effect on the financial sector as a whole as a result of TARP rescuing individual banks, insurance companies and other businesses?

c. Describe how the TARP program could indirectly benefit a non-TARP recipient.

d. Are the benefits of the TARP program commensurate with the dollars actually paid out, or is there some sort of multiplier effect?

Response to subsections (a)-(d): The benefits of TARP have not been limited only to TARP recipients. Although it is difficult to quantify the broader effects of TARP, it appears that the dramatic steps taken by Treasury and other agencies through TARP and related programs played a significant role in bringing the system back from the brink of collapse. As such, TARP has benefitted the broader financial system beyond just the direct recipients.

e. Which TARP programs provided the most benefit to the banks and other financial institutions covered by the President's proposal?

Response: CPP has provided by far the largest direct benefit to the banking industry as a whole, investing $204.9 billion in 707 participating institutions across the nation.[6] Other relevant programs are the Targeted Investment Program (which invested $20 billion of TARP funds in each of Citigroup and Bank of America), the Asset Guarantee Program (which involved the commitment of $5 billion of TARP funds towards loss protection to more than $300 billion of Citigroup assets), and the SSFI program (in which $69.8 billion of TARP funds has been committed to stabilize AIG).

4. a. The SIGTARP report released last month states that there are 77 institutions that have paid some or all of their TARP funds back. To what extent are there common characteristics among these institutions, and what are they?

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[6] Page 75 of the April Quarterly Report.

Response: One common characteristic is that the institutions that repaid Treasury's investments were deemed healthy by their primary regulators. Pursuant to the requirements of the CPP program, regulators are required to approve each request to repay Treasury's investment and exit TARP. According to Treasury's guidance:[7]

> All institutions seeking to repay CPP will be subject to the existing supervisory procedures for approving redemption requests for capital instruments. Supervisors will carefully weigh an institution's desire to redeem outstanding CPP preferred stock against the contribution of Treasury capital to the institution's overall soundness, capital adequacy, and ability to lend, including confirming that the institution has a comprehensive internal capital assessment process.

b. Last month's report also states there are 104 institutions that have missed dividend payments. To what extent are there common characteristics among these institutions, and what are they?

Response: There may be many reasons why a bank would decide not to pay dividends to its preferred shareholders, and SIGTARP has not studied the common characteristics of the 104 institutions that failed to make one or more dividend payment.

c. Three TARP recipients, CIT, UCBH and Pacific Coast National Bancorp, have failed since they received TARP funds. Why did they fail? How do their failures affect TARP losses? What traits do these companies have in common?

Response: Due to substantial financial weaknesses, UCBH and Pacific Coast went into FDIC receivership in November 2009.[8] CIT Group also filed for bankruptcy that month.[9] In addition to these three TARP recipients, Midwest Bank and Trust Co. went into FDIC receivership in May 2010.[10]

Pursuant to 12 U.S.C. § 1831o(k), the Inspectors General of these institutions' primary regulators must perform material loss reviews ("MLR") of these institutions if their failure resulted in losses of $25 million or more for their regulators. As noted in the April Quarterly Report, SIGTARP is participating in the MLR for UCBH. We will of course share our findings with you when these reports are ready for circulation.

As noted in the TARP transaction table, Treasury's TARP investments in CIT and Pacific Coast National were recorded as total losses of $2.3 billion and $4.1 million, respectively. UCBH remains in bankruptcy proceedings as of May 14. That loss has not been finally determined, but is likely to be most or all of the $298.7 million invested. The loss on Midwest's CPP investment is also likely to be most or all of the $89.4 million invested in that institution.

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[7] http://www.financialstability.gov/docs/CPP/FAQ_CPP_guidance.pdf

[8] Details on the UCBH failure may be found at http://www.fdic.gov/bank/individual/failed/ucb.html. Those for Pacific Coast National are at http://www.fdic.gov/bank/individual/failed/pacificcoastnatl.html.

[9] The Wall Street Journal's coverage may be found at http://online.wsj.com/article/SB125709781695721315.html.

[10] Details may be found at http://www.fdic.gov/bank/individual/failed/midwestil.html.

In addition to these four banks, as noted in our response to question 1, the CPP is expected to record a loss of approximately $216.4 million related to the sale of South Financial Group Inc., a participating institution, to Toronto-Dominion Bank.

> ***d. How can the repayment data be used to predict which institutions will not be able to repay their TARP funds so that the amount of TARP losses can more accurately be estimated?***

Response: Although all five of these institutions failed to make one or more dividends payments, we have not sufficiently studied the correlation, if any, between dividend payment failure and collapse to predict the failure of financial institutions and accurately project TARP losses.

5. ***In November of 2009, SIGTARP issued a report on AIG counterparty payments on credit default swaps. What did you discover regarding the financial state of AIG in September of 2008, AIG's connection to the rest of the financial industry, and what might have happened if AIG had been allowed to fail? Who were the largest recipients of AIG counterparty payments that were made with TARP funds?***

Response: As discussed in SIGTARP's audit report, *Factors Affecting Efforts to Limit Payments to AIG Counterparties,*[11] AIG, through its subsidiary AIG Financial Products ("AIGFP") offered a portfolio of products that included credit default swaps ("CDSs"), which are insurance-like instruments that, in exchange for payments from counterparties (*i.e.,* CDS purchasers), provide for payments to the counterparties if a defined event occurs with respect to an underlying security. Under the terms of AIGFP's CDSs, the counterparties were entitled to require AIGFP to post collateral when certain events occurred. Such events included a decline in the market value of the underlying collateralized debt obligations ("CDOs"), which are financial instruments that entitle the buyer to some portion of cash flows from a portfolio of assets. In addition, if the credit rating associated with the underlying CDOs were downgraded, AIGFP could also be required to post collateral.

Beginning in the third quarter of 2007 and continuing through 2008, AIG's financial condition deteriorated, causing a decline in market confidence that, in turn, triggered downgrades of AIG's credit rating. At the same time, the market value of the CDOs protected by AIGFP's CDSs declined. As a result, AIGFP was required to post collateral under the terms of its CDSs. Typically, AIGFP was required to make payments to its counterparties in amounts equaling the difference between the market value of the underlying CDO and its par value. By late summer 2008, however, AIGFP did not have the liquidity necessary to post the required collateral and therefore was on the verge of defaulting on its obligations to its CDS counterparties, which would likely have forced AIG to file for bankruptcy.

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[11] A copy is available at
http://www.sigtarp.gov/reports/audit/2009/Factors_Affecting_Efforts_to_Limit_Payments_to_AIG_Counterparties.pdf

On September 16, 2008, the Federal Reserve Board, with the encouragement of Treasury, authorized the Federal Reserve Bank of New York ("FRBNY") to make available to AIG an $85 billion revolving credit facility so that it could make the collateral payments and meet other obligations necessary to avoid bankruptcy. It soon became clear, however, that the initial $85 billion line of credit had not sufficiently addressed AIG's liquidity crisis. Accordingly, FRBNY began to consider further remedial measures.

On November 3, 2008, FRBNY proposed the creation of Maiden Lane III, LLC ("Maiden Lane III"), a special purpose vehicle through which the CDOs underlying AIGFP's CDSs would be purchased at market value. On November 6, 2008, AIG formally agreed to the creation of Maiden Lane III and requested that FRBNY engage in discussions with counterparties on its behalf. On November 10, 2008, the Federal Reserve Board authorized the FRBNY's establishment of, and loan to, Maiden Lane III. On November 25, 2008, Maiden Lane III was created and began purchasing the underlying CDOs from the counterparties. Table 2 of the audit report (page 20) lists the counterparties that received payments from Maiden Lane III; the top three recipients are Sociètè Gènèrale, Goldman Sachs, and Merrill Lynch.

All of the counterparty payments were made with funds supplied by FRBNY, not TARP. However, in November of 2008, Treasury purchased $40 billion of newly issued preferred shares under TARP's Systematically Significant Failing Institutions program. The proceeds of this securities sale were used to pay down, in part, the $85 billion FRBNY line of credit.

Although the precise consequences of an AIG failure remain unknowable, Treasury and Federal Reserve officials have testified that they provided AIG financing because of their concerns that permitting it to collapse would pose an unacceptable threat to the nation's financial stability and economic health.[12]

6. ***How many insurance companies and other lines of business purchased thrifts in order to qualify for TARP funds? How did these companies use the funds they received? Are these businesses going to be able to repay what they received?***

Response: SIGTARP's audit, *Additional Insight on the Use of Troubled Asset Relief Program Funds*, includes information concerning the receipt and use of TARP funds by insurance companies.[13] SIGTARP found that, in order to qualify for TARP assistance, Hartford Financial Services Group, Inc. ("Hartford"), and Lincoln National Corporation ("Lincoln") purchased the Federal Trust Bank and Newton County Loan & Savings FSB, respectively. Further, Hartford used TARP capital to purchase Federal Trust Bank. SIGTARP also found that Hartford invested 94% of its TARP funding in high quality short-term investments or money market funds. For its part, Lincoln invested 64% of its TARP funding in domestic corporate bonds and mortgage-backed securities, and invested the complementary 36% in commercial mortgage-backed securities, commercial real estate loans, domestic bonds and asset-backed securities.

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[12] See, for example, Federal Reserve Chairman Ben Bernanke's March 24, 2009 testimony before the House Financial Services Committee at http://www.federalreserve.gov/newsevents/testimony/bernanke20090324a.htm.

[13] A copy is available at http://www.sigtarp.gov/reports/audit/2009/Additional_Insight_on_Use_of_Troubled_Asset_Relief_Program_Funds.pdf

As noted in the attached TARP Transaction File, Hartford Financial Services Group repaid its CPP investment on March 31, 2010. The April Quarterly Report indicates that the TARP investment in Lincoln National remains outstanding, with no missed dividends.

7. ***To what extent is it appropriate that TARP recipients who have paid back their TARP funds are paying big bonuses to their executives? Do you think that businesses who received TARP funds should be subject to restrictions, or at least a policy of constraint, when deciding the size of bonuses to be paid?***

Response: By statute, TARP restrictions on executive compensation are applicable only during the period "in which any obligation [except for Federal warrant ownership alone] arising from financial assistance provided under the TARP remains outstanding."[14] Thus, according to the current governing law, if a financial institution has repaid Treasury's investment, then executive compensation restrictions no longer govern its payment of bonuses to its executives. SIGTARP has taken no position on the policy question of whether that law should be changed.

8. ***Many small businesses have been unable to obtain financing during the economic crisis, even from banks who received TARP funds. With the Fed's rates so low, banks have made a lot of money on the spread from borrowing at the Fed's rate and lending on the overnight markets instead of lending to small businesses.***

   a. To what extent should banks who received TARP funds be able to use TARP funds for proprietary trading instead of lending money to small businesses to make payroll and buy inventory?

Response: Treasury did not impose restrictions on using TARP funds for proprietary trading. For the sake of providing transparency in the administration of TARP, one of my first recommendations as Special Inspector General was that Treasury require each participant "to use best efforts to account for the use of TARP funds, to set up internal controls to comply with such accounting, and to report periodically to OFS-Compliance on the results, with appropriate certification."[15] Treasury initially declined to require all participants to report on their use of TARP investments. Later, however, Treasury changed its position and agreed to survey its recipients' use of TARP funds and publish the results.[16] Initial results of this use of funds survey should be available soon.

   b. What can be done within the TARP program to get the money moving to small businesses and out into the economy?

Response: The economic design of TARP programs is outside of SIGTARP's oversight role.

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[14] 12 U.S.C. § 5221(b).

[15] See SIGTARP's February 6, 2009, Quarterly Report to Congress at page 97, which is available at http://www.sigtarp.gov/reports/congress/2009/SIGTARP_Initial_Report_to_the_Congress.pdf.

[16] See SIGTARP's January 30, 2010, Quarterly Report to Congress at page 139, which is available at http://www.sigtarp.gov/reports/congress/2010/January2010_Quarterly_Report_to_Congress.pdf. Treasury confirmed its intention to collect use of funds information in a December 9, 2009 letter appended to SIGTARP's audit report, *Additional Insight on the Use of Troubled Asset Relief Program Funds*.

c. ***Have the big financial institutions and businesses used their TARP funds as Congress intended?***

Response: EESA, and Treasury when implementing EESA, imposed very few restrictions on how TARP funds could be used. SIGTARP has issued two audit reports discussing TARP participants' use of their public funding.[17] Generally, SIGTARP found that they were able to account for their use of TARP funds. Further, as discussed in our response to question 8a, above, Treasury recently implemented our recommendation that it periodically survey TARP recipients concerning their use of such funds and publish the results.

9. ***The Administration has proposed a new small business lending program, the Small Business Lending Fund, which will be funded with $30 billion rescinded from the TARP program. What is Treasury's position on giving SIGTARP oversight responsibilities for this new program? Why should SIGTARP have oversight responsibility for the new Small Business Lending Fund program?***

Response: Treasury's proposal for the Small Business Lending Fund did not give oversight responsibility to SIGTARP, and we believe this is a mistake that will result in a waste of taxpayer resources and increase fraud vulnerability.

In terms of its basic design and participants, and, SBLF would essentially be, from an oversight perspective, an extension of TARP's CPP program. Although the proposed legislation provides that SBLF would be established outside of TARP — and thus recipients would not be subject to TARP's executive compensation requirements or warrant provisions — the core goals and basic economic framework for the proposed SBLF are very similar to those of CPP, and the two programs share a wide range of features:

- As in CPP, SBLF involves capital investments in the form of preferred shares.
- As in CPP, the maximum amount of an investment under SBLF would be a percentage of the bank's risk-weighted assets — for banks with a $1 billion or more in total assets, the amount available under SBLF (3% of risk-weighted assets), would be the same as under CPP; banks with $1 billion or less in total assets could receive, under SBLF, as much as 5% of their risk-weighted assets.
- The initial SBLF dividend rate (5%) would be the same as the initial CPP dividend rate.
- The application structure would essentially be the same as in CPP, with the banks' primary regulators evaluating new SBLF applications.

In fact, many current CPP participants would likely convert their CPP investments to SBLF. Based on the proposal, which expressly contemplates that CPP participants with total assets of $10 billion or less will be eligible to convert to SBLF, SIGTARP expects that up to 95% of the

[17] These reports are available at
http://www.sigtarp.gov/reports/audit/2009/SIGTARP_Survey_Demonstrates_That_Banks_Can_Provide_Meaningful_Information_On_Their_Use_Of_TARP_Funds.pdf;
http://www.sigtarp.gov/reports/audit/2009/Additional_Insight_on_Use_of_Troubled_Asset_Relief_Program_Funds.pdf.

current CPP participants will be eligible to convert to SBLF; because of SBLF's financially more attractive and less restrictive provisions, SIGTARP anticipates that the overwhelming majority of eligible CPP participants will migrate to SBLF.

Due to these similarities, SBLF will present many of the same oversight challenges that CPP has thus far presented, and, because SIGTARP has already developed the specialized expertise and resources to address these challenges in connection with CPP, SIGTARP is uniquely qualified to address them under SBLF. Failing to take advantage of such expertise and existing resources would not only be a waste of taxpayer money (as another oversight entity would have to expend substantial investigative and audit resources that SIGTARP already has on board) but would also unnecessarily expose the program and thus taxpayers to waste, fraud and abuse during the substantial time period that another oversight entity gets up to speed on the complex program. Stated another way, SIGTARP is already the "cop on the beat" for CPP; finding a different entity to police the same kinds of activity for the very similar SBLF would be both duplicative and potentially dangerous.

Disregarding SIGTARP's substantial commitment and unique expertise in fashioning SBLF oversight would be a waste of taxpayer resources and would unnecessarily expose SBLF to waste, fraud and abuse. Even assuming that another oversight agency could find the available resources to address the challenges posed by SBLF, trying to assemble, from scratch, the expertise, staff, forensic capability, audit experience and relationships necessary to meet this responsibility would needlessly duplicate the capabilities SIGTARP has already developed, and would potentially leave $30 billion of taxpayer funds vulnerable to waste, fraud or abuse for the significant amount of time another agency would require to develop the necessary expertise, capabilities and relationships. In other words, SIGTARP could provide vigorous and effective oversight of SBLF under ongoing initiatives already being conducted by our agency at no additional expense and without any gap in oversight.

For these reasons, SIGTARP is clearly the most appropriate oversight body for this program to protect taxpayers from potential fraud in the proposed SBLF, to ensure accountability in its management, and to ensure continuity of oversight.

10. What challenges is the Treasury Department facing with the HAMP program? What losses do you expect will result from this program?

Response: SIGTARP's audit report entitled "Factors Affecting Implementation of the Housing Affordable Mortgage Program" ("SIGTARP's HAMP audit") addresses the effectiveness of HAMP at reaching participation goals and the challenges that Treasury has confronted in implementing the program.[18] SIGTARP found Treasury had not established meaningful participation goals for the program—focusing on trial rather than permanent modifications—and that thus far participation had been disappointing, for several reasons:

[18] The audit is available at http://www.sigtarp.gov/reports/audit/2010/Factors_Affecting_Implementation_of_the_Home_Affordable_Modification_Program.pdf

- Program rules had not been fully developed by the time the program began. Treasury thus had to revise guidelines repeatedly, causing participants confusion and delay;
- Treasury's decision to permit servicers to start trial modifications before receiving supporting documentation proved to be counterproductive, creating a large backlog of trial modifications, of which many will never become permanent;
- Treasury's marketing efforts were limited, with an inexplicable absence of its own television public service announcements a year into the program;
- Treasury did not fully address risk factors for re-defaults among participating borrowers, including negative equity and high total debt levels even after modification.

As discussed in further detail on pages 134-136 of the April Quarterly Report, Treasury announced a series of dramatic and substantial revisions to HAMP within days after the release of SIGTARP's HAMP audit. The new revisions included:

- A provision that servicers consider principal write-downs at their option as part of the loan modification process;
- A new program, to be backed by $14 billion in TARP funds and managed by both Treasury and the Federal Housing Administration ("FHA"), that will enable severely underwater homeowners to refinance their mortgages so that their total home debt will not exceed 115% of the home's value;
- Temporary payment reductions for unemployed borrowers for periods from three to six months while they seek new employment;
- Increased servicer incentives for permanent loan modifications to compensate them for costs associated with the revisions to HAMP;
- Expansion of HAMP to include borrowers with FHA loans and borrowers in active bankruptcy proceedings;
- Improved requirements for borrower solicitations;
- Additional assistance for homeowners who lose their homes through a short sale or deed in lieu.

While the new revisions to HAMP, as a whole, constitute a potentially important step forward for homeowner relief, to date the haste in rolling out these revisions has impeded their clear and efficient implementation. After carefully considering Treasury's announced revisions, SIGTARP made a series of additional recommendations, which the April Quarterly Report discusses on pages 136-144 in greater detail.

As discussed in our responses to questions 2a and 2b, estimates for the total cost of HAMP range between $22 billion and $49 billion. The key program terms provide for payments to loan servicers, investors and homeowners, with no provision for repayment thereof.

11. According to the SIGTARP website, the mission of SIGTARP is to advance economic stability by promoting the efficiency and effectiveness of TARP management. What criteria do you apply to determine if the TARP program is being run efficiently and effectively?

Response: Just as no two TARP programs are alike, SIGTARP does not rely on a single yardstick to evaluate the full range of different programs. However, there are some common measures that SIGTARP applies:

- Clear documentation of each program's procedures, along with meaningful, well-defined controls;
- Decision-makers' adherence to established procedures and documentation of their decision-making and required compliance;
- Public availability of each program's details, key decisions, and goals;
- Consistent determination of eligibility and treatment of participants in each program;
- Transparent accounting of each program's cost and progress to date against its stated goals;
- The presence of robust anti-fraud measures.

12. To what extent will any TARP losses be the result of waste, fraud or abuse within TARP?

Response: With a program as large as TARP, there is no question that criminals will attempt to criminally profit from this national crisis. SIGTARP has endeavored to work with Treasury and the other agencies managing TARP programs to make the TARP programs as safe as possible from a fraud perspective. Notwithstanding those efforts, some fraud losses are probably inevitable. Although it is too early to draw any conclusions about the size of fraud losses, SIGTARP anticipates that there will likely be a far lower percentage of taxpayer funds lost to fraud than in the typical Government program.

<u>Question from Senator Grassley</u>

13. General Motors: You testified at the hearing that GM was about to repay approximately $6 billion in TARP debt by drawing down on an equity facility of other TARP money at Treasury. GM filings at the SEC state that the Treasury TARP loan bore an interest rate of 7%. The SEC filings also mention a $2.5 billion loan GM owes their auto union healthcare plan (VEBA) that bears an interest rate of 9%. The filings say GM expected the escrow to have a $5.6 billion cash balance after the Treasury TARP debt repayment. SEC filings refer to the equity facility as "escrowed funds" and state that distributions from the escrow were subject to certain conditions outlined in the Treasury loan agreement with GM. Your office has stated in reports that the escrow was subject to Treasury supervision. We learned after the April 20 hearing that GM had already requested that it be allowed to withdraw funds from the TARP escrow sufficient to repay the Treasury TARP loan. Treasury apparently acquiesced in this request because on April 21, 2010, GM announced with great fanfare that it had repaid its debt to the US government "in full."

- ***a. Specifically, what conditions on distribution are set forth in the Treasury credit agreement with GM?***
- ***b. Do you have a copy of the Treasury credit agreement? If so, please provide a copy to my staff.***

Response: Section 4.2(a) of the Second Amended and Restated Secured Credit Agreement provides that Treasury may authorize release of the escrow funds in the event that the borrower has made no material misrepresentations in loan documents; no event of default has occurred; five days have expired since the borrower supplied written notice concerning the amount of funds requested for release and why. Treasury has made the credit agreement publicly available, and it can be accessed at the link footnoted below.[19]

*c. **How much money remained in the escrow account after GM withdrew the funds necessary to repay the TARP loan?***

Response: $6.6 billion.

*d. **How much money was released to GM from the escrow account?***

Response: $9.8 billion.

*e. **Does GM still owe money to the union healthcare VEBA?***

*f. **If the answer to the above question is yes, why did Treasury not require that GM repay the $2.5 billion union healthcare VEBA loan, bearing 9% interest, before repaying the Treasury TARP loan, which bore only a 7% rate of interest?***

*g. **Alternatively, why did Treasury not require GM to repay the 9% loan to the union VEBA as a condition to releasing the cash balance in the escrow to GM?***

Response: GM's March 31, 2010 Form 10-Q (Note 12) lists approximately $2.9 billion of VEBA Notes among its long-term liabilities. We have not examined Treasury's decision making with respect to which loan was more appropriate for GM to pay off. We respectfully refer you to Treasury for an answer.

14. ***HAMP: Your April 20, 2010, quarterly report discusses recent changes to the Making Home Affordable Program. Although the announcement of the program trumpeted that $50 billion in TARP funds would be used to help four million homeowners get mortgage modifications, there have been less than two hundred thousand permanent modifications from about $90 million in incentive payments to banks. There seems to be a pattern. The banks were handed hundreds of billions almost immediately. But a $15 billion program for small business loans shrank to a $24 million pilot project, and a $50 billion program to help homeowners has disbursed only $90 million, primarily to banks, and has a high re-default rate.***

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[19] See http://www.financialstability.gov/docs/AIFP/Binder1%20Second%20AR%20Credit%20Agreement%20and%201-5%20Amendments%2002-19-10.pdf?bcsi_scan_2FA4A0B98C9C1BFB=1VmeoZTtwS/q9WRpwfH0dtX+NOMJAAAAQ3w/CQ==:1&bcsi_scan_65B7E4F046E7F4EB=X7W+BtahNAjohi3CnxwUXjZfmdwJAAAAzJTvBw==:1&bcsi_scan_D92198957E035F0B=WGySq5qF8W5wjjNETmF32DVDXIUJAAAAnZ8tCA==&bcsi_scan_filename=Binder1%20Second%20AR%20Credit%20Agreement%20and%201-5%20Amendments%2002-19-10.pdf.

According to the Congressional Oversight Panel's April report, even after receiving a modification to reduce their mortgage payment, the average homeowner in the program still had a total debt load of nearly 70% of their income. No wonder there are so many re-defaults.

a. *Can you explain what adjustments, if any, Treasury is making to address this issue and what changes should they make?*
b. *Why should taxpayers subsidize banks to encourage mortgage modifications that are doomed to re-default?*

Response: As reflected in SIGTARP's HAMP audit, we very much share your concerns about high back-end debt-to-income ratios and the resulting risks of re-default by participating homeowners. Accordingly, we recommended that Treasury re-examine HAMP's structure to ensure that it is adequately minimizing the risk of re-defaults driven by negative equity, high non-first-mortgage debt, and other risk factors. Although Treasury was initially reluctant to address this recommendation and others included in our audit report, it recently changed course and introduced major revisions to HAMP, including new provisions designed to address the plight of unemployed homeowners and to require consideration of principal write-downs for borrowers with negative equity. In the context of these revisions, SIGTARP has outlined follow-up recommendations in the April Quarterly Report. Pages 140-144 discuss those addressing unemployed homeowners and principal reductions.

SIGTARP will continue to monitor these developments and in particular whether re-defaults threaten the program's effectiveness.

Questions from Senator Hatch

15. *Mr. Barofsky, on January 14, 2010, President Obama proposed what he labeled a "Financial Crisis Responsibility Fee" on financial institutions with over $50 billion in assets that was designed to raise $90 billion over ten years.*

    According to the Administration, the purpose of the fee is to recoup an estimated $117 billion of TARP losses (more recent estimates from CBO place the loss figure at $99 billion) and to discourage the risky behavior that led to the financial crisis.

    Even though CBO projects $99 billion in losses, Treasury stated on April 2, 2010 that they estimate that TARP "will earn a profit thanks to dividends, interest, early repayments, and the sale of warrants. Total bank investments of $245 billion in FY2009 that were initially projected to cost $76 billion are now projected to bring a profit. Taxpayers have already received $14 billion through just interest and dividends and that number could be considerably higher by the end of this year."

    And in December of last year, Secretary Geithner stated before the Congressional Oversight Panel "We now expect to make - not lose - money on $245 billion of investments in banks. We estimate that in the aggregate, major bank stabilization programs funded

through TARP will yield a positive net return of over $19 billion, thanks to dividends, interest, early repayments, and the sale of warrants. In short, taxpayers are being repaid at a substantial profit by banks."

- ***Mr. Barofksy, where are these losses coming from?***
- ***Do you expect the government will be repaid the full value of the investment in AIG?***
- ***How much did we lose from GM and Chrysler?***

Response: We respectfully refer you to our responses to Questions 2a and 2b above, which address these questions directly.

Questions from Senator Bunning

15. Mr. Barofsky, the Obama Administration has apparently claimed that the proposed bank tax would be used for deficit reduction, to recoup losses to the Treasury that have resulted from TARP. If Congress uses a bank tax to pay for new government spending, rather than reducing the portion of the deficit that was caused by TARP, will this bank tax actually succeed in recouping TARP losses to the Treasury, or will those losses still exist?

Response: Section 134 of the Emergency Economic Stability Act of 2008 ("EESA"), Public Law No. 110-343 directs that "...where there is a shortfall, the President shall submit a legislative proposal that recoups from the financial industry an amount equal to the shortfall in order to ensure that the Troubled Asset Relief Program does not add to the deficit or national debt." The Administration has stated that the recently proposed Financial Crisis Responsibility Fee is intended to meet this obligation. If the full amount of TARP losses is recouped through the proposed fee, it would likely meet Section 134's requirements. At this point, SIGTARP does not possess information on the proposed fee beyond what has been publicly announced, and has no additional information regarding any proposed plans to use the recouped funds for a separate program.

16. Thank you for your testimony about the Administration's Home Affordable Mortgage Program (HAMP). You stated in your testimony that "until Treasury fulfills its commitment to provide a thoughtfully designed, consistently administered, and fully transparent program, HAMP risks being remembered not for catalyzing a recovery from our current housing crisis, but rather for bold announcements, modest goals, and meager results." Would it be fair to say that the HAMP program as currently structured poses a significant financial risk to taxpayers, without offering much benefit to homeowners?

Response: Given the $50 billion of TARP funding committed to HAMP, the program undoubtedly entails a major commitment of taxpayer resources. As discussed in detail on pages 134-138 of the April Quarterly Report, SIGTARP has therefore recommended that Treasury clearly define meaningful metrics for the success of HAMP and publicly report progress against them, as well as detailed breakdowns of the program's costs. These steps are necessary for Congress and the American public to measure HAMP's success and critically evaluate whether the program's cost is worthwhile.

17. ***I understand that in the past you have had severe difficulty getting information from Treasury, the Fed, and others involved in the TARP program that you have needed to provide effective oversight of TARP. Are you currently getting all the information you need in a timely manner, and has anyone placed restrictions on this information that you found to be unnecessary and unhelpful?***

Response: SIGTARP generally receives cooperation in its audits and investigations, although I note the current SIGTARP investigation into the cooperation provided my agency by the Federal Reserve Bank of New York during research for our November 17, 2009 audit report, *Factors Affecting Efforts to Limit Payments to AIG Counterparties*. Otherwise, I have not so far been in a position to report, pursuant to 12 U.S.C. § 5231(e)(4)(B), that information or assistance requested by SIGTARP has been unreasonably refused or not provided. If such an unreasonable refusal or lack of cooperation occurs, then I will promptly notify the relevant Committees.

Questions from Senator Enzi

18. ***Under the Administration's proposal, the largest and most leveraged firms are targeted by assessing a tax on those with $50 billion or more in consolidated assets, excluding FDIC-assessed deposits and insurance policy reserves. The ten largest financial institutions will bear the heaviest burden (60%) of the fee. There are a lot of reasons that have been cited as the impetus for the Administration's proposal. Is it your belief that one of those reasons is the need to eliminate risky transactions on the part of large financial institutions? I have been told that small business loans are risky transactions. Do you think that the Administration's proposal will limit small business lending at a time when our economy is still struggling to create jobs?***

Response: We have not to date examined Treasury's or the Administration's decision making with regard to the proposed fee or independently researched whether enactment of the proposed fee would benefit or hinder small business lending.

19. ***It is my experience that once a tax is put into place, it is very difficult to stop collecting that tax. Assuming that the Administration figures are accurate and $90 billion would be raised over the course of ten years from this proposed bank tax, is the Administration planning to work with Congress to sunset this tax once taxpayer dollars are recovered? I'm skeptical that the proposed tax will actually recoup all of our taxpayer dollars. Do you actually believe this tax on banks would recoup all of the taxpayer dollars from TARP?***

Response: At this point, SIGTARP does not possess information on the proposed fee or the Administration's plans for using the proceeds thereof beyond what has been publicly announced. We must therefore respectfully refer you to Treasury and the Administration for more detail on specifics of whether and how the Administration plans to incorporate sunset provisions for the fee.

20. ***The Administration has indicated that this proposed fee will help stabilize our financial system and will punish Wall Street's bad actors. Wyoming is a long way from Wall Street, but I'm concerned that this proposal will have some far-reaching unintended***

consequences. How can Congress be assured that the proposed bank tax would only impact financial institutions and not their customers, investors and employees? What portions of the Administration's proposal will ensure that this tax is not simply passed along to consumers and small businesses trying to survive in this tough economic climate?

Response: At this point, SIGTARP does not possess information on the proposed fee beyond what has been publicly announced, nor has it done any independent examination of the effects of the proposed fee.

21. ***As I've studied the benefits and problems with this proposal, some individuals have predicted that implementing this tax would significantly reduce incentives to continue participating in small businesses lending. It is my understanding that the bank tax, as proposed, would affect 90% of all bank holding corporations and it is also my understanding that adding this fee means we will also see large banks fighting community banks for deposits in order to mitigate the amount of assessed fees. Has the Administration considered the detrimental impact of this proposal on community banking?***

Response: SIGTARP does not possess information on the proposed fee beyond what has been publicly announced, and we have not to date examined Treasury's or the Administration's decision making with regard to the proposed fee. Again, we must therefore respectfully refer you to Treasury for more details.

22. ***The recent financial crisis brought to light areas within our markets that need to be addressed through financial reform. However, if this tax is to recoup taxpayer dollars or even create risk aversion, why are financial institutions which never took TARP funds and did not contribute to the financial crisis also subject to this tax?***

Response: We have not to date examined Treasury's or the Administration's decision making with regard to the proposed fee. We must therefore respectfully refer you to Treasury for more details.

23. ***As the Treasury Department drafted this proposal, what negative economic impacts were considered? Because of the structure of the Administration's proposal, do you anticipate that any industries would lessen their involvement in the financial markets in order to avoid this tax? If so, can you provide some general examples of where we may see this exit from financial markets?***

Response: At this point, SIGTARP does not possess information on the proposed fee beyond what has been publicly announced, nor has it done any independent examination of the effects of the proposed fee.

If you are aware of fraud, waste, abuse, mismanagement or misrepresentations affiliated with the troubled asset relief program, please contact the SIGTARP Hotline.

Via Online: WWW.SIGTARP.GOV
Via Toll Free Phone: 877-SIG-2009
Via Fax: 202-622-4559

Via Mail: Hotline, Office of the SIGTARP
1801 L St., N.W.
Washington, D.C. 20220

CPP_TARP Repayment Detail, as of 5/14/2010

				Capital Repayment Details		Treasury Investment Remaining After Capital Repayment
Investment Date	Institution	Investment Description	Investment Amount	Capital Repayment Date	Capital Repayment Amount	Remaining Capital Amount
10/28/2008	Bank of America Corporation	Preferred Stock w/ Warrants	$ 15,000,000,000	12/9/2009	$ 15,000,000,000	$ 0
10/28/2008	The Bank of New York Mellon Corporation	Preferred Stock w/ Warrants	$ 3,000,000,000	6/17/2009	$ 3,000,000,000	$ 0
10/28/2008	The Goldman Sachs Group, Inc.	Preferred Stock w/ Warrants	$ 10,000,000,000	6/17/2009	$ 10,000,000,000	$ 0
10/28/2008	JPMorgan Chase & Co.	Preferred Stock w/ Warrants	$ 25,000,000,000	6/17/2009	$ 25,000,000,000	$ 0
10/28/2008	Morgan Stanley	Preferred Stock w/ Warrants	$ 10,000,000,000	6/17/2009	$ 10,000,000,000	$ 0
10/28/2008	State Street Corporation	Preferred Stock w/ Warrants	$ 2,000,000,000	6/17/2009	$ 2,000,000,000	$ 0
10/28/2008	Wells Fargo & Company	Preferred Stock w/ Warrants	$ 25,000,000,000	12/23/2009	$ 25,000,000,000	$ 0
11/14/2008	Northern Trust Corporation	Preferred Stock w/ Warrants	$ 1,576,000,000	6/17/2009	$ 1,576,000,000	$ 0
11/14/2008	Washington Federal, Inc.	Preferred Stock w/ Warrants	$ 200,000,000	5/27/2009	$ 200,000,000	$ 0
11/14/2008	BB&T Corp.	Preferred Stock w/ Warrants	$ 3,133,640,000	6/17/2009	$ 3,133,640,000	$ 0
11/14/2008	Umpqua Holdings Corp.	Preferred Stock w/ Warrants	$ 214,181,000	2/17/2010	$ 214,181,000	$ 0
11/14/2008	Comerica Inc.	Preferred Stock w/ Warrants	$ 2,250,000,000	3/17/2010	$ 2,250,000,000	$ 0
11/14/2008	Capital One Financial Corporation	Preferred Stock w/ Warrants	$ 3,555,199,000	6/17/2009	$ 3,555,199,000	$ 0
11/14/2008	Valley National Bancorp	Preferred Stock w/ Warrants	$ 300,000,000	6/3/2009	$ 75,000,000	$ 225,000,000
				9/23/2009	$ 125,000,000	$ 100,000,000
				12/23/2009	$ 100,000,000	$ 0
11/14/2008	U.S. Bancorp	Preferred Stock w/ Warrants	$ 6,599,000,000	6/17/2009	$ 6,599,000,000	$ 0
11/14/2008	TCF Financial Corporation	Preferred Stock w/ Warrants	$ 361,172,000	4/22/2009	$ 361,172,000	$ 0
11/21/2008	First Niagara Financial Group	Preferred Stock w/ Warrants	$ 184,011,000	5/27/2009	$ 184,011,000	$ 0
11/21/2008	HF Financial Corp.	Preferred Stock w/ Warrants	$ 25,000,000	6/3/2009	$ 25,000,000	$ 0
11/21/2008	Centerstate Banks of Florida Inc.	Preferred Stock w/ Warrants	$ 27,875,000	9/30/2009	$ 27,875,000	$ 0
11/21/2008	City National Corporation	Preferred Stock w/ Warrants	$ 400,000,000	12/30/2009	$ 200,000,000	$ 200,000,000
				3/3/2010	$ 200,000,000	$ 0
11/21/2008	First Community Bankshares Inc.	Preferred Stock w/ Warrants	$ 41,500,000	7/8/2009	$ 41,500,000	$ 0
11/21/2008	Webster Financial Corporation	Preferred Stock w/ Warrants	$ 400,000,000	3/3/2010	$ 100,000,000	$ 300,000,000
11/21/2008	Boston Private Financial Holdings, Inc.	Preferred Stock w/ Warrants	$ 154,000,000	1/13/2010	$ 50,000,000	$ 104,000,000
11/21/2008	Trustmark Corporation	Preferred Stock w/ Warrants	$ 215,000,000	12/9/2009	$ 215,000,000	$ 0
12/5/2008	WesBanco, Inc.	Preferred Stock w/ Warrants	$ 75,000,000	9/9/2009	$ 75,000,000	$ 0
12/5/2008	Manhattan Bancorp	Preferred Stock w/ Warrants	$ 1,700,000	9/16/2009	$ 1,700,000	$ 0
12/5/2008	Iberiabank Corporation	Preferred Stock w/ Warrants	$ 90,000,000	3/31/2009	$ 90,000,000	$ 0
12/5/2008	Eagle Bancorp, Inc.	Preferred Stock w/ Warrants	$ 38,235,000	12/23/2009	$ 15,000,000	$ 23,235,000
12/5/2008	CVB Financial Corp	Preferred Stock w/ Warrants	$ 130,000,000	8/26/2009	$ 97,500,000	$ 32,500,000
				9/2/2009	$ 32,500,000	$ 0
12/5/2008	Bank of Marin Bancorp	Preferred Stock w/ Warrants	$ 28,000,000	3/31/2009	$ 28,000,000	$ 0
12/5/2008	Old Line Bancshares, Inc.	Preferred Stock w/ Warrants	$ 7,000,000	7/15/2009	$ 7,000,000	$ 0
12/12/2008	Old National Bancorp	Preferred Stock w/ Warrants	$ 100,000,000	3/31/2009	$ 100,000,000	$ 0
12/12/2008	SVB Financial Group	Preferred Stock w/ Warrants	$ 235,000,000	12/23/2009	$ 235,000,000	$ 0
12/12/2008	Susquehanna Bancshares, Inc	Preferred Stock w/ Warrants	$ 300,000,000	4/21/2010	$ 200,000,000	$ 100,000,000
12/12/2008	Signature Bank	Preferred Stock w/ Warrants	$ 120,000,000	3/31/2009	$ 120,000,000	$ 0
12/12/2008	Bank of the Ozarks, Inc.	Preferred Stock w/ Warrants	$ 75,000,000	11/4/2009	$ 75,000,000	$ 0

12/12/2008	Sterling Bancshares, Inc.	Preferred Stock w/ Warrants	$ 125,198,000	5/5/2009	$ 125,198,000	$ 0
12/12/2008	The Bancorp, Inc.	Preferred Stock w/ Warrants	$ 45,220,000	3/10/2010	$ 45,220,000	$ 0
12/12/2008	First Litchfield Financial Corporation	Preferred Stock w/ Warrants	$ 10,000,000	4/7/2010	$ 10,000,000	$ 0
12/12/2008	LSB Corporation	Preferred Stock w/ Warrants	$ 15,000,000	11/18/2009	$ 15,000,000	$ 0
12/19/2008	Wainwright Bank & Trust Company	Preferred Stock w/ Warrants	$ 22,000,000	11/24/2009	$ 22,000,000	$ 0
12/19/2008	Berkshire Hills Bancorp, Inc.	Preferred Stock w/ Warrants	$ 40,000,000	5/27/2009	$ 40,000,000	$ 0
12/19/2008	Flushing Financial Corporation	Preferred Stock w/ Warrants	$ 70,000,000	10/28/2009	$ 70,000,000	$ 0
12/19/2008	Monarch Financial Holdings, Inc.	Preferred Stock w/ Warrants	$ 14,700,000	12/23/2009	$ 14,700,000	$ 0
12/19/2008	Union First Market Bankshares Corporation (Union Bankshares Corporation)	Preferred Stock w/ Warrants	$ 59,000,000	11/18/2009	$ 59,000,000	$ 0
12/19/2008	Bancorp Rhode Island, Inc.	Preferred Stock w/ Warrants	$ 30,000,000	8/5/2009	$ 30,000,000	$ 0
12/19/2008	Alliance Financial Corporation	Preferred Stock w/ Warrants	$ 26,918,000	5/13/2009	$ 26,918,000	$ 0
12/23/2008	First Financial Bancorp	Preferred Stock w/ Warrants	$ 80,000,000	2/24/2010	$ 80,000,000	$ 0
12/23/2008	Magna Bank	Preferred Stock w/ Exercised Warrants	$ 13,795,000	11/24/2009	$ 3,455,000	$ 10,340,000
12/31/2008	The PNC Financial Services Group Inc.	Preferred Stock w/ Warrants	$ 7,579,200,000	2/10/2010	$ 7,579,200,000	$ 0
12/31/2008	CIT Group Inc.	Contingent Value Rights	$ 2,330,000,000	2/8/2010	$ (2,330,000,000)	$ 0
1/9/2009	Bank of America Corporation	Preferred Stock w/ Warrants	$ 10,000,000,000	12/9/2009	$ 10,000,000,000	$ 0
1/9/2009	FirstMerit Corporation	Preferred Stock w/ Warrants	$ 125,000,000	4/22/2009	$ 125,000,000	$ 0
1/9/2009	Peapack-Gladstone Financial Corporation	Preferred Stock w/ Warrants	$ 28,685,000	1/6/2010	$ 7,172,000	$ 21,513,000
1/9/2009	Commerce National Bank	Preferred Stock w/ Warrants	$ 5,000,000	10/7/2009	$ 5,000,000	$ 0
1/9/2009	Sun Bancorp, Inc.	Preferred Stock w/ Warrants	$ 89,310,000	4/8/2009	$ 89,310,000	$ 0
1/9/2009	American Express Company	Preferred Stock w/ Warrants	$ 3,388,890,000	6/17/2009	$ 3,388,890,000	$ 0
1/9/2009	Independent Bank Corp.	Preferred Stock w/ Warrants	$ 78,158,000	4/22/2009	$ 78,158,000	$ 0
1/9/2009	LCNB Corp.	Preferred Stock w/ Warrants	$ 13,400,000	10/21/2009	$ 13,400,000	$ 0
1/9/2009	F.N.B. Corporation	Preferred Stock w/ Warrants	$ 100,000,000	9/9/2009	$ 100,000,000	$ 0
1/9/2009	Shore Bancshares, Inc.	Preferred Stock w/ Warrants	$ 25,000,000	4/15/2009	$ 25,000,000	$ 0
1/16/2009	Bar Harbor Bankshares	Preferred Stock w/ Warrants	$ 18,751,000	2/24/2010	$ 18,751,000	$ 0
1/16/2009	Somerset Hills Bancorp	Preferred Stock w/ Warrants	$ 7,414,000	5/20/2009	$ 7,414,000	$ 0
1/16/2009	SCBT Financial Corporation	Preferred Stock w/ Warrants	$ 64,779,000	5/20/2009	$ 64,779,000	$ 0
1/16/2009	Texas Capital Bancshares, Inc.	Preferred Stock w/ Warrants	$ 75,000,000	5/13/2009	$ 75,000,000	$ 0
1/16/2009	OceanFirst Financial Corp.	Preferred Stock w/ Warrants	$ 38,263,000	12/30/2009	$ 38,263,000	$ 0
1/16/2009	Centra Financial Holdings, Inc.	Preferred Stock w/ Exercised Warrants	$ 15,000,000	3/31/2009	$ 15,000,000	$ 0
1/16/2009	Pacific Coast National Bancorp	Preferred Stock w/ Exercised Warrants	$ 4,120,000	2/11/2010	$ (4,120,000)	$ 0
1/16/2009	State Bankshares, Inc.	Preferred Stock w/ Exercised Warrants	$ 50,000,000	8/12/2009	$ 12,500,000	$ 37,500,000
1/16/2009	First Manitowoc Bancorp, Inc.	Preferred Stock w/ Exercised Warrants	$ 12,000,000	5/27/2009	$ 12,000,000	$ 0
1/23/2009	First ULB Corp.	Preferred Stock w/ Exercised Warrants	$ 4,900,000	4/22/2009	$ 4,900,000	$ 0
1/23/2009	Midland States Bancorp, Inc.	Preferred Stock w/ Exercised Warrants	$ 10,189,000	12/23/2009	$ 10,189,000	$ 0
1/23/2009	FPB Financial Corp.	Preferred Stock w/ Exercised Warrants	$ 3,240,000	12/16/2009	$ 1,000,000	$ 2,240,000
1/30/2009	Middleburg Financial Corporation	Preferred Stock w/ Warrants	$ 22,000,000	12/23/2009	$ 22,000,000	$ 0
1/30/2009	Hilltop Community Bancorp, Inc.	Preferred Stock w/ Exercised Warrants	$ 4,000,000	4/21/2010	$ 4,000,000	$ 0
2/13/2009	Westamerica Bancorporation	Preferred Stock w/ Warrants	$ 83,726,000	9/2/2009	$ 41,863,000	$ 41,863,000
				11/18/2009	$ 41,863,000	$ 0
2/13/2009	Midwest Regional Bancorp, Inc.	Preferred Stock w/ Exercised Warrants	$ 700,000	11/10/2009	$ 700,000	$ 0
2/27/2009	First State Bank of Mobeetie	Preferred Stock w/ Exercised Warrants	$ 731,000	4/14/2010	$ 731,000	$ 0
3/13/2009	Discover Financial Services	Preferred Stock w/ Warrants	$ 1,224,558,000	4/21/2010	$ 1,224,558,000	$ 0
3/13/2009	1st United Bancorp, Inc.	Preferred Stock w/ Exercised Warrants	$ 10,000,000	11/18/2009	$ 10,000,000	$ 0
4/24/2009	Frontier Bancshares, Inc.	Subordinated Debentures w/ Exercised Warrants	$ 3,000,000	11/24/2009	$ 1,600,000	$ 1,400,000
6/26/2009	Hartford Financial Services Group, Inc.	Preferred Stock w/ Warrants	$ 3,400,000,000	3/31/2010	$ 3,400,000,000.00	$ 0

Testimony of Steve Bartlett
Before the Committee on Senate Finance
"The President's Proposed Fee on Financial Institutions Regarding TARP: Part 2."
May 4, 2010

Chairman Baucus, Ranking Member Grassley, and members of the Finance Committee, I am Steve Bartlett, and I am the President and Chief Executive Officer of The Financial Services Roundtable. Thank you for the invitation to testify on the Administration's proposed "Financial Crisis Responsibility Fee."

The members of the Financial Services Roundtable are committed to repaying our TARP obligations, and we are particularly encouraged by the following statement made by the Treasury Department on April 2nd:

> *Treasury currently estimates that its programs aimed at stabilizing the banking system will earn a profit thanks to dividends, interest, early repayments, and the sale of warrants. Total bank investments of $245 billion in FY2009 that were initially projected to cost $76 billion are now projected to bring a profit. Taxpayers have already received $14 billion through just interest and dividends and that number could be considerably higher by the end of this year.*

Treasury further estimates that the return to taxpayers on TARP investments in banks is nine percent. These are amazing developments, and they hardly seemed possible a year ago. However, other programs under the TARP may result in losses, and it is appropriate to begin thinking about ways to deal with those costs. The Administration's approach, however, raises several significant questions.

First, we have questions about timing. The Emergency Economic Stimulus Act of 2008, which created the TARP program, requires the Administration to submit a report to Congress in 2013 calculating net TARP gains or losses, and then, in the event of losses, to submit a legislative proposal to recover such amounts. In writing EESA, Congress realized that it would be years before we would know the true cost of the TARP program. And today, we simply do not have a clear picture. Projected TARP losses have been declining rapidly – when the Administration proposed the fee in January, it estimated that TARP losses would be $117 billion, and it proposed the level of the tax accordingly. That amount was based in part on a projection that TARP losses related to investments in AIG would total nearly $50 billion; today, Treasury says those losses are likely to be "substantially lower." Estimated losses in other TARP programs are similarly declining. And as the economy recovers, more banks pay back TARP obligations, and warrants are sold, taxpayer gains from bank investments will grow. Not only does the Administration proposed to begin imposing the tax now, in 2010, it does not propose any adjustment to the tax to reflect continuing improvement in TARP losses.

Second, we have questions about how this tax interacts with other proposals, domestic and international, to impose fees and taxes on the financial industry. The International Monetary Fund is recommending that G-20 nations jointly impose new sector-wide taxes on financial firms to help pay for the cost of future industry rescue efforts. One tax the IMF is recommending would be imposed on non-deposit liabilities, precisely the same mechanism proposed by the Administration in its Financial Crisis Responsibility Fee. It is unclear whether the pending financial services regulatory reform legislation will include proposals to impose new fees on the financial firms to create a resolution fund, as both proposals approved by the Senate Banking Committee and the House of Representatives have done. It will be important for U.S. policymakers to ensure that our firms are not subject to multiple levels of overlapping taxes. Additionally, it is far from certain that there is international consensus for imposing a new tax on the financial industry; while countries may agree that taxpayers should not be exposed to the costs of a future crisis,many countries disagree such a tax is necessary. Policymakers will need to consider the potential impact on the international competitiveness of U.S. firms in the event foreign companies are not subjected to similar requirements.

Third, we do not have a clear understanding of the intended purpose of the tax. The Administration has stated that the proposed Financial Crisis Responsibility Fee is intended not only to recoup TARP costs, but also to act as a "deterrent against excessive leverage" in the financial industry. We do not believe the Tax Code is the best tool for addressing concerns about financial industry risk. We would submit that marketplace and current regulatory efforts already are de-leveraging industry balance sheets, and that the pending financial services regulatory reform legislation is the better forum to address concerns about systemic financial risk. Further, international regulatory bodies are actively discussing new capital, liquidity, and risk management standards that may have dramatic effects. These are complex issues, and there is every possibility that a hastily conceived tax may have unintended marketplace consequences. Further, the Administration's proposal must not morph into a permanent tax or revenue stream for the federal government. It must be temporary and limited to recovering TARP losses that are attributable to the financial industry.

Fourth, we question why the financial industry should be asked to pay for TARP losses attributable to other industries. We certainly would not expect the other industries to be asked to pay for any TARP losses attributable to the financial industry. And we hope that TARP losses from other industries will diminish as their industry, like ours, continues to recover.

Fifth, we have concerns that the proposed recoupment fee will reduce incentives to manage TARP investments carefully. We are concerned that TARP dollars might be invested, or simply spent, from this point forward without proper regard to costs or efficiencies, since the financial industry in the end would be on the hook to cover losses. The financial industry should not serve as a blank check for new TARP spending.

Finally, and perhaps most importantly, we have questions about the economic impact of the proposed fee. The fee would reduce the total supply of credit in the financial system. The fee is designed to raise $90 billion over 10 years, which means a $90 billion reduction in regulatory capital. Assuming a 10% leverage ratio, this loss of capital would reduce financial industry lending capacity by $900 billion, a huge number. The Congressional Budget Office and the Joint Committee on Taxation also have concluded that customers would absorb some of the cost in the form of higher borrowing costs. While we do not know the precise impact the tax would have on

lending and borrowing costs, directionally the results are clear. And they are reason for pause. The Administration's proposal should not be viewed in isolation as other regulatory and tax reform policies around the globe will each have effects on the availability of credit throughout the financial system. The IMF, Financial Stability Board and Basel Committee on Banking Supervision are engaged in an ongoing effort to assess the cumulative quantitative impact of the numerous regulatory and tax proposals that are in varying stages of implementation. Policymakers would be well served to have a better understanding of the interactions and potential consequences of these proposals and proceed in a thoughtful manner.

Taking these questions and concerns into account, the Financial Services Roundtable does not support the Administration's Financial Crisis Responsibility Fee as proposed. We look forward to working with the members of this committee as you weigh these issues. Given the significant issues involved, it is important to move carefully.

Senate Finance Committee Hearing
"The President's Proposed Fee on Financial Institutions Regarding TARP: Part 2"
May 4, 2010
Responses to Questions for Steve Bartlett, President and CEO, Financial Services Roundtable

Questions from Senator Hatch

1. The Administration justifies the fact that its so-called bank tax proposal would hit banks that have paid back their TARP obligations or that never received TARP money on the grounds that they hugely benefited from an unprecedented amount of taxpayer intervention. Is this an accurate rationalization?

   Answer: TARP was not designed to benefit the banking industry. It was designed to benefit the economy as a whole. Banks are financial conduits. They intermediate the flow of funds between depositors and borrowers. TARP allowed banks to continue to perform that role so the economy would not collapse into a depression. TARP achieved that goal. Most of the banks that received TARP funds have repaid those funds, plus more. The industry is committed to repaying all TARP funds, and the Treasury Department already has predicated that TARP payments to makes will generate a positive return to taxpayers.

2. The Administration also argues that the $90 billion plus projected to be raised from this tax would not necessarily be passed on to the customers of the affected institutions in the form of higher fees, but that it would simply serve to reduce the amount of executive bonuses available to be distributed to the few at the top who many believe have been unjustly enriching themselves while these institutions drove the U.S. economy into the ground. What do you think of this reasoning?

   Answer: Consumers will be impacted by this proposed tax. If you assume that for every $1 in capital a bank can make $10 in loans, a $90 billion tax would translate into roughly $900 billion in lost loans to consumers and businesses.

3. One of the factors you mention in your testimony in opposing the proposed tax on financial institutions is that it could reduce incentives to manage TARP investments carefully. Could you elaborate on this concern?

   Answer: Currently firms have an incentive to repay TARP funds. This incentive flows from the statutory requirement that the financial industry repay any net losses to taxpayers associated with TARP. In other words, firms realize that if they repay they will not face any additional costs. If this "recoupment" provision is replaced with a simple tax the existing incentive for firms to repay TARP funds may diminish or even disappear.

4. Why would this proposal not act as a deterrent against excessive leverage in the financial industry? Is excess leverage among these firms still a valid concern in this stage of the recovery?

Answer: The financial crisis demonstrated a need for stronger capital and liquidity requirements. However, capital and liquidity is being addressed by US and EU regulators within the context of so-called Basel III negotiations, and those negotiations are expected to produce new capital and liquidity standards by the end of the year. This tax is not the right place to address capital requirements.

COMMITTEE ON FINANCE
NEWS RELEASE

Max Baucus, Chairman
http://finance.senate.gov

April 20, 2010

Hearing Statement of Senator Max Baucus (D-Mont.)
Regarding the Proposed Bank Tax and the TARP Program

The Epistle of James says: "See how great a forest a little fire kindles!"

The financial crisis of 2008 kindled a fire that spread through our entire economy.

That fire destroyed more than 8 million jobs. That fire led to more than 6 million foreclosures. And that fire led to 3 million bankruptcies.

The spark for that fire was lit in the financial industry.

To generate huge profits and big bonuses, the financial sector was playing with fire. Big banks were writing bad mortgages that they should have known folks were not going to be able to pay. And they would have known it, if they had done their homework on the loan applications.

Next, big banks bundled good and bad mortgages together and sold them to investors. They called these bundles "collateralized debt obligations" or "CDOs." And they called selling them "securitization."

And then big banks insured the collateralized debt obligations against failure. They called their insurance policies "credit default swaps." Credit default swaps allowed the banks to protect their risk and make big profits even if the mortgages that they were writing went bad. Basically, they hedged their bets.

Unfortunately, the financial system did not have enough money to cover all its bets.

And now there are charges that big banks may have been both assembling packages of mortgages on one side and betting against them at the same time.

Then the spark kindled the flame. And suddenly, our nation's economy was engulfed in the fire.

The Dow plunged, dropping to just above 6,500 in March of 2009. Unemployment rose above 10 percent.

Then-Treasury Secretary Paulson knew that he had to act. He came to Congress with a proposal to save the economy. The proposal turned into the emergency law that authorized the Treasury to distribute almost $700 billion through the Troubled Asset Recovery Program, or TARP.

I knew when we were working on this legislation that we needed to hold the Treasury and TARP recipients accountable for how the money was spent. TARP was spending hard-earned taxpayer dollars to save the big banks.

And those big banks had been paying out bonuses worth billions of dollars. Those big banks had sometimes been rewarding excessive risk taking.

So I proposed that we build right into the law a special, unbiased investigator. This investigator would ensure the transparency and accountability of TARP funds. That proposal resulted in the Special Inspector General for the Troubled Asset Relief Program. And that person is sitting before us today, Mr. Neil Barofsky. Welcome, Mr. Barofsky.

Mr. Barofsky is responsible for overseeing the TARP program. He keeps track of where the money goes, how it is spent, and whether it is paid back.

And that leads us to the purpose of today's hearing.

The TARP legislation anticipated that there might be losses. Congress anticipated that the banks might pay back something less than all of the TARP money.

The most recent estimates anticipate that the Treasury will end up losing about $89 billion. We need to think about how we are going to get that money back on behalf of American taxpayers.

In January, President Obama proposed a bank fee to recover TARP losses. His fee is estimated to raise $90 billion over 10 years. It would apply to about the 50 largest financial institutions in the country.

This Committee is going to take some time over the course of several hearings to consider the President's proposal and other options to recover TARP losses.

We want to understand the best approach to designing a fee, to whom it should apply, and how it might affect the economy and the markets. We need to learn whether banks will pass it on to consumers, and how it might affect lending to small businesses. And we need to take into account what European countries might do as they consider similar levies.

We begin today with Mr. Barofsky. We'll ask who has benefited from the TARP program, how much they have repaid, and why some TARP beneficiaries might never be able to pay back the American taxpayers.

The financial crisis of 2008 kindled a great fire that spread through our entire economy.

Let us examine how widely that fire spread. Let us see who benefitted from our efforts to put out the fire. And let us try to learn what we can to prevent such further economic fires in times to come.

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May 4, 2010

Hearing Statement of Senator Max Baucus (D-Mont.)
Regarding the Proposed Bank Tax

Thomas Jefferson may have gone too far, when he warned that "banking institutions are more dangerous . . . than standing armies."

But in this Great Recession, we have certainly learned that financial institutions can dramatically affect the economy. Financial institutions have certainly affected each and every American taxpayer.

It has been nearly two years since the financial crisis hit. The Bush Administration responded with the Troubled Asset Relief Program, or TARP.

Today, we convene the second of our three hearings to consider President Obama's proposal for a tax to recoup the losses from TARP.

TARP helped to keep the financial sector afloat. And there's a decent argument that the financial sector received more benefit from TARP than just the dollars that TARP lent them.

Two weeks ago, we heard from Neil Barofsky, TARP's Special Inspector General. He provided an update on TARP. He explained who had received TARP money, and who'd probably be able to pay the money back.

Today, our first witness, Secretary Geithner, will describe President Obama's proposal. Secretary Geithner will address concerns that the banks are likely to raise. And he can discuss different ways that the bank tax could be structured.

Our second panel includes a cross-section from the financial sector. It's no surprise that financial institutions are not enthusiastic about the proposal.

We'll look forward to learning how they think that a bank tax might affect their business. We're eager to hear their specific concerns.

We need to understand the best way to design the tax so that it's fair and achieves its purpose. We need to understand who should pay the tax. And we need to understand what effect the tax would have on small businesses and the economy.

We need to know if banks will be able to pass the cost of the tax on to customers and small businesses. And we need to understand the effects of the bank tax on small business lending.

Small businesses suffered when credit dried up during the financial crisis. So we want to make sure that banks do not harm small businesses when we try to make the banks pay back the American taxpayer.

We want to learn how a bank tax will affect the economy. We need to know how it might affect the ability of financial institutions to compete. And we need to learn what kinds of bank levies other countries are considering.

And so, let us examine the responsibility of financial institutions to bear some of the fiscal burden created by the financial crisis. Let us try to understand the best way to assess those burdens. And let us try to figure out the way that's best for the American economy.

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May 11, 2010

Hearing Statement of Senator Max Baucus (D-Mont.)
Regarding the Proposed Bank Tax

Criticism of the big Wall Street banks is nothing new. Nearly a century ago, Louis Brandeis wrote:

"The goose that lays golden eggs has been considered a most valuable possession. But even more profitable is the privilege of taking the golden eggs laid by somebody else's goose. The investment bankers and their associates now enjoy that privilege."

Ninety-four years later, with the financial crisis of 2008, much remained the same. Wall Street bankers still took the golden eggs. And the American taxpayers' goose got cooked.

The financial crisis of 2008 led to the Great Recession. And the financial crisis led to President Bush's bank bailout, the Troubled Asset Relief Program, or TARP.

Today, we convene our third and final hearing to consider President Obama's proposal for a tax to recoup the losses from TARP.

Three weeks ago, we heard from Neil Barofsky, TARP's Special Inspector General. He provided an update on TARP. He explained who had received TARP money, and who'd probably be able to pay the money back.

Last week, we heard from Treasury Secretary Geithner. He gave us details about how the bank tax would be calculated. He told us to whom it would apply. And he made the case for the tax.

We also heard from a panel of financial industry experts. They outlined their concerns with paying the tax.

Today's hearing will help us to address many questions:

Who should pay the tax?

What's the best way to structure the tax?

How can we best ensure that the tax is fair?

And how can we minimize unintended consequences?

Our hearings have demonstrated that the financial crisis had effects much wider than the direct costs of the TARP program. The financial crisis resulted in federal spending to rescue the financial industry. And it resulted in increases in spending for unemployment insurance and assistance to help keep folks in their homes.

Today, we hope to further our understanding of the extent of the economic effects of the financial crisis. And today we hope to learn the true costs of weathering the economic storm.

We also will delve more deeply into the economics of a bank tax. And we will examine its effects on consumers, our nation's economy, and our financial system.

Douglas Elliott, from The Brookings Institution, and David John, from the Heritage Foundation, will discuss the policy and economic implications of a bank tax.

Edward DeMarco, from the Federal Housing Finance Agency, the overseer of Fannie Mae and Freddie Mac, will give us an update on the status of these two enterprises. We can ask him whether the bank tax should apply to Fannie and Freddie.

And Nancy McLernon, from the Organization for International Investment, will tell us how she thinks a domestic bank tax will affect U.S. subsidiaries of foreign financial institutions. And she will give us an update on what the G-20 countries are doing.

When we close our series of hearings today, we will have established a solid foundation to build on as we move forward on the bank tax.

There may always be Wall Street bankers taking the golden eggs laid by somebody else's goose. But let's consider today whether we can get some of the bounty back, for the American taxpayer.

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Testimony of James Chessen
on behalf of the
American Bankers Association
Before the
Committee on Finance
of the
United States Senate
May 4, 2010

Chairman Baucus, Ranking Member Grassley, and members of the Committee, my name is James Chessen. I am the Chief Economist for the American Bankers Association (ABA). I am pleased to be here today representing ABA to discuss the Administration's proposed "Financial Crisis Responsibility Fee" (or "bank tax"). The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's $13 trillion banking industry and its two million employees.

There is no question that the banking industry – indeed, the entire country – benefited from the extraordinary actions taken by policy makers in the fall of 2008. It was a time of considerable stress and required decisive action to stop the growing anxiety and uncertainties in markets worldwide. Unfortunately, the purpose of the programs implemented to deal with the crisis were not well articulated, and often changed as new issues arose. This was particularly the case ever since the Troubled Asset Relief Program (TARP) was authorized under the Emergency Economic Stabilization Act (EESA). Originally, the TARP, as the name implies, was for the purchase of troubled assets. Then in a matter of days after enactment, everything changed and the policy shifted to putting capital in healthy, viable banks (under the Capital Purchase Program). The fact that this was a program for generally healthy banks – ***and one that promised a significant return to the government*** – was lost on the public, and worse, often completely mischaracterized as a bailout.

As the economic recession took hold, the use of TARP funds expanded well ***beyond*** providing capital to the banking industry. ***It became a ready source of funds for dealing with the bankruptcies of non-banks, including General Motors, Chrysler, and AIG.*** And yet, while the program was expanded to non-bank firms – and is where the losses are concentrated – the EESA requirement that losses be recouped from the financial industry remained. ***Had the TARP been***

limited to the banking industry, there would be no losses on that program. In fact, President Obama said in a speech at the Brookings Institution last December that "...assistance to banks, once thought to cost the taxpayers untold billions is on track to actually reap billions in profit for the taxpaying public."[1] According to Herb Allison Jr., Assistant Secretary for Financial Stability, as of April 16, 2010, "TARP has received $19 billion in dividends and warrant proceeds from banks."[2] Moreover, according to SNL Financial, the bank-TARP programs have earned an estimated 8.5 percent profit for taxpayers – a very good return by any measure.[3]

Besides the unfairness to pay for losses outside the banking industry, the bank tax proposed would have significant unintended consequences. Payments of $90 billion to $117 billion (as proposed) mean that $90 billion to $117 billion cannot be used directly for lending. But even that does not begin to capture the impact on lending as $1 dollar in capital supports up to $10 dollars of new loans – thus the total impact could well be nearly $1 trillion in foregone credit.

Finally, while the bank tax has direct, and severe, consequences for large institutions, it has a broader impact on the smaller banks as well. Because the proposed tax covers non-deposit liabilities, it will affect how large banks fund themselves. This will inevitably alter the economics of ***all*** bank-funding markets, including the deposit market, the federal funds market, the pricing of Federal Home Loan Bank advances, and the short-term Repo (repurchase) market – which will raise the cost of funding loans for community banks. Thus, the tax burden will not be limited to the largest banks, but will be felt by smaller banks as well. Ultimately, it is the owners and borrowers, particularly small business borrowers who are often financed by local community banks, that end up paying for the tax.

It is for these reasons that the ABA is opposed to this bank tax or any other fee targeted at the financial services industry. In the remainder of this testimony, I would like to elaborate on three key points:

- Taxpayers will make a profit on every bank-TARP program;
- The bank tax will have significant unintended consequences; and
- Large banks are directly affected, but smaller banks will also feel the ripple effects.

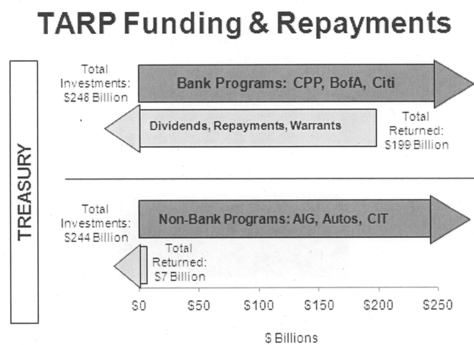
[1] Speech at the Brookings Institution, December 8, 2009, http://www.whitehouse.gov/the-press-office/remarks-president-job-creation-and-economic-growth

[2] Testimony of Herbert M. Allison Jr., Assistant Secretary for Financial Stability, before the U.S. House of Representatives Committee on Appropriate Subcommittee on Financial Services and General Government, April 22, 2010 http://www.treas.gov/press/releases/tg653.htm

[3] SNL Financial, "Treasury Reaps 8.5% from TARP," April 1, 2010.

I. Taxpayers Will Make a Profit on Every Bank-TARP Program

"Treasury now expects to *make* – not lose – money on the $245 billion of investments in banks made through TARP programs," said Herb Allison, Assistant Secretary for Financial Stability, before Congress just two weeks ago. He continued: "This is in sharp contrast to the original 2010 President's budget estimate that Treasury's investments in the banks would cost taxpayers $79 billion. In fact, Treasury is being repaid at a very substantial rate."[4] As the chart below shows, the real costs have come from non-bank firms.



The Congressional Budget Office (CBO), in response to your questions Ranking Member Grassley, acknowledged that "For the most part, the firms paying the fee would not be those that are directly responsible for losses realized by the TARP." The CBO went on to say that non-banks, such as AIG would be subject to the fee, but that "the fee would not apply to the automotive industry, which account for $47 billion of the program's estimated total cost of $99 billion."

The bank tax is an arbitrary tax on institutions of a certain size without regard to where the losses actually occurred or the payments made by banks which have provided a significant return to taxpayers. Moreover, setting a new tax to target an individual industry or set of firms within an industry sets a very bad precedent and violates the principle of fair taxation.

It is also noteworthy that the estimates of losses on TARP continue to decline every quarter. This is the reason why the EESA required a report on net TARP losses in ***2013***, so that there would be

[4] April 22, 2010, Op. cit.

a clearer picture of the magnitude of losses and the source of those losses. It is certainly too soon to know the extent of losses from the auto companies or AIG, which is where the current losses are concentrated. Given the continual downward revisions in expected losses, any discussion of repayment is premature, and in fact, implementing such a tax now would likely lead to a greater withdrawal of resources in a shorter period of time than is appropriate or prudent, particularly given the anemic state of the economy.

II. There are Negative Unintended Consequences of the Bank Tax

A tax of any kind on banks has consequences. The current proposal would apply a tax of approximately 15 basis points on non-deposit liabilities (except Tier 1 capital) of banks over $50 billion in assets. This is expected to generate $90 billion over 10 years and $117 billion over 12 years.[5,6] This means that all non-deposit sources of funds (which many large banks rely on) – such as repurchase agreements, Federal Home Loan Bank advances, federal funds, and types of secondary capital, such as subordinated debt, would be relatively more expensive. The magnitude of the proposed bank tax – $90 billion to $117 billion – has both direct consequences, particularly on credit availability, and indirect impacts as banks alter their funding strategy to less costly sources.

➢ ***The Bank Tax Will Reduce Credit Availability***

The most immediate – and clearly the most important – impact of the tax is that it immediately reduces the amount of funds available for lending. A $90 billion to $117 billion tax means a $90 billion to $117 billion reduction in credit. But the impact on credit goes far beyond this, as the tax drives investor dollars away from banks (to industries and firms with lower tax burdens). This is important because $1 of capital supports up to $10 dollars of loans. Therefore, with $90 billion to $117 billion in taxes sent to Washington over the next decade, ***it can mean up to $1 trillion of loans not made***. Moreover, this is more likely to impact small businesses – and the jobs they create – as they have fewer alternatives than large firms for funding their operations. Such a bank tax is completely counter to efforts to stimulate job creation in this tepid economy.

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[5] Banks already pay significant premiums to the FDIC on total domestic deposits.

[6] http://www.whitehouse.gov/sites/default/files/financial_responsibility_fee_fact_sheet.pdf

- ***The Bank Tax Drives Capital Out of the Banking Industry***

  This impact on investors was dramatically illustrated when investor reaction to the announcement of the tax on January 12, 2010 destroyed $18 billion in market capitalization of the largest banks. Investors are keenly aware of the government's efforts to impose greater costs or regulations on banks and they react quickly to any news, moving money to other industries.

  Moreover, the administration argues that a bank tax will be "deterrent against excessive leverage."[7] Excessive leverage is a concern that is best met through direct and targeted means and not through a blunt instrument like the tax code. Even the mere suggestion of a bank tax has already driven capital away from banks, thereby hurting, not helping the ability of banks to raise capital levels. Moreover, because the tax applies to other forms of capital, such as subordinated debt and other Tier 2 capital instruments, investors will shun these instruments as well. This further hurts the ability of banks to attract capital to backstop their operations.

- ***The Bank Tax Will Severely Impact Short-term, Low-Risk Repo Market***

  A very important and flexible market for managing liquidity is the repo, or repurchase, market. In repo transactions, securities are exchanged for cash with an agreement to repurchase the securities at a future date. The securities serve as collateral for what is essentially a cash loan and, conversely, the cash serves as collateral for a securities loan. Because repos are short-maturity collateralized instruments, they have strong linkages with securities markets. It is a low credit risk transaction, which means it trades with extremely small spreads. The 15 basis point bank tax would severely damage this market as it would represent a significant percentage increase in the cost. The artificially high bid-asked spreads would make cash instruments uncompetitive as trading vehicles and hedging tools. Driving activity away from cash trading would damage the liquidity of the Treasury and agency securities market and is clearly counter to assuring a steady market in traditional credit delivery channels.

- ***The Bank Tax Will Hinder the Federal Reserve's Monetary Policy Strategy***

  Negative impacts for the repo market has serious consequences for the conduct of monetary policy as it will hinder the Federal Reserve's ability to use reverse repos as a monetary policy tool. The Fed will have to pay 15 bps higher for the transactions to offset the tax these covered banks would pay to entice them to participate. Federal Reserve Chairman, Ben Bernanke, noted this

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[7] http://www.ustreas.gov/press/releases/tg506.htm

concern in testimony on February 24, 2010: "And one issue which has arisen is that imposing the tax on nondeposit liabilities could have some negative consequences for the repo market."[8]

- ***The Bank Tax Will Disrupt the Fed Funds Market***

  The fed funds market is the primary interbank market, with transactions flowing from banks of all sizes. Large banks, often the purchaser of funds from smaller banks, would be far less willing to buy funds if the tax were applied to the purchase. They would only be willing to pay 15 basis points ***less*** than normal, reflecting the full cost of the bank tax they would have to pay. In this low-interest rate environment, such a reduction makes these transactions uneconomical and thereby unlikely to occur. Simply put, the bank tax will virtually kill fed fund sales from small to large banks, thereby disadvantaging both sized banks and hurting liquidity options.

- ***The Bank Tax Means That Banks with Better Credit Will Pay More***

  The proposed tax would increase funding costs more for banks with better credit. On a relative basis, the tax will increase costs of funding more for banks with high credit ratings than those with lower credit ratings. For example, a higher-rated bank that is able to borrow overnight at 20 basis points will suffer a 75 percent increase in costs from a 15 basis points tax; in contrast, a lower-rated bank that can only borrow overnight at 50 basis points would suffer a 30 percent increase in cost. Thus, the bank tax is likely to stop any short-term transactions, particularly the lowest risk ones, leaving a greater share of short-term funding with higher-risk credits.

- ***The Bank Tax Will Increase the Cost of Mortgage Finance, as Large Banks and Insurance Companies Use Fewer Federal Home Loan Bank Advances***

  Banks, large and small, use the advances from the Federal Home Loan Banks (FHLBs) to make housing-related loans. The business model for FHLBs depends on serving institutions of all sizes, and if large banks withdraw, advance costs for smaller banks will rise. Adding additional costs of 15 basis points on these funds for large banks will reduce the use of advances. This means less mortgage liquidity that would be available, and what is available would cost more. The result is a decrease in the level of credit ultimately available to homeowners.

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[8] Transcript of Testimony before the House Committee on Financial Services, February 24, 2010.

Moreover, this also has important implications for the financial stability of the FHLBs themselves (which would have less income and less capital as a consequence), and would impact the availability and cost of advances for smaller banks (as well as hurt the investments those smaller banks have in the FHLBs). It could lead to a downward spiral for the FHLBs and their members, because as borrowing from the FHLBs becomes more expensive, fewer advances will be made. As fewer advances are made, members will reduce their holdings of the FHLB stock required to borrow, thus shrinking the System and its ability to provide liquidity to all members.

➢ ***The Bank Tax Shifts Business to Foreign Competitors***

The proposed bank tax must be considered in a larger, global context. First, it is unclear what action will be actually be taken by other countries. While there is considerable discussion on the topic, there is no consensus on what, if anything, needs to be done (let alone, whether it can realistically be implemented consistently across many countries).

Second, if there are inconsistencies, which seem inevitable, it will lead to competitive issues. For example, as noted above, the tax squeezes the already tight spreads on many wholesale products supported by non-deposit liabilities. The 15 basis point tax would make U.S. firms uncompetitive in low-margin money market and foreign exchange products, which would leave these markets in the hands of foreign competitors, whose prices are not constrained by the bank tax. While regional and community banks are not subject to the tax, it is unreasonable to assume that they could create and replace the large-scale, low-risk, repo markets that are being disrupted by the tax. Thus, this leaves foreign banks to take market share from U.S. institutions. It may also encourage U.S. banks with multi-national operations to shift operations from the U.S. to countries with more favorable tax treatments.

III. Large Banks are Directly Affected by the Bank Tax, But Smaller Banks Will Also Feel the Ripple Affects

Large banks with over $50 billion in assets are, of course, directly impacted by this large bank tax. The tax reduces capital to support loans, raises the cost of funding loans, and disrupts short-term liquidity markets. But the implications of this tax do not stop with the largest banks. In fact, the costs and consequences will ripple through the financial services system, imposing costs on all banks and their customers.

The previous section discussed the negative consequences on many short-term funding markets. These impacts raise the cost of funding for smaller banks and, in turn, affect the pricing of loans that they extend. For example, as large banks seek to minimize the financial burden of non-deposit funding sources, they will increase competition for deposits. Community banks, which largely raise deposits from local sources, have fewer alternatives to raise funds to finance local loans. As the competition for deposits increase due to the bank tax on non-deposit funding sources, it will be even more difficult, and certainly more expensive, to finance loans for community banks. This inevitably will lead to higher costs for borrowers.

Community banks often sell fed funds to larger banks, facilitating effective management of liquidity and promoting efficient flows of short-term funding. As large banks would have to pay 15 basis points for any such borrowing, the price they are willing to pay for such funds – if they are willing, given these spreads – is reduced by an equivalent amount. This disadvantages both parties, but particularly limits the ability of community banks to benefit from this short-term market.

Community banks also utilize FHLB advances. While these advances would still be available, the increased costs for using advances by large banks means that the income to the FHLBs is reduced and could impair viability of some of these FHLBs. Since all banks that borrow from the FHLBs must also hold capital in the system, any impairment of income to the system has consequences to all FHLB-stockholding banks. It also has consequences for how the advances that are made available are priced. Thus, the combination of reduced usage of advances by the largest banks, the reduction in income that reduces the value of the stock owned, and the likely increase in the cost of advances all will make funding of loans – which generally supports housing market loans – more difficult and expensive for community banks

There is a broader issue than just the likely ripple effects that will impair community banks' ability to meet the needs of their communities. Many small banks believe that once the precedent is set to assess an additional tax on large banks, it is only a matter of time before the tax is spread to other banks. It also sets precedents to arbitrarily raise taxes on any specific sector or any specific firm or group of firms. Thus, an industry-specific tax is not appropriate and sets a precedent that will affect all industries, not just the banking industry. It will inevitably affect healthy, well-run firms – whether banks or other healthy businesses and whether they are large or small.

Conclusion

The banking industry appreciates the extraordinary actions taken by the government to address the financial crisis. Unfortunately, there continues to be considerable confusion about those programs, including the expansion of support to non-banks and even non-financial companies. There has also been a failure to recognize the significant returns already provided by the banking industry to taxpayers and the unfairness created when banks are asked to pay for the losses created by non-banks. Large banks will clearly bear the brunt should any bank tax be applied, but the consequences go well beyond the largest banks and will likely affect community banks' funding costs and the ultimate borrowing costs for their customers. The ABA, therefore, must oppose such a tax.

Senate Finance Committee Hearing
"The President's Proposed Fee on Financial Institutions Regarding TARP: Part 2"
May 4, 2010
Responses to Questions for James Chessen, Chief Economist, American Bankers Association

Question from Senator Bingaman

1. You argue that had the TARP been limited to the banking industry, there would be no losses on that program. While that statement may be true, doesn't it ignore the enormous total costs incurred by the government -- and our economy -- due to risky behavior undertaken by certain banks? Bloomberg estimates that the Fed and Treasury have provided $9.7 trillion in assistance to banks -- $3 trillion in lending, $5.7 trillion in pledges, and $1 trillion for the two stimulus bills. And that's not to mention the impact on American businesses and families. Furthermore, a recently issued report by Pew finds "U.S. households lost on average nearly $5,800 in income due to reduced economic growth during the acute stage of the financial crisis from September 2008 through the end of 2009." Given the massive costs incurred on U.S. governments, businesses, and families, how can one justify assertions that a tax raising less than $100 billion "unfairly" singles out the nation's largest financial institutions?

Mr. Chessen's Answer:
There is no question that the banking industry – indeed, the entire country – benefited from the extraordinary actions taken by policy makers in the fall of 2008. Unfortunately, there continues to be considerable confusion about the goals of many of the government programs, including the expansion of support to non-banks and even non-financial companies. There has also been a failure to recognize the significant returns already provided by the banking industry to taxpayers – over 8.5 percent to date – and the unfairness created when banks are asked to pay for the losses created by non-banks. As I emphasized in my prepared remarks, had the TARP been limited to the banking industry, there would be no losses on that program. TARP funds became a ready source of funds for dealing with the bankruptcies of non-banks, including General Motors, Chrysler, and AIG.

There also is a great deal of confusion about the ***actual*** outlays versus the ***potential*** outlays for these programs. The numbers often reflect the total possible funding, not the actual funding. This appears to be the case in the numbers you cited in your question. Moreover, the numbers often cited typically do not include collateral pledged, monies returned, and profits earned (from dividends, interest, and the value of warrants).

As I mentioned in my written statement, the President and Treasury officials have acknowledged the significant returns to taxpayers from bank-TARP programs. Speaking on the first panel of this hearing, Treasury Secretary Geithner stated in response to a question that the government expects to make over $20 billion on the bank-TARP programs. The Federal Reserve, which as you pointed out provided significant liquidity support for banks, returned $34 billion in revenue (exceeding costs) in 2009 and is expected to return up to $70 billion in 2010 – returns far exceeding any historic payment made to Treasury. The FDIC emergency programs have raised

$11.2 billion and, while there will be some costs related to protection of transaction accounts, they are expected to be small in comparison to the revenue collected.

It is also noteworthy that the estimates of losses on TARP continue to decline ***every*** quarter. This is the reason why the EESA required a report on net TARP losses in ***2013***, so that there would be a clearer picture of the magnitude of losses and the source of those losses. It is certainly too soon to know the extent of losses from the auto companies or AIG, which is where the current losses are concentrated.

Questions from Senator Hatch

1. You indicated in your testimony that this bank tax proposal can mean that up to $1 trillion in loans that would otherwise be made would not be made. Isn't this an exaggeration? Even if it is only half this amount, can you estimate the number of jobs that might not be created as a result?

Mr. Chessen's Answer:
As I said in my prepared remarks, there are two impacts of taking such a huge amount of resources out of large banks with the proposed bank tax. First, is the immediate consequence that payments of $90 billion to $117 billion (as proposed) mean that $90 billion to $117 billion cannot be used directly for lending. Second, is the impact on lending due to the fact that capital cannot be used to support additional lending. Since $1 of bank capital can support up to $10 in lending, the simple translation is that it could mean up to $1 trillion in loans not made over the 10-year period of the tax.

Certainly, it is hard to know precisely what level of lending is ultimately not made, but the connection is direct and the impact real. Even if it is only half of this amount, as you asked in your question, the potential impact is very large. For example, the Congressional Budget Office estimated that the $787 billion stimulus in the American Recovery and Reinvestment Act "increased the number of full-time-equivalent jobs by 1.8 million to 4.1 million compared with what those amounts would have been otherwise." Using that same relationship, the loss of $500 billion in loans would translate into between 1.1 million and 2.6 million in lost jobs over the 10-year period.

2. You assert in your testimony that it is borrowers, and particularly small business borrowers, who will end up paying for the proposed tax. Won't the tax simply come out of the bonuses of high paid executives of the big financial firms that are directly hit by the tax?

Mr. Chessen's Answer:
The proposed bank tax of $90 billion to $117 billion represents an enormous cost that impacts all bank stakeholders, from employees, to investors, to borrowers. Employees of the bank could be affected, not only through reductions in salaries and bonuses, but through layoffs as well. Job

losses, wage cuts, and restraints on new hires within the banking industry is, of course, completely counter to Congressional efforts to lower the unemployment rate and revive the economy.

Stockholders are immediately affected as the value of the stock adjusts to reflect this enormous cost as investors re-evaluate the income potential and growth potential of these firms. ***In fact, the day the Administration announced the proposed bank tax, $18 billion in market capitalization was lost by the six largest financial firms.*** Capital moves very quickly as investors seek better relative returns. At a time when capital remains scarce, imposing a tax on banks that drives capital away has serious consequences. Every loan made by a bank is backed by capital. If capital flows out of banks, it means fewer loans will be made.

Borrowers and other customers also end up paying some of the cost of the tax. With capital moving to other industries and the reality of a large tax payment, some borrowers may not have access to credit or will have access to credit on terms that would not be as favorable in absence of the tax. Small businesses, which have fewer alternatives for funding than larger businesses, would most likely feel the impact of this bank tax more keenly.

While the actual incidence of the tax on each of these is unknowable, what is perfectly clear is that none of these impacts are good – for employees, stockholders, borrowers, and the economy.

3. Can you elaborate on the idea you presented in your testimony that the bank tax, even at 15 basis points, could make U.S. financial institutions uncompetitive in global markets?

Mr. Chessen's Answer:

The proposed bank tax must be considered in a larger, global context. First, it is unclear what action will be actually be taken by other countries. While there is considerable discussion on the topic, there is no consensus on what, if anything, needs to be done (let alone, whether it can realistically be implemented consistently across many countries). In fact, Canada, Australia, Japan, Brazil, and Switzerland have come out publicly against such a tax. If there are inconsistencies, which seem inevitable, it will lead to competitive issues. Business will flow to financial firms in countries that do not have the same tax burden.

It is also the case that some foreign banks operating in the U.S. will be subjected to this tax. Thus, not only does the bank tax make U.S. banks less competitive, it also makes foreign banks that are subject to the U.S. bank tax less competitive as well versus other foreign banks not subject to the tax.

Second, in my prepared remarks, I detailed the negative implications on low-margin, low-risk markets. For example, as noted above, the tax squeezes the already tight spreads on many wholesale products supported by non-deposit liabilities. The 15 basis point tax would make U.S. firms uncompetitive in low-margin money market and foreign exchange products, which would

leave these markets in the hands of those foreign competitors (that are not subject to the tax) whose prices are not constrained by the bank tax. While regional and community banks are not subject to the tax, it is unreasonable to assume that they could create and replace the large-scale, low-risk, repo markets that are being disrupted by the tax.

Thus, this leaves foreign banks (not subject to the tax) to take market share from U.S. institutions (or from foreign banks in the U.S. that are subject to the tax). It may also encourage U.S. banks with multi-national operations to shift operations from the U.S. to countries with more favorable tax treatments.

Statement of

Edward J. DeMarco, Acting Director

Federal Housing Finance Agency

Before the U.S. Senate Finance Committee on the

President's Proposed Fee on Financial Institutions Regarding TARP

May 11, 2010

Chairman Baucus, Ranking Member Grassley, and members of the Committee, thank you for the opportunity for the Federal Housing Finance Agency (FHFA) to testify on the Financial Crisis Responsibility Fee and the nation's housing government-sponsored enterprises (GSEs) – the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac) and the Federal Home Loan Banks (FHLBs).

The Emergency Economic Stabilization Act of 2008, the statute that created the Troubled Asset Relief Program (TARP), requires the President put forward a plan "that recoups from the financial industry an amount equal to the shortfall in order to ensure that the Troubled Asset Relief Program does not add to the deficit or national debt." In January, President Obama proposed a Financial Crisis Responsibility Fee that will be levied on the liabilities of the largest financial firms. The purpose of the fee is both to raise sufficient revenue to offset any budget cost of TARP and, by levying a fee on the liabilities of the largest financial firms, to provide a deterrent against excessive leverage.

The Administration proposal has the following key features:

- The fee would be applied to banks, thrifts, bank and thrift holding companies, brokers, and securities dealers that were eligible for the emergency assistance program put in place to resolve the crisis. Firms with consolidated assets of less than $50 billion would not be subject to the fee for the period when their assets are below this threshold.
- The assessable base of the fee would include the worldwide consolidated liabilities of U.S. financial firms. The fee base would include a broad set of liabilities with a few

designated exceptions including Federal Deposit Insurance Corporation-assessed deposits and, for insurance companies, certain policy-related reserves. In addition, adjustments would be provided to prevent avoidance and to appropriately treat less risky activities, such as lending against certain high quality collateral.

- The fee rate would be approximately 15 basis points.

We understand that the Administration does not intend for Fannie Mae and Freddie Mac (the Enterprises) to be covered by the proposal. And as I will explain, given the Enterprises' current financial condition and financial support from the Treasury Department, subjecting the Enterprises to the fee would not increase revenue to the Federal government. While Fannie Mae and Freddie Mac are not TARP recipients, they are the recipients of substantial government support.

When the housing bubble burst, the Enterprises' financial situation deteriorated rapidly, driven by credit losses and other than temporary impairments on mortgage-backed securities held on their balance sheets. These losses quickly overwhelmed the relatively low levels of capital that the Enterprises were required to hold against potential losses. Ultimately intervention was required because of the inability of the Enterprises to raise new capital and access debt markets in their customary way. These actions were necessary because the Enterprises' ability to fulfill their mission was compromised by their financial condition and their collapse would have had devastating consequences for the housing finance system and the broader economy due to their interconnectedness.

Therefore, in September 2008, FHFA placed Fannie Mae and Freddie Mac into conservatorships – a statutory process designed to stabilize the troubled institutions. In conjunction with that action, the Treasury Department agreed to provide financial support to the Enterprises through the Senior Preferred Stock Purchase Agreements (PSPAs). The PSPAs are structured to provide ongoing financial support to the Enterprises to ensure they remain active participants in the marketplace. The PSPAs are ongoing, explicit and irreversible contractual commitments by the Federal government to ensure that Fannie Mae and Freddie Mac can meet their obligations. The PSPAs work by ensuring that the Enterprises maintain a positive net worth. Since the initial

establishment of the PSPAs, the Treasury Department twice has increased its financial commitment to maintain market confidence in the Enterprises.

The PSPAs have worked as intended. Investors have confidence in the U.S. government's commitment to honor these obligations. As a result, investors have continued to support U.S. housing finance through investment in Enterprise securities. This has been of tremendous benefit to homeowners, home buyers, local communities, lenders, and pension funds, among others. To see this benefit, consider that roughly three-quarters of mortgages originated last year were guaranteed by the Enterprises, with most of the remainder guaranteed by the Federal Housing Administration or the Veterans Administration. Further, more than four million households last year lowered their monthly mortgage payment or moved to a more stable mortgage by refinancing their mortgages with the involvement of the Enterprises. And, while serious delinquencies continue to rise, we have begun to see some signs of improvement, however fragile, in house prices and mortgage performance.

In the first two full years of this housing crisis, from July 2007 through 2009, combined losses at the Enterprises totaled $207 billion. During 2009 alone, the Enterprises reported net losses of $94 billion. The Enterprises' financial performance continues to be dominated by credit-related expenses and losses stemming principally from purchases and guarantees of mortgages originated in 2006 and 2007. Since the establishment of the conservatorships, the combined losses at the two Enterprises depleted all their capital and required them to draw over $125 billion from the Treasury Department under the PSPAs. As conservator and regulator, FHFA is acting aggressively to assure that Fannie Mae and Freddie Mac are fully supervised for safety and soundness, are acting to reduce losses, and are undertaking only activities tied to their core responsibilities. Nevertheless, with continuing uncertainty regarding economic conditions, employment, house prices, and mortgage delinquency rates, the short-term outlook for the Enterprises remains uncertain and they are likely to require additional draws under the PSPAs.

More detailed information on the purpose and status of the conservatorships, as well as FHFA's views on the future direction of the Enterprises' business activities while they are in

conservatorship, is detailed in a letter I sent to Chairmen Frank and Dodd and Ranking Members Bachus and Shelby in February 2010. This letter is available on the FHFA website (link).

Today the financial state of the Enterprises makes them poor candidates for inclusion in a fee proposal because the Enterprises are projected to have continuing losses that will be funded by the PSPAs. Any additional fee assessments will add to those losses, resulting in increased draws through the PSPAs. Applying the fee to the Enterprises would be an exercise in moving money between government accounts.

Let me make two related observations. First, the Enterprises already have the obligation to pay a ten percent dividend to Treasury on draws made under the PSPAs. Today, this quarterly obligation exceeds $1 billion for each company and those dividends are effectively being "paid" by further draws on the PSPA. So, we are already moving money from one government account to another. Second, the Housing and Economic Recovery Act of 2008 required each Enterprise to allocate 4.2 basis points of the principal balance of new business purchases to support the Housing Trust Fund established by the legislation. In view of the condition of the Enterprises, FHFA has used its authority to suspend these contributions. Had FHFA allowed these payments, they would have been funded entirely by Treasury draws.

Looking ahead, the Enterprises' operating in conservatorship cannot be a long-term solution. We are in the midst of a "time-out" to allow careful consideration of the role of the Federal government in housing finance and the ultimate resolution of the Enterprises. I believe we are in the midst of an important national discussion about this issue. As the new roles, responsibilities, form, and structure of the Enterprises or their successors emerge from this debate, it may be appropriate to consider subjecting these institutions to a Financial Crisis Responsibility Fee just as part of the debate will undoubtedly touch on repayment of taxpayer funds used to provide financial support to the Enterprises. However, in the absence of concluding the debate on fundamental reform, it would be premature to subject the Enterprises to the Financial Crisis Responsibility Fee. As I stated earlier, given the Enterprises' current financial condition and financial support from the Treasury Department, subjecting the Enterprises to the fee would not increase revenue to the Federal government.

Before closing, let me turn to the Federal Home Loan Banks (FHLBanks). While the Administration did not propose applying the fee to the FHLBanks, I would like to make some observations about the potential impact of such a fee. As member-owned cooperatives, the FHLBanks are owned by two groups of financial institutions: those that would be subject to the proposed fee and those explicitly not subject to the proposed fee. Consequently, assessing the fee on FHLBanks would result in some combination of further increasing the fee that would be assessed on large institutions and imposing the fee on smaller institutions that the Administration had sought not to assess. Beyond this, there are numerous questions of how such a fee would affect the FHLBanks, including equity within the System, the availability of System funding, and the weak financial state of several FHLBanks. In addition, if advances are included in the fee assessment base for other financial institutions, the current operation and structure of some FHLBanks could be materially affected. These are important issues that should be fully considered in the context of overall housing finance reform.

Thank you for the opportunity to appear here today. I would be glad to answer any questions.

FEDERAL HOUSING FINANCE AGENCY
Office of the Director

February 2, 2010

Honorable Christopher Dodd
Chairman
Committee on Banking, Housing,
and Urban Affairs
United States Senate
Washington, DC 20510

Honorable Richard C. Shelby
Ranking Minority Member
Committee on Banking, Housing,
and Urban Affairs
United States Senate
Washington, DC 20510

The Honorable Barney Frank
Chairman
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

Honorable Spencer Bachus
Ranking Minority Member
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

Dear Chairmen and Ranking Members:

I am writing to update you on the conservatorships of Fannie Mae and Freddie Mac (the Enterprises). Recently there has been considerable speculation regarding how the future direction of the Enterprises' business activities interacts with their status in conservatorship. A key motivation for this letter is to provide greater clarity to policymakers and market participants on the Federal Housing Finance Agency's (FHFA) plans for the Enterprises' business activities while they operate in conservatorship.

The first part of the letter will review the establishment and purposes of the conservatorships, and how the conservatorships are operating. FHFA is focused on conserving the Enterprises' assets and meeting the goals of the conservatorship. The second part of the letter describes FHFA's views on the future direction of the Enterprises' business activities while they are in conservatorship, particularly: loan modifications and mitigating credit losses; retained portfolio; new products; and affordable housing mission.

1700 G Street, N.W., Washington, D.C. 20552-0003 • 202-414-3800 • 202-414-3823 (fax)

Background

Establishment and Purposes of the Conservatorships

After careful analysis and in consultation with the Secretary of the Treasury and the Chairman of the Board of Governors of the Federal Reserve System, FHFA placed each Enterprise into conservatorship on September 6, 2008. At that time and pursuant to the statute, FHFA set forth the purpose and goals of conservatorship as follows:

> The purpose of appointing the Conservator is to preserve and conserve the Company's assets and property and to put the Company in a sound and solvent condition. The goals of the conservatorship are to help restore confidence in the Company, enhance its capacity to fulfill its mission, and mitigate the systemic risk that has contributed directly to the instability in the current market.

Critical to the establishment of the conservatorships were the actions taken at the same time by Treasury, consistent with its authority granted in the Housing and Economic Recovery Act of 2008 (HERA), to establish three funding facilities. Two of these – the liquidity facility and the mortgage-backed securities purchase facility – expired as scheduled at the end of last year. The third facility – the Senior Preferred Stock Purchase Agreements (PSPAs) – was structured to provide ongoing financial support to the Enterprises to ensure they remain active participants in the marketplace. The PSPAs work by ensuring that the Enterprises maintain a positive net worth, and Treasury's initial financial commitment was up to $100 billion per company. As explained at the time of the conservatorships by Treasury Secretary Paulson:

> These agreements support market stability by providing additional security and clarity to GSE debt holders - senior and subordinated – and support mortgage availability by providing additional confidence to investors in GSE mortgage backed securities. This commitment will eliminate any mandatory triggering of receivership and will ensure that the conserved entities have the ability to fulfill their financial obligations. It is more efficient than a one-time equity injection, because it will be used only as needed and on terms that Treasury has set.

In the face of a potentially catastrophic failure of our nation's housing finance system, these actions, along with the Federal Reserve's decision a few months later to purchase Enterprise debt and mortgage-backed securities, succeeded in maintaining an important measure of stability in the housing finance market. As nearly all other non-governmental participants in housing finance abandoned the market, the Enterprises in conservatorship, operating with the benefit of the PSPAs, have ensured that credit continues to flow to housing. As evidence of this, the Enterprises' share in financing or guaranteeing new single-family mortgage production rose from 54 percent in 2006 to 73 percent in 2008 and 78 percent in 2009 through September. The Enterprises have also played a significant role in multifamily housing finance with their market share growing from 33 percent in 2006 to 79 percent in 2008 and 64 percent in 2009 through September.

In February 2009, the Obama Administration reiterated the importance of the PSPAs in maintaining market confidence in the Enterprises by announcing an increase in the financial commitment to each company from $100 billion to $200 billion. The importance of maintaining market confidence in the Enterprises was further reiterated with a final adjustment to the financial commitment under the PSPAs on December 24, 2009. That adjustment increased the Treasury's financial commitment to each company to the greater of $200 billion or $200 billion plus cumulative net worth deficits experienced during 2010, 2011, and 2012, less any net worth surplus remaining as of December 31, 2012.

Since the establishment of the conservatorships, Fannie Mae has realized losses of $111 billion, and Freddie Mac has realized losses of $63 billion. These losses have exhausted the value of each company's shareholder equity and resulted in considerable draws from Treasury under the PSPAs. To date, Fannie Mae has drawn $59.9 billion and Freddie Mac has drawn $50.7 billion. These calls on taxpayer funds are troubling to all of us.

The PSPAs continue to serve their original intent – providing assurance to capital market investors in Enterprise debt and mortgage-backed securities that continued investments in such securities are sound. In that way, the Enterprises remain a stable source of funds for new home purchases and refinancings of existing mortgages. However, given the existing taxpayer outlays and the extraordinary public backing now in place, I believe that FHFA owes your committees and taxpayers a clear view on how the conservatorships are operating to limit losses and maximize recoveries in the future. I will turn to those issues next.

Conservatorship Operations

As conservator, FHFA has the powers of the management, boards, and shareholders of the Enterprises. However, the Enterprises continue to operate as business corporations. For example, they have chief executive officers and boards of directors, and must follow the laws and regulations governing financial disclosure, including requirements of the Securities and Exchange Commission. Like other corporate executives, the Enterprises' executive officers are subject to the legal responsibility to use sound and prudent business judgment in their stewardship of their companies.

At the inception of the conservatorships, FHFA made clear that the Enterprises would continue to be responsible for normal business activities and day-to-day operations. FHFA continues to exercise oversight as safety and soundness regulator and has a more active role as conservator. While FHFA has very broad authority, the focus of the conservatorships is not to manage every aspect of the Enterprises' operations. Instead, FHFA reconstituted the boards of directors at each Enterprise and charged the boards with ensuring normal corporate governance practices and procedures are in place. The new boards are responsible for carrying out normal board functions, but they remain subject to review and approval on critical matters by FHFA as

conservator. The Enterprises are large, complex companies, and this division of responsibilities represents the most efficient structure for carrying out FHFA's responsibilities as conservator.

The reconstituted boards at each company oversee their respective management teams and are functioning as boards should. Like FHFA, the boards are focused on conserving assets, minimizing corporate losses, ensuring the Enterprises continue to serve their mission, overseeing remediation of identified weaknesses in corporate operations and risk management, and ensuring that sound corporate governance principles are followed.

In my view, maintaining and, where needed, strengthening these important private sector disciplines associated with each Enterprise's corporate infrastructure promotes the goals of the conservatorships and maximizes the government's options in a post-conservatorship world, including the opportunity to gain some return for taxpayers in a resolution of these companies. Any preservation of value in the Enterprises is directly related to maintaining the value of the intangible assets of these companies, including their human resources and business platforms.

There has been substantial executive management turnover at each Enterprise since the establishment of the conservatorships, starting with the replacement of each Enterprise's Chief Executive Officer (CEO) at the time the conservatorships were announced. At Fannie Mae, since conservatorship began, there have been two CEOs and new executives appointed to head almost every key business unit. Eight of the eleven highest paid employees pre-conservatorship are no longer with the company. At Freddie Mac, since conservatorship, there have been two CEOs and an Interim CEO. In just the past five months, after lengthy searches by the board, Freddie Mac has added a new Chief Operating Officer and a new Chief Financial Officer. The four highest paid employees at Freddie Mac pre-conservatorship are no longer with the company.

In short, the directors and senior executives tied to the financial collapse at each Enterprise are no longer with the companies. The senior executives who remain as well as those that were recently hired are essential to the Enterprises fulfilling the important goals of the conservatorships. As FHFA has stated since the outset of the conservatorships, it is critical to retain existing staff, including many senior managers, and critical to attract new executive management to fill the vacancies. The challenge of meeting this goal with companies in conservatorship is immense. The Enterprises operate with an uncertain future that will be the source of much public debate. As conservator, I believe it is critical to protect the taxpayer interests in the Enterprises by ensuring that each company has experienced, qualified people managing the day-to-day business operations in the midst of this uncertainty. Any other approach puts at risk the management of more than $5 trillion in mortgage holdings and guarantees that are supported by taxpayers through the PSPAs.

I will now turn to specific actions and issues pertinent to accomplishing the important goals of the conservatorships.

Accomplishing Conservatorship Goals Going Forward

Loan Modifications and Mitigating Credit Losses

Conserving the assets of the Enterprises requires, first and foremost, minimizing their credit losses from delinquent mortgages. This is and will remain the central goal of FHFA and the Enterprises.

Furthermore, FHFA operates under a statutory mandate in the Emergency Economic Stabilization Act of 2008 (EESA), Section 110, to "implement a plan that seeks to maximize assistance for homeowners and use its authority to encourage the servicers of the underlying mortgages, and considering net present value to the taxpayer, to take advantage of the HOPE for Homeowners Program ... or other available programs to minimize foreclosures." This provision specifies loan modifications and tenant protections as part of the mandate and establishes a monthly reporting requirement for FHFA. Our monthly reports pursuant to this requirement are sent to each of you and are on our website under Federal Property Managers Reports at http://www.fhfa.gov/Default.aspx?Page=172.

In pursuit of the goal of minimizing credit losses and fulfilling this statutory mandate, FHFA and the Enterprises worked with the Administration a year ago to help develop and implement the Making Home Affordable program (MHA). The Enterprises' participation in MHA is a critical step to minimizing their credit losses. Loan modifications are often a lower cost resolution to a delinquent mortgage than is foreclosure. Similarly, providing opportunities for borrowers to refinance into a more affordable mortgage helps mitigate future credit losses. Since the Enterprises own or guarantee about half the mortgages in the country, efforts like MHA that provide stability to borrowers also serve to restore stability to housing markets, which directly benefits the Enterprises by reducing credit exposure. The Enterprises also will continue to act as agents for Treasury in implementing the MHA loan modification program. FHFA views this activity as consistent with the goals of the conservatorship and the EESA mandate.

FHFA will continue to ensure the Enterprises look to foreclosure alternatives, starting with loan modifications, to minimize credit losses. I have communicated to each Enterprise the need for rigorous analytics in considering different forms of loss mitigation to ensure credit losses are being minimized. Such analysis will also guide the Enterprises' participation in any potential new Administration efforts regarding foreclosure prevention. The Enterprises' current and future efforts surrounding foreclosure prevention will focus on mitigating losses, which is fundamental to the FHFA's mandate to conserve assets. And where there is no available, lower-cost alternative to foreclosure for a particular defaulted mortgage, my expectation is that the Enterprises will move to foreclose expeditiously.

Retained Portfolios

The December amendments to the PSPAs included a change to the Enterprises' retained portfolio limits. Briefly, the change preserves the original PSPA requirement that the Enterprises begin shrinking their retained portfolios by ten percent per year, beginning this year. But, rather than starting the reduction from the Enterprises' year-end 2009 balances, the reduction now begins from their maximum allowed balances ($900 billion) as of year-end 2009. This means that each Enterprise may have a retained portfolio no greater than $810 billion by December 31, 2010. Currently, each Enterprise is below that amount.

FHFA remains committed to the principle of reducing the retained portfolios as set forth in the PSPAs. Consistent with the goals of conservatorship and in accord with the recent Treasury announcement, FHFA does not expect the Enterprises to be substantial buyers or sellers of mortgages, with an important exception. As I stated in December, the increased flexibility provided with the retained portfolio amendment may be important for maintaining the Enterprises' capacity to purchase delinquent mortgages out of guaranteed mortgage-backed security pools.

Given the size of the Enterprises' current outstanding retained portfolios, and the potential volume of delinquent mortgages to be purchased out of guaranteed mortgage-backed security pools, it is my expectation that any net additions to their retained mortgage portfolios would be related to this activity. I also expect that other private parties will begin to invest in new Enterprise mortgage-backed securities as the Federal Reserve gradually withdraws its purchase activity. To aid in complying with the requirements of the PSPA portfolio limitations in light of these factors, I am instructing each Enterprise to develop a detailed plan for how it will manage its portfolio to stay within those limitations.

New Products

HERA established a requirement that FHFA implement a public review process for new products that may be undertaken by the Enterprises. In July 2009, FHFA published an interim final rule implementing this provision. To date, no new product submission has gone through this process.

After considering the statutory requirement and the goals of conservatorship, I have concluded that permitting the Enterprises to engage in new products is inconsistent with the goals of conservatorship. Therefore, I am instructing the Enterprises not to submit such requests under the rule.

In view of the critical and substantial resource requirements of conserving assets and restoring financial health, combined with a recognition that the Enterprises operate today only with the support of taxpayers, I believe the Enterprises should concentrate on their existing core businesses, including minimizing credit losses. I reach this conclusion as various proposals seek

Enterprise involvement that, even if within charter limitations, could require large expenditures of funds, entry into new business lines with little prior experience, or dedication of personnel already operating in a stressed environment. New products could also require new risk measuring tools, compliance procedures, and additional oversight from FHFA.

In short, the Enterprises will be limited to continuing their existing core business activities and taking actions necessary to advance the goals of the conservatorship. This type of limitation on new business activities is consistent with the standard regulatory approach for addressing companies that are financially troubled. And it is even more pertinent for the Enterprises given their uncertain future and reliance on taxpayer funds.

Affordable Housing Mission

While the Enterprises are in conservatorship, FHFA expects them to continue to fulfill their core statutory purposes and that includes their support for affordable housing. One set of measures of the Enterprises' support for affordable housing comes through the housing goals, which Congress revised significantly in HERA.

Shortly, FHFA will publish for public comment a proposed rule setting the housing goals for 2010 and 2011. In that rule, FHFA will establish the framework for ensuring that the Enterprises' participation in the mortgage market includes support for the affordable housing segments of the market, consistent with their mission and with safety and soundness.

FHFA does not intend for the Enterprises to undertake uneconomic or high-risk activities in support of the goals nor does it intend for the state of conservatorship to be a justification for withdrawing support from these market segments. Under the conservatorships, the Enterprises have tightened their underwriting standards to avoid the poor quality mortgages that have contributed so much to their losses. Maintaining this type of sound underwriting discipline going forward is important for conserving assets and supporting the Enterprises' mission in a sustainable manner.

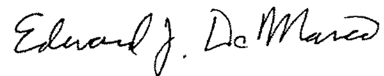
Concluding Thoughts

The Enterprises' operating in conservatorship cannot be a long-term solution. When the conservatorships and Treasury's financial commitment were established in 2008, Secretary Paulson described the arrangement as a "time-out" to allow policymakers to further consider the role of the Federal government and the Enterprises in the future system of housing finance. There are a variety of options available for post-conservatorship outcomes, but the only one that FHFA may implement today under existing law is to reconstitute the two companies under their current charters.

I recognize that the Administration and Congress have difficult and important decisions to make in the coming months on the future structure of the housing finance system. In my testimony before the Senate Banking Committee last October, I offered some of my own views on this subject. Going forward, FHFA looks forward to offering its technical assistance to both the Administration and Congress in considering policy alternatives.

The purpose of this letter has been to clarify the goals of the conservatorships and how FHFA is striving to achieve these goals. I also hope that this letter has helped to set the framework for how the Enterprises are operating in conservatorship as Congress considers the future structure of the housing finance system. I welcome the opportunity to meet with you personally to further discuss the matters covered here. As I believe the information contained here is also important to an improved public understanding of the conservatorships, I will be releasing this letter this afternoon.

Yours truly,



Edward J. DeMarco
Acting Director

Douglas J. Elliott
May 7, 2010

Testimony Before the Senate Finance Committee: The Proposed "Financial Crisis Responsibility Fee"

Thank you, Chairman Baucus, Ranking Member Grassley, and members of the Committee, for your kind invitation to discuss this important, and fairly misunderstood, topic. My name is Douglas Elliott and I am a Fellow at the Brookings Institution. The views expressed here are my own and do not necessarily reflect those of the Brookings Institution, which does not normally take "house" positions on policy issues.

Since I have not previously testified in front of this committee, let me briefly explain my background. I was an investment banker for almost two decades, primarily at J.P. Morgan. As such, I provided a wide range of advice and capital raising services to a client base of financial institutions. At Brookings, I have used the expertise developed as an investment banker to focus on financial institutions, markets, and their regulation, publishing several dozen papers on the financial crisis and regulatory reform[1]. The research is actually a continuation of work that I did from 2003-6 when I founded a small think tank called the Center On Federal Financial Institutions[2], for which I worked as a volunteer until we ran out of money and I had to return to Wall Street. COFFI focused on the federal government's own lending and insurance activities, which were already of very considerable size even prior to the financial crisis. Finally, to save everyone the usual Washington guessing game, let me explain that I am a political independent and a moderate.

I am strongly supportive of the overall idea of recovering the losses on the TARP from the financial industry so that taxpayers do not bear the ultimate cost. Repayment is self-evidently the right public policy unless there is a compelling reason not to charge a fee. It is difficult to envision a public policy rationale for why it would be more appropriate for taxpayers to bear the cost than for the industry that benefitted directly from the government actions, absent some substantial negative effect of imposing the fee. As I will explain, I firmly believe that the financial industry and the economy could absorb the relatively small fee required without significant negative effects.

I am less wedded to a particular way of imposing the fee, although I like the general approach the Administration has proposed, since it would help in a modest way to achieve other public policy objectives at the same time. It is structured to fall most heavily on the firms that represent the most risk to taxpayers going forward and that represented the greatest danger during the crisis. It is also tilted away from the core lending activities that are generally supported by deposits and towards the riskier activities that are less central to economic growth. These are worthwhile goals, although I view them as clearly secondary to the objective of repaying the taxpayers.

Opponents legitimately point out that imposing a fee on a bank, as with any other business, is likely to cause at least some of the cost to be passed through to the bank's customers. In particular, they suggest

[1] My Brookings papers can be found at http://www.brookings.edu/experts/elliottd.aspx

[2] My COFFI papers can be found at www.coffi.org

that loans could become significantly more expensive and harder to obtain. They are right directionally, but a review of the facts shows that any effect should be quite small, given the immense size of the financial industry. Also, it is worth noting that taxpayers as a group still deserve their money back even if some taxpayers ultimately bear a portion of the cost in their capacity as bank customers, especially since those who end up bearing the greatest burden are also likely to have benefitted the most from the rescue of the financial system. For example, a business that ends up paying slightly more for a loan going forward might have been paying much more for loans now if our financial system had melted down completely.

The Administration is proposing to collect $9 billion a year for a minimum of 10 years. This compares to a core earnings power for the U.S. banking industry of approximately $200 billion a year, after-tax[3]. Non-interest expense, of which compensation is the main item, is at least $300 billion, after-tax[4]. Thus, the fee would be less than 2% of after-tax income plus non-interest expense, which appears extremely reasonable given the scale of aid we taxpayers have provided the industry.

Comparing it on another dimension, banks and thrifts reported $13 trillion of assets to the FDIC, which does not count considerable investment banking and other non-bank assets. Thus, the industry could cover the $9 billion fee by charging less than an additional 0.1% on each dollar of assets, on a pre-tax basis, assuming the fee is not tax-deductible. In practice, the industry might pass along half of this to customers, or approximately 0.05% per dollar of assets, and absorb the other half by taking a 1% hit to income plus non-interest expense. For comparison, the Fed would never bother with an interest rate move this small, because the effect on the overall economy would be minor.

I notice that industry lobbyists are magnifying the reported effect by aggregating the 10 years of fees to a total $90 billion hit to capital and indicating that this $90 billion could have supported $900 billion of lending at a 10:1 ratio. They could just as easily have indicated that the industry could support an additional $900 billion of lending by voluntarily cutting non-interest expense by 3-4% for each of the next 10 years, principally by cutting compensation. In addition, $9 billion a year for 10 years has a lower value in today's dollars than $90 billion. Discounting at a 12.5% cost of equity would bring that figure down to under $50 billion, making the necessary adjustments even smaller.

Opponents have also argued that the TARP money infused into the banks as additional capital is likely to be repaid at a net profit to the taxpayers and therefore it is unfair for the financial industry to bear the cost of the TARP. They are factually correct about the repayments, although the figures are sometimes exaggerated by looking only at the returns to taxpayers on the banks that have already repaid their aid. Our problem was never going to be the banks that were strong enough to repay quickly; the losses will come over time from the weak ones that never make their full payments. Nonetheless, I do expect that

[3] FDIC figures show that the institutions reporting to it earned approximately $280 billion in 2009 prior to taxes and excluding loan losses. Adding in earnings for the industry from investment banking and other activities that are not conducted in entities reporting to the FDIC, subtracting a normal level of loan losses, and adjusting for taxes, the result is approximately $200 billion a year as a running rate.

[4] FDIC figures show non-interest expense of $385 billion in 2009. Adding an estimate of investment banking and non-banking expenses and subtracting taxes implies a figure north of $300 billion, although it is hard to be precise.

the narrowly defined category of capital infusions from TARP into the banks will yield a profit for taxpayers.

However, I think it borders on the churlish for the banks to focus on such a narrow measure when the total aid provided by the taxpayers was of far greater value to them than the relatively small cost of the proposed fee. The banks, and to a lesser extent other financial institutions, were major contributors to the financial crisis that led to our most severe recession since the Great Depression. Despite this, they were massively aided by taxpayers, with the government taking unprecedented actions to assist. The aid that was provided was generally priced well below what the private market would have charged for taking on the same risk. This was appropriate, but it means that merely paying off the aid under the terms required does not come close to fully compensating taxpayers for the risks they successfully took to restore the economy.

Besides, we should focus more broadly than solely on the direct benefits of the government's extraordinary actions. At the point the government acted so forcefully, trillions of dollars of value had been destroyed on securities and loans, much of it in the hands of the institutions which would be paying this fee. Failure of the government to act in the extraordinary manner that it did would have allowed a further meltdown that would have destroyed trillions of dollars more in value. The industry should be extremely grateful for this aid, instead of minimizing the nature of the help in order to avoid a relatively trivial fee. Nor do I think it is in their long-term interests to be perceived as refusing to make the taxpayers whole.

Let me be clear. I do believe the industry has good arguments on a few of their specific complaints, particularly the unfairness of asking the banks to pay for the auto rescue. Similarly, in a narrow sense, they have a reasonable argument for postponing the imposition of the fee until we know the size of the ultimate losses better. However, I think these arguments are dwarfed in importance by the over-riding requirement that taxpayers be repaid in total and that it be demonstrated quickly that this will indeed occur. The proposed fee is so far below the value the government provided to the financial industry that there should be no quibbling about exactly how this modest figure was calculated.

I should also note that some opponents of the fee make the argument that their particular financial institutions benefitted from the government's actions only indirectly, in the same manner as anyone else living in this country. This notion is misleading. Any large holder of financial instruments is far better off today than they would have been if the government had refused to put the taxpayers' money at risk. It is true that everyone in the economy benefited indirectly, but those with major financial investments benefitted much more significantly than those who were only affected by the general economy. It would be reasonable to have a portion of the fee spread much more widely across financial institutions, but we have to draw the line somewhere and the approach the Administration suggests is reasonable and has other advantages.

There has also been a movement to have Fannie Mae and Freddie Mac foot their share of the bill. This would be great in theory, but is impractical. Whatever the technicalities of how the government accounts for Fannie and Freddie, they are effectively government-owned. The current market value of the private shareholdings in the two firms is about $2 billion, reflecting the fact that they are likely to prove totally worthless. The fact that they have value at all is a combination of option value, since a

miraculous recovery could occur, plus the possibility that they may be paid something for their nuisance value. If we reconstitute them as public companies in the future by selling them back to the market, the expected cost of any future fees would just be subtracted by potential buyers from the price they would otherwise pay us. So, including Fannie and Freddie in the fee would have virtually no net benefit to taxpayers.

I will not say a lot about the specifics of the fee, both because I feel less strongly about them than I do about the broad concept and because I suspect that there will be considerable further changes before final legislation is finished. Given that we are going to charge a fee, it is reasonable to try to assist with another important public policy goal, which is to provide disincentives for institutions to act in ways that present the greatest risks to the public. The Administration's first step in this direction was to limit the financial institutions subject to this fee to those that have at least $50 billion in assets. This is sensible, since institutions smaller than this represent a considerably lower risk of a taxpayer bailout than do the largest institutions. The exact cut-off, however, is arbitrary and could be moved without great harm.

The second step was to suggest using "risk-weighted assets" as the base figure from which to calculate the fee. The size of assets makes sense to use as the base, because it is a good measure of the size of a financial institution and size directly relates to both capacity to pay and the total level of risk represented by an institution. Using the risk-weighted approach is consistent with the main method for calculating the risk of an institution for determining minimum capital requirements. The primary risk for a bank is that the value of its assets declines. Since certain of those assets are riskier than others, risk-weighting simply uses a higher multiplier for risky assets than for non-risky ones. Thus, a bank with risky assets will look bigger for purposes of this fee than an otherwise identical bank with lower risk assets. This does have the effect of modestly tilting the fee towards commercial lending, including to small businesses, and away from mortgage lending or holding government debt. However, the total effect on lending is likely to be small anyway, so the implications of that tilt are not serious and do have the benefit of reflecting risk levels.

Third, the portion of assets funded by equity and insured deposits would be excluded. This is intended to provide incentives for banks to support their activities with these more stable sources of funding and, to some extent, to counter any likely effects on lending. In practice, deposit money tends to be used to support loans, particularly at the smaller banks, so excluding deposits from the fee should reduce any impact on lending. It is also currently true that deposits are subject to FDIC insurance premiums and therefore this approach avoids charging twice, however the FDIC seems likely to move to charging based on assets rather than deposits, in which case this point would become moot.

Overall, the structure of the proposed fee seems broadly reasonable, but may need tweaking to avoid technical difficulties, such as have been raised in regard to repurchase agreements. More importantly, whatever the method, we should put into place a fee that recovers for the taxpayers the losses they are currently bearing from the TARP. These losses should fall on the financial industry, not the public.

Thank you for the opportunity to express my views on this important topic.

Statement of Treasury Secretary Timothy F. Geithner
Committee on Finance
U.S. Senate
May 4, 2010

Chairman Baucus, Ranking Member Grassley, Members of the Committee, thank you for the opportunity to testify before you today regarding the Financial Crisis Responsibility Fee.

On October 3, 2008, Congress gave the Treasury Department authority to stabilize the American economy through the enactment of the Emergency Economic Stabilization Act (EESA). Congress included in the legislation a requirement that the President put forward a plan "that recoups from the financial industry an amount equal to the shortfall in order to ensure that the Troubled Asset Relief Program (TARP) does not add to the deficit or national debt."

The principle that the cost of putting out a financial fire should be recovered from financial institutions was adopted by Congress in the aftermath of the savings-and-loan crisis. The FDIC Improvement Act (FDICIA) required the FDIC to recoup any losses it incurred as a result of closing failed banks through assessments on banks. This same principle is incorporated into the financial reform proposals adopted by the House and now being considered by the Senate. Both bills require the financial industry to repay the government for any costs associated with the resolution of a failing financial institution.

The cost of this economic crisis has been enormous, hitting Americans harder than any downturn since the Great Depression. Millions have lost their jobs, their businesses, their homes, and their savings. And the resulting loss of revenue has added substantially to our national debt.

The purpose of the Financial Crisis Responsibility Fee proposed by President Obama in January is to make sure that the direct costs of TARP are paid for by the major financial institutions, not by the taxpayer. Assessments on these institutions will be determined by the risks they pose to the financial system. These risks, the combination of high levels of riskier assets and less stable sources of funding, were key contributors to the financial crisis.

The fee would be applied over a period of at least ten years, and set at a level to ensure that the costs of TARP do not add to our national debt. One year ago we estimated those costs could exceed half a trillion dollars. However, we have been successful in repairing the financial system at a fraction of those initial estimates. The estimated impact on the deficit varies from $109 billion according to CBO to $117 billion according to the Administration. We anticipate that our fee would raise about $90 billion over 10 years, and believe it should stay in place longer, if necessary, to ensure that the cost of TARP is fully recouped.

We propose to assess the fee on financial institutions that have over $50 billion in assets and were eligible for the emergency assistance programs put in place to resolve the crisis. These firms are U.S.-based bank holding companies, thrift holding companies, certain broker dealers, as well as companies that control insured depositories and certain broker dealers. The U.S. subsidiaries of international firms that fall into these categories and are larger than $50 billion would also be covered. These firms were eligible for, and were the major beneficiaries of, the Treasury's capital investments under the TARP, the FDIC's Temporary Liquidity Guarantee Program, the Federal Reserve's Primary Dealer Credit Facility and other Federal Reserve liquidity facilities.

We designed the fee so that it would fall most heavily on firms that fund riskier activities with less stable forms of funding. Firms would pay a fixed percentage of their assets adjusted for risk, minus their capital, insured deposits, and certain insurance policy reserves. Firms that take on more risk and fund those activities with less stable sources of financing would pay more than firms that are managed more conservatively. This framework has the significant benefit of including derivatives and off-balance sheet items not otherwise reflected under conventional accounting. In this way, the fee targets, and thereby would help discourage, activities that pose the most risk to the stability of the financial system.

The fee is designed to limit the risk of any adverse impact on lending. The fee excludes over 99 percent of U.S. banks, which currently provide the majority of small loans to businesses and farms across the country. If covered firms try to pass on the costs of the fee to their borrowers, they will lose market share to other institutions. The Congressional Budget Office (CBO), in its review of our proposal, highlighted these advantages by noting that the proposal "would improve the competitive position of small- and medium-size banks, probably leading to some increase in their share of the loan market."

As we work with Congress to design legislation to protect the taxpayer from the costs of this financial crisis, we recognize that there are a number of possible approaches to meeting the legal requirement in EESA to cover the costs of the TARP. We will work closely with the Congress on how best to meet that obligation.

As we do, we are also working with governments around the world who are considering similar efforts. We will meet the legal requirement to recoup TARP's cost in a way that makes sense for our country, but we want to design the fee in a way that improves the chances that other governments will adopt similar measures. Since the announcement of the proposed fee, a number of countries have expressed support for the approach embodied in our proposal.

This fee is designed to complement efforts to improve the stability of our financial system by providing modest incentives against funding riskier activities with less stable funding. However, it is not a substitute for our proposals to put in place much more conservative capital and liquidity requirements on large institutions. And similarly, higher capital requirements cannot be a substitute for a fee on risk by large institutions, because they would not contribute resources to the taxpayer to cover the direct fiscal costs of the crisis.

We believe this fee is an important complement to the financial reforms now on the Senate Floor. Those reforms will provide better protection for American families and businesses, require stronger limits on risk taking by large institutions, bring transparency and oversight to derivatives markets, and enable the government to break apart failing firms with no exposure to the taxpayer.

Enacting this fee now will make it clear to the American people that they will not have to shoulder the direct costs of protecting the economy from future financial failures.

Responses to Questions for the Record

The Honorable Timothy F. Geithner, Secretary, United States Department of Treasury

Questions from Senator Baucus

1. **The Administration's Budget document states that the fee applies to "brokers, and securities dealers." Your written testimony submitted for the May 4, 2010 hearing states that the tax will apply to "certain broker dealers," and in your oral testimony you stated that the tax applies to "primary dealers." How do you define "primary dealers?"**

   "Primary dealer" means a broker or dealer designated by the Board of Governors of the Federal Reserve System or the Federal Reserve Bank of New York as a primary dealer in government debt instruments. Our current proposal would not apply to a broker-dealer that is not a primary dealer (unless the broker-dealer falls into one of the other categories of covered firms).

2. **Because "risk weighted asset" (RWA) is a term specific to banking, how would you apply it to life insurers?**

   The regulatory framework for calculating risk-weighted assets can be applied to non-banks. There are a number of examples of institutions whose primary business is not commercial banking that have computed risk weighted assets in a manner consistent with U.S. regulatory guidance. For instance, several non-banks that applied to TARP were required to do so. It should also be noted that, under the recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act some large, non-bank financial companies will already need to calculate RWA. Under the new law, firms whose distress would pose a threat to U.S. financial stability would be subjected to Federal Reserve supervision and prudential standards, including capital standards that require the calculation of RWA.

3. **Would the fee apply to an insurer with assets of $50 billion or more and that owns a thrift that is used primarily for trust business?**

   There are a limited number of companies that are large enough to be potentially captured and who own such "trust-only" depository institutions. As currently contemplated, these firms would be covered by the Financial Crisis Responsibility Fee (FCRF) since they own a depository and would have technically been eligible for extraordinary assistance extended by the government to address the last financial crisis.

4. **Since the fee is to be assessed on financial institutions that have over $50 billion in assets that were eligible for relief under programs authorized by the Emergency Economic Stabilization Act, can you confirm that the fee will be applied only to those life insurers that own an insured depository institution, thrift or broker dealer?**

   That is correct – the proposed fee would be applied only to those life insurers that were eligible for the emergency programs put in place to resolve the crisis. These firms are U.S.-based bank holding companies, thrift holding companies, primary dealers, as well as companies that control insured depositories and primary dealers. The U.S. subsidiaries of international firms that fall into these categories and whose consolidated U.S. assets exceed $50 billion would also be covered.

5. **Would the fee apply to life insurers who own a depository institution, thrift or broker dealer if the assets of their depository institution, thrift or broker dealer are not greater than $50 billion?**

   Possibly. The fee would apply to covered institutions with over $50 billion in consolidated assets.

6. **Will there be consensus among G-20 and other countries to impose a bank tax or similar levy?**

   What is your role as a world leader with respect to influencing decisions by other countries on whether to impose a bank tax or levy, and how such a tax or levy would be structured and used?

   What will be the competitive effect on American banks if other countries with major banking sectors decide not to impose a bank tax?

   How would you ensure that American banks were not doubly taxed if they had branches in foreign countries that also imposed a bank tax?

   At the behest of the G-20 Leaders in Pittsburgh, the IMF completed in June 2010 a study of various policy options for countries to ensure that the financial sector makes a fair and substantial contribution toward paying for the burden associated with government interventions to repair the banking system. At its end-June Summit in Toronto, the G-20 Leaders commended the IMF for its work.

   The Administration fully supports the decisions the G-20 made at their Toronto Summit, which were made in light of the IMF's work:

   - The Leaders recognized that the imposition of a levy or fee on banks is one reasonable approach in a range of policy options, especially for countries which used government interventions to address the financial crisis.
   - At the same time, Leaders explicitly said that some countries may choose not to levy a bank fee.
   - The G-20 Leaders agreed on a set of five principles that, whether using a bank levy or not, countries' financial responsibility policies should: protect taxpayers, reduce risks from the financial system, protect the flow of credit, take into account country-specific differences, and help promote a level playing field.
   - The Leaders did not commit to any additional work on IMF proposals.

   Tax differences of any kind between jurisdictions are among the many factors that firms consider in their overall business strategy. In the case of the very large financial institutions in various countries which will likely be subject to "bank taxes;" the existence of such taxes is unlikely to play nearly as large a role as factors such as desired market share, servicing their nonfinancial firm customers abroad, being able to continue to be key players in

payments systems in important financial centers, the quality of regulation, the reliability of the legal system, etc. Hence, countries with large, important financial centers are not likely to see massive out-migration of financial firms and activity in the event they were to institute a bank tax.

7. **How do you envision the IRS will interact with the banking regulators to administer and enforce the bank tax? Will the IRS need more resources and will the IRS need to recruit new employees with expertise in the banking industry to enforce this tax?**

   Under the Administration's proposal, liability for the FCRF would be determined on the basis of information that is reported to, and verified by, appropriate financial regulatory authorities under applicable non-tax laws. The Internal Revenue Service (IRS) would review these amounts to determine the accuracy of the tax liability calculation. We would expect those other regulatory authorities to assist the IRS in examining the tax liability computations made by the affected financial institutions. As a result, it would not be necessary for the IRS to develop significant additional expertise with regard to bank regulatory requirements or other aspects of the financial industry in order to collect the appropriate amount of tax.

8. **The risk-weighted asset approach would rely on the Basel standards for assigning risk to bank assets.**

   How does the Basel Committee determine international capital standards?

   The Basel Committee establishes working groups of experts drawn from its members to develop proposals for capital standards. These proposals are issued for public consultation. The Basel Committee also engages, through its members, with the banking industry to obtain quantitative information the Basel Committee can use to analyze the effects of its proposals. The process of issuing a proposal for comment, collecting and analyzing comments, and collecting quantitative information for analysis may require more than one round before the Basel Committee finalizes a standard. A proposal becomes final when it is approved by the full membership of the Basel Committee.

   Basel standards consider small business loans to be quite risky. To what extent do you agree with what the Basel Committee considers risky or not risky?

   The Basel Committee's Basel II risk-based capital standards are sensitive to the riskiness of a given loan or obligation. This risk of a loan is judged not only by the borrower's credit, but also by the existence of collateral, guarantees or other factors that mitigate risk. The financial crisis revealed weaknesses in Basel II which underestimated the riskiness of certain elements, principally dealing with securitizations and large trading portfolios. These weaknesses are being addressed in Basel III.

   What are the possibilities for manipulating the risk-weighting system? Would a bank tax based on risk-weighted assets create the potential for loopholes?

A risk-weighting system can be subject to capital arbitrage if the risk weights are not closely aligned with the underlying risk of the exposure. In the case of Basel I, the risk weight bucketing approach was not well aligned with the underlying risk of the exposures and led in some cases to capital arbitrage. One of the key recommendations arising out of the Asian financial crisis in the 1990s was the need to revise the risk sensitivity of Basel I. Basel II sought to address many of these issues. Basel III will address flaws that have been observed in Basel II, as a result of the lessons learned from the most recent financial crisis, especially for securitizations and large trading portfolios. It should be noted that the addition of a leverage ratio requirement under Basel III will act as a supplement to the risk weighting approach and limit the degree of capital arbitrage.

A bank fee that is based on a risk weighted system does not create "loopholes" in the risk-based capital system. Such a tax would add to the cost of a transaction or loan, thereby changing a bank's incentive structure, which is the purpose of a risk-sensitive bank fee.

How will the risk-weighted asset approach be affected by new Basel II and Basel III risk-weighting guidelines?

The effects of Basel III will mainly occur by tightening the definition of capital, raising the overall amount of capital required, and increasing the capital requirements for particular areas (such as securitization and large trading operations) that have proven to be more risky than Basel II had provided for.

Basel II and Basel III will take into account more factors when looking at the risk of any given asset, including the credit ratings of the borrower.

a) **What discretion will a bank have in determining the risk-weighting of each of its assets?**

   The Advanced Approaches of Basel II permit the largest and most sophisticated banks an opportunity to apply models to determine risk weights. The Advanced Approaches in the U.S. are tightly supervised by the banking regulators, who apply strict quantitative and qualitative standards to these banks. The Standardized Approach, which has not yet been adopted by the U.S. banking supervisors, uses a risk weighting system that is similar to Basel I, but with a more risk sensitive design.

b) **Will Basel II and Basel III result in more or fewer loopholes compared to Basel I standards?**

   A major reason for developing Basel II was to reduce opportunities for regulatory capital arbitrage, since the global financial system had significantly evolved since Basel I was introduced in 1988. The financial crisis revealed weaknesses in Basel II which underestimated the riskiness of certain elements, principally dealing with securitizations and large trading portfolios. These weaknesses are being addressed in Basel III. Although the final provisions of Basel III have not yet been decided, it is apparent that it will be a significant improvement over Basel I and Basel II.

<u>**Question from Senator Bingaman**</u>

1. **One of the thorniest considerations in designing any bank fee is the base against which the fee is assessed. If I understand correctly, the primary rationale for the Administration's proposed fee is that it constitutes a sort of retroactive insurance premium for benefits incurred, directly or indirectly, through the TARP program. If that's the case, then why not base the fee on the actual level of benefit that inured to a financial institution through the TARP program, rather than its current assets? Douglas Diamond and Anil Kashyap of the University of Chicago say policymakers should do this by levying the fee on each bank above the asset threshold based on the difference between its assets at the end of August 2008 and its current level. Why doesn't the Administration's proposal take this approach?**

   The FCRF is not intended to be a retroactive insurance premium. Rather, as proposed the FCRF is designed to recoup certain costs currently borne by the taxpayer that result from the response to the last financial crisis, including specifically TARP, as required by EESA, in a way that discourages large financial firms from funding the riskier investments with risky sources of funding. In this regard, it is appropriate that the fee be applied to firms that were eligible for the emergency programs put in place to resolve this crisis—particularly considering the significant indirect benefits of these actions realized by the entire financial sector, regardless of whether they participated in any particular program. In addition, unlike alternative, backward looking approaches—like the Diamond-Kashyap proposal—the FCRF has the advantage of including incentives against financial institutions taking on excessive size and excessive risk.

2. **Secretary Geithner, you noted in your testimony that a life insurance company with total assets above $50 billion could be subject to the President's proposed fee if it owns a bank or thrift (and, consequently, it could have been eligible to receive TARP assistance). But for many such insurers, the bank or thrift represents a very small share of the company's total assets. Is it fair to sweep in a life insurer merely because it has a bank or thrift subsidiary? If the argument is that these companies benefited indirectly, did they benefit any more than a life insurance company or other financial company that did not happen to own a bank or thrift? And assuming the cut-off for taxing companies is going to be owning a bank or thrift, should the fee be assessed based on the insurer's total assets, or rather just the bank or thrift assets?**

   The FCRF is designed to recoup money for the American taxpayers, as required by EESA. While it is true that many financial firms that were ineligible for emergency programs nevertheless benefited indirectly from those programs, we believe it is appropriate that the fee be applied to firms that were eligible for the emergency programs put in place to resolve the crisis.

Questions from Senator Grassley

1. **On April 21, 2010, GM and Treasury announced that GM paid back the balance of its taxpayer TARP loan in full, with interest, years ahead of schedule. It turns out that this claim was not true. Rather, Treasury allowed GM to use another source of TARP funds to repay the TARP loan, but this was not made clear in the press releases or the TV commercial. The TARP escrow funds used to repay the loan came from TARP money Treasury paid for GM stock. The escrow funds were placed under Treasury supervision for use by GM to pay extraordinary expenses.**

   GM filings at the SEC state that the taxpayer TARP loan bore an interest rate of 7% and ran until 2015. The SEC filings also list a $2.5 billion loan GM still owes their auto union healthcare plan that runs until 2017 and bears an interest rate of 9%.

   After GM took $4.7 billion out of the escrow account to repay the TARP loan, Treasury released the escrow balance of $6.6 billion to GM with no restrictions on GM's use of the funds. Treasury did not require GM to repay the 9% union loan before releasing the $6.6 billion to GM. Therefore, the American taxpayer continues to subsidize this expensive debt.

   GM and Treasury were criticized in the New York Times on Sunday, May 2, for "employing spin and selective disclosure" regarding the repayment. GM was quoted in the article saying: "The bottom line is, our strong business performance has put us in the position that we don't need these funds," referring to the cash in the escrow account.

   At the hearing I asked why Treasury did not require GM to repay the 9% union loan before allowing GM to take the final $6.6 billion from escrow free and clear. You said that Treasury does not involve itself in the management of GM.

   However, the taxpayers remain 61% owners of the company.

   The Treasury website says that, with respect to the Government's ownership interest in GM, Treasury will be guided by four principles:
   - **seek to dispose of its ownership interest as soon as practicable**
   - **reserve the right to set upfront conditions to protect taxpayers, promote financial stability, and encourage growth**
   - **protect the taxpayers' investment by managing its ownership stake in a hands off, commercial manner**
   - **vote on core governance issues, including the selection of a company's board of directors and major corporate events and transactions**

   If you truly were protecting taxpayers' by managing their ownership stake in a commercial manner, then why, when GM asked permission to use escrow funds to repay the 7% loan, did Treasury not also require GM, as an upfront condition, to repay

the 9% loan? That would have been common sense, as well as sound commercial practice.

As we have communicated to you in a letter dated April 27, we have provided full disclosure relating to GM's repayment of our loan.

As you know, Treasury is a reluctant shareholder of GM and does not manage the day-to-day operations of the company. As a result, Treasury defers to the commercial judgment of GM's management and Board of Directors on decisions as to the timing for repayment of its remaining debt. Treasury's goal continues to be recovering funds for the taxpayer and exiting TARP investments as soon as practicable.

The VEBA loan was entered in July 2009 in connection with the restructuring of GM, at the same time as the terms of Treasury's loan were largely established. The contracts, including an intercreditor agreement between Treasury and the VEBA, provide that GM must repay the VEBA loan and the Treasury loan pro rata in certain situations, but not in the case of the escrowed funds. By contract, the escrowed funds were required to be applied only to repay Treasury's loan if not used for approved expenses; the VEBA loan did not have a right to repayment from the funds.

As to GM's decision to repay the Treasury loan before the VEBA loan, there are a number of reasons other than interest rate that may cause a company to repay one loan over another, including differing rights to repayment and cash interest payment requirements. We would note that GM does not have to pay cash interest on the VEBA loan until principal payments are due, so prepaying the VEBA loan would not have reduced GM's monthly cash needs in the same way that paying the Treasury loan did. This fact is partly why the VEBA loan bears interest at a higher rate than Treasury's loan.

It is inaccurate to characterize allowing a sizable repayment of the American taxpayer's investment in GM as anything other than Treasury protecting the taxpayer's investment consistent with the rights under the contract.

2. **When you testified before the Committee in February, you promised, in the presence of the Chairman, to ensure that I would receive all the information I requested on excessive bonuses and severance payments to AIG executives. Notwithstanding that this request was made on behalf of the Committee, at a Committee hearing, Treasury Department lawyers have claimed that I am not entitled to receive "Privacy Act-protected information" related to particular AIG executives. Although the Privacy Act allows agencies to provide such information to Congressional Committees, Treasury has selectively imposed a policy (not contained in or required by the statute) of not providing information unless a Chairman requests it. This attempt to thwart oversight of Treasury by Congress is not legally supportable.**

   Please produce the requested documents and information as soon as possible.

The Treasury Department is firmly committed to transparency and accountability. In response to your requests for information about AIG severance payments, Treasury has provided your office with numerous briefings and relevant documents. The Special Master for TARP Executive Compensation, Kenneth Feinberg, has sent you four detailed letters. He also has provided your staff with an in-person briefing, and he has repeatedly offered to meet with you at your convenience to explain his decisions and how Treasury has fulfilled its statutory mandate. In regard to the application of the Privacy Act, Treasury follows the legal guidance of the Department of Justice.

Furthermore, Treasury was supposed to police executive compensation at TARP-recipients like AIG to ensure that taxpayers didn't subsidize excessive payments to their executives. However, Treasury has relied on a provision of the law which "grandfathered" certain existing contracts and expanded it by regulation to avoid limiting certain payments to lower-level, but still highly compensated executives. One in particular is Suzanne Folsom, AIG's former Chief Compliance Officer. She reportedly received a $1 million severance payment at the end of 2009. It is my understanding that she did not have a grandfathered severance contract, but that Treasury allowed her to be paid anyway. Treasury has refused to provide documents or information detailing the circumstances surrounding her severance agreement, or the date and amount of her severance payment.

In addition to the information previously requested regarding Ms. Folsom's employment and severance agreement, please explain why Treasury allowed this executive to receive a reported $1 million payment under a contract that was not grandfathered?

As you know, I share your frustration about excessive executive compensation. As a result, Treasury used the authority granted by Congress in the Recovery Act to create the Office of the Special Master ("OSM") and to empower the office to limit executive pay at companies that received exceptional taxpayer assistance, such as AIG. Mr. Feinberg's rulings have had a dramatic impact upon the general compensation practices of these firms. We generally limited cash salary to $500,000 and required senior executives to take the remainder of their pay in stock that must be held over the long term. At AIG in particular, we reduced cash compensation by over 90% and total pay by over 50%.

The jurisdiction of the OSM, however, is not unlimited. EESA, the Recovery Act, and Treasury regulations define the mandatory jurisdiction of the OSM. It has jurisdiction to approve compensation structures and payments to the "top twenty-five" executives of firms that received exceptional TARP assistance; and it has jurisdiction to approve the compensation structures, but not individual payments, of the next seventy-five employees of those firms. Ms. Folsom did not fall within either category. Therefore, AIG did not provide documents to Treasury regarding her severance payment.

3. **A Global Bank Tax?**

The International Monetary Fund has suggested a globally-coordinated bank tax. Actually, the IMF has proposed two bank taxes – a so-called Financial Stability Contribution, mainly based on a bank's balance sheets, to help pay for the cost of winding down troubled financial institutions. The other proposed IMF bank tax would be a "Financial Activities Tax", levied on the sum of profits and compensation of financial institutions, to help finance the broader costs of a financial crisis.

Your recent counter-part in the UK, the Chancellor of the Exchequer, Mr. Alistair Darling, has welcomed these IMF proposals for two international bank taxes. Mr. Darling has gone on to say that a unilateral tax, imposed by just one country, "would simply risk being undermined."

Strong allies and trading partners of the US, such as Canada, Australia, Japan, and India have expressed significant reservations about the proposed IMF global bank tax.

The Wall Street Journal recently (April 30, 2010, "A Global Bank Heist") stated "Mr. Geithner ... want[s] a *global* bank tax because [he] realize[s] that a country-specific tax could drive financial institutions to less-confiscatory regimes."

a) Do you support either of the IMF's suggestions for a global bank tax?

The U.S. fully supports the agreement G-20 Leaders arrived at on this issue at their June 2010 Summit in Toronto. At the behest of the G-20 Leaders in Pittsburgh, the IMF completed in June 2010 a study of various policy options for countries to ensure that the financial sector makes a fair and substantial contribution toward paying for the burden associated with government interventions to repair the banking system. At its end-June Summit in Toronto, the G-20 Leaders commended the IMF for its work.

We fully support the G-20's Toronto Summit decisions, which were informed by the IMF's work:

- The Leaders recognized that the imposition of a levy or fee on banks is one reasonable approach in a range of policy options, especially for countries which used government interventions to address the financial crisis.
- At the same time, Leaders explicitly said that some countries may choose not to levy a bank fee.
- The G-20 Leaders agreed on a set of five principles that, whether using a bank levy or not, should guide countries' financial responsibility policies: protect taxpayers, reduce risks from the financial system, protect the flow of credit, take into account country-specific differences, and help promote a level playing field.
- The Leaders did not commit to any additional work on IMF proposals.

b) Is the Wall Street Journal correct that you want a global bank tax?

The U.S. is fully on-board with the G-20's Toronto Summit position, which recognizes the differences in individual countries' approaches to the financial responsibility issue, and which therefore does not advocate coordination across countries of a bank tax or levy.

c) **Is the Chancellor of the Exchequer correct that a unilateral tax, imposed by just one country, "would simply risk being undermined"?**

d) **At the margin, would a US-specific bank tax drive financial institutions to countries without a bank tax? Why or why not?**

e) **Let us suppose for a moment, even though this is unlikely, that all G20 countries agreed to impose a global bank tax, along the lines of what the IMF has proposed. However, let us suppose that Hong Kong, one of the world's leading banking and financial centers, refused to impose a bank tax. Would this drive tremendous amounts of banking from the G20 countries to Hong Kong?**

Answer responds to Questions 3c – e:

Tax differences of any kind between jurisdictions are among the many factors that firms consider in their overall business strategy. In the case of the very large financial institutions in various countries which will likely be subject to "bank taxes;" the existence of such taxes is unlikely to play nearly as large a role as factors such as desired market share, servicing their nonfinancial firm customers abroad, being able to continue to be key players in payments systems in important financial centers, the quality of regulation, the reliability of the legal system, etc. Hence, countries with large, important financial centers are not likely to see massive out-migration of financial firms and activity in the event they were to institute a bank tax.

f) **How should the US respond to the concerns of Canada, Australia, Japan, and India about the proposed IMF global bank tax?**

The U.S. fully supports the G-20's Toronto Summit position, which explicitly recognizes that some countries will choose not to institute a bank levy.

4. **Congressional Review Act**

Were Congress to enact a bank tax, this presumably would give additional powers to the Internal Revenue Service. However, I am growing increasingly concerned that the powers the IRS already has are not used properly. Thus, I have reluctance to extend still more power to the IRS, such as with a bank tax. Specifically, I have grown increasingly concerned about IRS's apparent lack of compliance with the Congressional Review Act.

a) **Do you agree that the CRA requires that before any rule takes effect, the Federal agency promulgating such rule must, among other requirements, notify Congress as to whether the rule is a major rule?**

The CRA states that "[b]efore a rule can take effect, the Federal agency promulgating such rule shall submit to each House of the Congress and to the Comptroller General a report containing . . . a concise general statement relating to the rule, including whether it is a major rule."

b) Do you agree that the determination of whether a rule is major is made by OMB's Administrator of the Office of Information and Regulatory Affairs (OIRA)?

In a memo directed to heads of departments and agencies, the director of OMB stated:

If the rule is subject to E.O. 12866 review, you should indicate whether you consider the rule as 'major' when you submit both the proposed rule and final rule for OMB review. If the rule is not subject to E.O. 12866 review, you should contact your Desk Officer in OMB's Office of Information and Regulatory Affairs (OIRA) in accordance with your established practice.

- OMB Memo M-99-13 (March 30, 1999)

However, the current General Counsel of the Treasury Department, George W. Madison, recently wrote to me that:

> ***The IRS and Treasury complied fully with the CRA in regard to Notice 2010-2. Pursuant to longstanding agency practice across several Administrations, the IRS and Treasury generally have concluded that IRS notices are not 'major' rules under the CRA, and, in particular, reached that conclusion with respect to Notice 2010-2. Accordingly, the Notice was not submitted to the Office of Information and Regulatory Affairs for determination of 'major' status under the CRA.***
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> **- Letter to Chuck Grassley from George W. Madison (April 28, 2010).**

The CRA defines the term "major rule" to mean any rule that the Administrator of OIRA finds has resulted (or is likely to result) in one of three specified criteria being satisfied. The CRA does not require that agencies submit every rule to OIRA for this determination, and it has not been the practice of the IRS and Treasury to do so.

c) Since enactment of the CRA, how many IRS rules have been designated as "significant" within the meaning of E.O. 12866?

Pursuant to Office of Management and Budget ("OMB") guidance implementing E.O. 12866, and longstanding agreements between OMB and Treasury—only IRS legislative rules that constitute "significant regulatory actions" are subject to E.O. 12866 review. The Government Accountability Office's Federal Rules Database lists seven rules issued jointly by the IRS and other agencies that were determined by the other agencies to have

satisfied this standard and that were submitted by the other agencies to OMB for EO 12866 review. An additional two regulations issued independently by the IRS and Treasury have been designated as significant regulatory actions under EO 12866.

d) **Since enactment of the CRA, how many IRS rules have been subject to E.O. 12866 review?**

Please see the answer to Question 4(c).

e) **Of the 796 IRS rules published in the Federal Register since enactment of the CRA, how many were subject to OIRA review?**

IRS submissions to OIRA pursuant to E.O. 12866 are addressed in the answer to Question 4(c). Apart from that process, IRS rules generally have not been submitted to OIRA for a determination of whether they are "major" under the CRA, because the IRS and Treasury have taken the position—pursuant to longstanding Treasury practice across several Administrations—that IRS rules generally are not "major" within the meaning of the CRA.

f) **Do you believe OMB Memo M-99-13 ever applied to the IRS? Does it now? To the extent M-99-13 applies to the IRS, wouldn't this mean that all IRS rules subject to E.O. 12866 review must receive OIRA review?**

We agree that all IRS rules subject to E.O. 12866 review must receive OIRA review for a determination of whether they are "major" within the meaning of the CRA. As discussed in the answer to Question 4(c), the Government Accountability Office's Federal Rules Database lists seven rules issued jointly by the IRS and other agencies that were determined by the other agencies to have been subject to E.O. 12866 review and thus also to OIRA determination of whether they were "major" under the CRA. With respect to the other two rules issued independently by the IRS and Treasury, one has been determined by OIRA not to be "major" within the meaning of the CRA, and no determination has been made on the other, because it has not yet been finalized.

g) **If only OIRA can designate a rule to be "major," and if every CRA report to Congress must indicate whether a rule is major or non-major, then doesn't this strongly imply that every rule otherwise subject to the CRA must have OIRA review? Can "longstanding agency practice" change that?**

We respectfully disagree. The CRA defines the term "major rule" to mean any rule that the Administrator of OIRA finds has resulted (or is likely to result) in one of three specified criteria being satisfied. The CRA, however, does not require that agencies submit every rule to OIRA for this determination, and imposes obligations on agencies, not OIRA, to submit rules to Congress. Treasury is responsible for alerting OMB to any ruling document that reasonably could be expected to have a significant economic impact, which also would enable OMB to determine whether the ruling document is "major" within the meaning of the CRA.

h) **The current General Counsel of the Treasury Department, George W. Madison, wrote: "Notice 2010-2 does not have a prospective effective date. Therefore, a taxpayer theoretically could rely on the Notice with respect to transactions that occurred prior to its date of issuance." Letter to Chuck Grassley from George W. Madison (April 28, 2010).**

How is this consistent with 5 USC § 801, which states that "Before a rule can take effect, the Federal agency promulgating such rule shall submit to each House of the Congress and to the Comptroller General a report containing ... a copy of the rule ..." and various other items? That is, the earliest that section 801 was complied with regarding Notice 2010-2 was December 18, 2009 – so, how could it have been effective prior to that date?

The effective date and applicability of a rule are two distinct concepts. The CRA does not foreclose retroactive application of a rule (as permitted by law), once that rule becomes effective. For example, a regulation relating to a recently-enacted statute may apply retroactively under section 7805(b)(2), but the regulation will "take effect"—meaning it will begin to apply both prospectively and retroactively—only once the CRA requirements have been met.

i) **Please respond to my December 22 and March 15 requests, restated below.**

On December 22, 2009 I wrote you asking that:

[Y]ou provide the Finance Committee with all records relating to communications pertaining to the issuance of Notice 2010-2 between Treasury officials, Citigroup, Inc., or other Troubled Asset Relief Program (TARP) participants and/or their representatives. Please also provide a timeline for, and documentation of, Treasury and IRS discussions and approvals for Notice 2010-2 as well as any discussions about the impact this notice would have on the tax gap.

On March 15, 2010, I wrote you stating:

Please describe all communications that any officers, employees, or representatives of Citigroup had in 2009 or 2010 with officers, employees or representatives of the Treasury Department (including the IRS and Office of Chief Counsel) concerning section 382

On May 31, 2009, the Obama Administration announced the core principles that guide Treasury's management of its ownership interests in private corporations such as Citigroup—specifically, recovering funds for the American taxpayer and exiting TARP investments as soon as practicable. Consistent with and in furtherance of these principles, Treasury and the IRS issued Notice 2010-2 to protect the American taxpayers' financial interest in Citigroup and to help Treasury exit its investment as soon as

practicable. As with all of its investments in private entities, Treasury acted in full accordance with these principles.

5. **Housing and Economic Recovery Act**

As I understand it, Section 1117 of HERA (PL 110-289) gave Treasury the authority to purchase obligations and securities of Fannie Mae and Freddie Mac in such amounts at the Secretary may determine. In response, Treasury established the Preferred Stock Purchase Agreements (PSPAs) to buy preferred shares, initially capped at $100 billion for each GSE. This cap was subsequently eliminated and the PSPAs extended through 2012. However, the purchase authority provided under Section 1117 expired at the end of December 2009. So, what's the legal basis for Treasury to continue this program?

If the PSPAs are binding contracts, does the language which states – the "maximum amount" means the greater of (1) $200 billion or (2) $200 billion plus the cumulative total deficiency amount – commit the Treasury to purchase at least $200 billion in obligations from both Fannie and Freddie?
http://www.treas.gov/press/releases/2009122415345924543.htm

Section 1117 of the Housing and Economic Recovery Act of 2008 (HERA) gave Treasury temporary authority to purchase any obligations and other securities issued by Fannie Mae or Freddie Mac (the GSEs). This statutory provision specifically authorized Treasury to determine the terms and conditions of any such purchase and the amounts of any such purchase. This provision also included funding resources for the purchases without any predetermined limit. In adopting HERA, Congress gave Treasury broad discretion to fashion financial remedies that would see the GSEs through the current capital markets crisis, recognizing that the full extent of the capitalization and liquidity needs of the GSEs was unknown.

Treasury's authority to purchase GSE obligations and securities under this HERA provision terminated on December 31, 2009. In September 2008 (i.e., before the sunset date), Treasury purchased a senior preferred stock certificate from each GSE. The HERA termination provision did not apply to Treasury's exercise of rights after the sunset date under a GSE security purchased before the sunset date, and HERA provides Treasury funds with which to do so.

<u>Questions from Senator Hatch</u>

1. **Mr. Secretary, this tax has been designed to raise about $90 billion over ten years. Am I correct that this amount is viewed as a minimum or a floor by the Administration?**

   Yes. As proposed, the Fee would run for a minimum of 10 years and be expected to raise $90 billion over that time.

2. **Can you tell me how much the Administration is now estimating that the total TARP losses will be? The last figure I heard was about $117 billion.**

   The $117 billion figure was contained in the 2011 President's Budget and was based on data as of November 30, 2009. In the Office of Financial Stability's Agency Financial Report released November 15, 2010, the estimated losses associated with TARP are approximately $45.9 billion, which assumes that the AIG transaction is completed as announced with a market price equal to that of October 1, 2010. However, the ultimate cost of TARP will depend on how financial markets and the economy perform in the future.

3. **Two questions. First, is the Administration prepared to insist that this bank tax be repealed just as soon as the amount of the TARP losses have been recouped?**

   Second, because there is much talk here in the Senate that some in this body would like to use the money raised by this tax to offset tax bills that lose revenue to the Treasury, and the stated purpose of this tax is to make the Treasury whole from TARP losses, is the Administration willing to assert that it will not support a bill unless every penny from it is dedicated to reducing the deficit?

   As proposed in January by the Administration the FCRF was designed to run for a minimum of 10 years. If TARP losses were not recouped after 10 years, the fee would run until they were.

4. **Mr. Secretary, as I understand it, this proposed tax is essentially applied on an arbitrary amount of "covered liabilities" of certain financial institutions with more than $50 billion in assets. Recently, you stated that this tax is not intended to punish Wall Street. I think you said "it makes economic sense because we're doing it in a way that is, in effect, a tax on leverage, it's a tax on risk in some ways, and it's borne by the people that benefitted most from the crisis." Critics have argued that it is not really a tax on leverage because it is not based on a ratio of debt to equity. And, the tax is clearly not borne by the entities that benefitted the most from the TARP rescue because it does not include Fannie Mae, Freddie Mac, GM, and Chrysler. Can the Administration really tell us that this is not a poorly designed tax?**

   As proposed by the Administration last January, the FCRF is designed to recoup money for the American taxpayers, including specifically TARP, as required by EESA, in a way that discourages large financial firms from financing the riskiest investments with unstable sources of funding. In this regard, it is appropriate that the fee be applied to firms that were eligible for the emergency programs put in place to resolve the crisis. Because the fee

applies to the liabilities of the covered firms, it targets the size and leverage of those firms—larger firms that rely more heavily on debt—rather than equity or deposit—funding will pay higher fees. Accordingly, the fee will provide an incremental incentive for many of our largest, most interconnected firms to reduce their size, leverage, funding volatility, and overall risk.

5. **For the past quarter century, broker-dealer financial institutions underwrote, marketed and sold student loan auction rate securities to their customers. In February 2008, these institutions abruptly and unexpectedly halted all student loan security auctions. The U.S. Securities and Exchange Commission told Congress these firms misrepresented to their customers that ARS were safe, highly liquid investments equivalent to money market funds. While the SEC required broker-dealers to make smaller investors whole, tens of billions of dollars of student loan auction rate securities (SLARS) owned by large investors remain illiquid to this day. This situation has decreased employment, investment and profitability in scores of businesses across America. Approximately 20 senators have written to Treasury highlighting this situation and asking the Department to help resolve the problem. Please outline measures the Department has taken to liquefy SLARS. Specifically, (1) state efforts by the Department to bring investors, broker-dealers and other stakeholders together to identify a fair and equitable means to liquefy SLARS at par, or near par levels, (2) state efforts by the Department to consult with the Securities and Exchange Commission, the Department of Education and other federal and state government entities to identify a recommended course of action on SLARS, and (3) identify possible legislative measures the Department would support to liquefy any remaining frozen SLARS held by non-financial entities.**

The Treasury Department has met with holders of SLARS on various occasions. The Department has also met with financial institutions and with State Securities regulators regarding SLARS. Finally, the Department has been in repeated contact with the Department of Education regarding the market place for student loan securities, including previously issued SLARS. The Department has not identified any legislative measures that it is currently supporting regarding outstanding issuances of SLARS.

<u>**Questions from Senator Roberts**</u>

1. **In your testimony, you state that you are working with governments around the world who are considering similar efforts to assess a tax on banks. You indicated that you want to design it in a way that improves the chances that other governments will adopt similar measures.**

   Recently, Mr. Nout Wellink, chairman of the Basel committee, said that proposals for a global banking tax are "premature" and that the move "might be a hindrance" to regulatory efforts to make the financial system safer and more stable by toughening capital and liquidity rules. Mr. Wellink goes on to say that "I doubt whether this is a good idea. It's born out of frustration. There are strong political motives behind it."

   What are your thoughts on these comments? How would the administration's proposed bank tax compliment or detract from the work of the Basel committee?

   Since the time of Mr. Wellink's comments, the G-20 has directly addressed the bank fee issue, as discussed above. In addition, G-20 Leaders highlighted the need for banking systems around the world to improve the quality and increase the quantity of capital, and arrived at positions on that issue, and the bank fee issue, that they believe are in no way at odds with each other.

   In the same vein, the Administration's proposed the Financial Crisis Responsibility Fee is completely consistent with the G-20 Leaders' agreement. The fee would deter excessive leverage among the largest financial firms and is designed to help recover losses borne by the taxpayer, including specifically the costs of TARP.

Questions from Senator Enzi

1. **This week, the Pension Benefit Guaranty Corporation (PBGC) issued its Annual Report for 2009. For the first time, the PBGC has developed a Pension Insurance Modeling System (PIMS) model for multiemployer plans. Using the new PIMS model, PBGC has calculated that PBGC's liability with respect to multiemployer plans will more than quadruple from today's deficit, $869 million, to a deficit of $4 billion by 2019. As the multiemployer pension system backs more than 10.4 million workers, what is the Administration's proposal to reduce the current and anticipated deficit and in what time frame?**

   The PBGC Board of Directors is comprised of three members of the Administration, the Secretaries of the Treasury, Labor, and Commerce. The Board is sympathetic to financial problems facing multiemployer plans and hopes to find balanced solutions. We need to ensure that any solutions protect the retirement security of workers and retirees and the PBGC's ability to continue to pay guaranteed benefits to all of the workers and retirees whose defined benefit plans it is responsible for insuring in both the single-employer and multiemployer programs.

   Efforts to address expected future deficits must look at premium levels, payout requirements, and at the rules under which future pension liabilities are acquired, all of which are set by Congress. The Board will work with the new PBGC Director to provide Congress with information and leadership on these important issues.

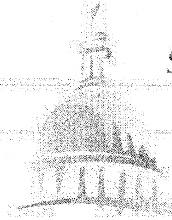
2. **Recently, legislation has been introduced in Congress that would force the PBGC to accept the partition of certain multiemployer plans. Currently, the PBGC has the authority pursuant to section 4233 of ERISA to partition plans. Should the PBGC be forced to partition plans outside of the parameters of current law? Should the PBGC use monies from PBGC's Single Employers Trust Fund to offset losses and liabilities in the multiemployer system?**

   The Create Jobs and Save Benefits Act of 2010 (S. 3157) has proposed a "qualified partition." This would permit a multiemployer plan to spin off into a new plan ("partitioned plan") the liabilities and certain assets attributable to employees of employers who have filed for bankruptcy or who have failed to pay their full withdrawal liability. The proposal would transfer responsibility to the PBGC for payment of the full benefits of participants transferred to the partitioned plan as compared to the amount guaranteed by the PBGC under current law. The rationale for treating the group of participants in the partitioned plan under S. 3157 differently than other participants in other plans when there are not sufficient funds to pay benefits is not clear. PBGC should not be forced to accept such partitions.

   The PBGC Single Employer Trust Fund should not be used to offset losses and liabilities in the multiemployer system because such a policy undermines and destabilizes the single-employer insurance program. Under current law, the assets and liabilities of the multiemployer program are segregated from those of the single-employer program. PBGC reported that its single-employer program had a negative net position "deficit" of $21 billion,

as of September 30, 2009 (that is, the PBGC Single Employer Trust Fund has more annuity liabilities than assets). Draining funds from the single-employer program to pay for the full benefits of participants in the partitioned plan exacerbates the shortfall of resources from payment of obligations to participants in the single-employer plans trusteed by the PBGC.

United States Senate
Committee on Finance



Sen. Chuck Grassley · Iowa
Ranking Member

Opening Statement of Sen. Chuck Grassley
Hearing, "The President's Proposed Fee on Financial Institutions Regarding TARP"
Tuesday, April 20, 2010

Mr. Barofsky, I want to welcome you here today. You and I are both big believers in oversight, accountability and transparency. Today we're discussing what the President calls a Financial Crisis Responsibility Fee. However, the Assistant Secretary for Tax Policy told the dozens of people in attendance at a briefing for Senate staff on the President's fiscal year 2011 budget earlier this year that the President's proposed fee is actually an excise tax.

This is similar to the name game that the Administration and Congressional Majority played with the excise taxes in their health care bill. Although they referred to the excise taxes as fees, the legislative text clearly states that they are actually excise taxes. I will refer to it as the TARP tax, and not the bank tax as some call it, because the proposal applies not only to banks, but also to insurance companies, securities brokers, and thrifts, among others.

The statute that created TARP required the President to submit a plan by 2013 to recover any losses under TARP so that the taxpayers are fully repaid for any TARP losses. However, three years before it was required, the President proposed this excise tax—the TARP tax. One problem that surfaced recently is that Congressional Democrats are already reportedly planning ways to spend the money raised by the proposed TARP tax.

One proposal gaining steam among many on the other side lately is to add the TARP tax to the financial regulatory reform bill. The Congressional Majority is so strapped for money to pay for out of control spending that members are looking to the banks and other financial institutions for money. This reminds me of the story about a reporter asking Willie Sutton, a notorious bank robber, why he robbed banks. Sutton allegedly said, "because that's where the money is." I cannot emphasize this next point enough, if Congress decides to pass a TARP tax, that money should only go toward paying down the deficit. Otherwise, the TARP tax wouldn't even pay for losses from TARP, it would just enable more taxing and spending by those who want to spend more.

All economists state that corporate entities don't actually bear the burden of taxes—people do. I wanted to know which people would bear the burden of the proposed TARP tax. So I wrote a letter asking the nonpartisan experts at the Congressional Budget Office and Joint Committee on Taxation a series of questions.

The CBO responded to my letter by saying that customers would probably pay higher borrowing rates and other charges, employees might bear some of the cost, and investors could bear some of the cost. The CBO also said that the TARP tax "would also probably slightly decrease the availability of credit for small businesses." In addition, the CBO said that, "for the most part, the firms paying the fee would not be those that are directly responsible for loss realized by the TARP."

One other item from the CBO letter worth noting is that the TARP tax would not apply to firms in the automotive industry. That is really odd, since CBO's March 2010 TARP report states that the automotive industry accounts for $34 billion of the program's estimated total cost of $109 billion. Chairman Baucus and I invited GM to testify before our Committee at one of the later hearings, but GM representatives said they didn't want to testify. I believe GM's silence is deafening.

On another TAR-related matter, I want to thank you for investigating the multi-million dollar severance payments that Treasury is allowing TARP recipients like AIG to pay their departing executives. As you know, I have communicated on several occasions with Treasury and the TARP Special Master for Executive Compensation about this troubling issue, and I have run into a stone wall. I am also pleased that you are going to investigate the possible conflicts of interest on the part of key people at Treasury who worked on the TARP executive compensation regulations.

Since those regulations helped executives walk away with huge severance payments, we need to find out if they were drafted by people who used to represent the very executives affected by the regulations. Treasury claims that all the proper recusals were made, but it has provided none of the documentation necessary to verify that claim. I trust that you will be able to get to the bottom of these important questions and report back to the Committee in the near future.

United States Senate
Committee on Finance

Sen. Chuck Grassley · Iowa
Ranking Member

Opening Statement of Sen. Chuck Grassley
Finance Committee Hearing, "The President's Proposed Fee on Financial Institutions Regarding TARP: Part 3"
Tuesday, May 11, 2010

I want to make crystal clear that taxpayers should be paid back every penny of TARP losses. The statute that created TARP said that the President is supposed to propose a plan in 2013 to repay taxpayers for any losses from TARP. However, earlier this year, three years before he was supposed to under the statute, the President proposed what he called a Financial Crisis Responsibility Fee.

Obviously, in 2013 we will have a much better estimate of projected TARP losses than we have now in 2010. The President said that one of the purposes of the TARP tax is to repay taxpayers for any losses from TARP. I want to make sure this actually happens, and that it's not just empty rhetoric. Any losses that result from TARP will increase the deficit, which has ballooned under President Obama. Therefore, to pay back taxpayers for any TARP losses, any money raised from the TARP tax would have to be used to pay down the deficit. If a TARP tax is imposed and the money is simply spent, that doesn't repay taxpayers one cent for any TARP losses. It's like getting a raise and saying you're going to pay down your credit card with the extra money, but then choosing to spend the money instead of paying down the credit card.

It shouldn't be any surprise to learn that your credit card balance didn't go down. Saying you're going to pay down your credit card -- in this case, the deficit -- doesn't do any good. You have to actually do it. I've heard that some of my friends on the other side of the aisle are already looking to use the money raised from a TARP tax to spend it under their arbitrary pay-go rules.

When I tried to get a commitment from Secretary Geithner on this point, he wouldn't give me one. That's disappointing. However, I was encouraged that it sounds like the Chairman of the Ways and Means Committee and I see the TARP tax the same way. Martin Vaughan wrote a May 5 Dow Jones Newswires column titled, "House Panel Chairman: Bank Tax Plan Not Ready For Prime Time." The column states, "Levin signaled he doesn't favor pairing the bank tax with legislation already pending in Congress, such as the financial overhaul bill or a separate bill to extend expired tax breaks. First, he said, the tax should be used for deficit reduction and not to pay for new spending. 'At this point, I don't think the bank tax is ready to be a pay-for,' Levin said."

In looking at the President's TARP tax proposal, which I understand the President has already felt the need to change, it's interesting that GM and Chrysler, which are responsible for about 30 billion of projected losses in TARP, are not subject to the President's proposed tax. Secretary Geithner said that GM and Chrysler were simply victims of the financial crisis, and therefore shouldn't be subject to the President's tax. However, Ford didn't take any TARP money and survived just fine. In addition, with GM and Chrysler responsible for such large amounts of TARP losses, it seems only fair that they should be subject to the TARP tax to pay back some of those losses. GM and Chrysler were both invited by Chairman Baucus and me to testify at this hearing and make their case regarding why they shouldn't be subject to the tax, and both declined. Their silence is deafening.

Also, Fannie and Freddie are not subject to the tax. We'll explore whether that makes sense at today's hearing. And hedge funds are not subject to the President's proposed tax. Meanwhile, companies that did not take any TARP money are subject to the proposed tax.

The President's proposed tax is so lacking in details that members of Congress that are being asked to support it are having a very difficult time figuring out how it would apply and who is subject to the tax. When I asked CBO to tell me who would bear the burden of the TARP tax, they said that one of the groups that would bear the burden of the tax would be consumers. CBO stated in their letter to me that the President's tax will reduce small business lending. Under the new version of the tax proposed by the President, small business loans would be considered the riskiest assets held by the banks, and therefore subject to the highest taxes. Considering the 9.9 percent unemployment rate, the trouble small businesses are having getting credit, and the proposed tax hikes on small business, I am very concerned with that aspect of the proposal.

One of the purposes for the tax stated by the President is to reduce risky behavior by financial institutions. However, CBO stated in their letter to me that the TARP tax, quote, "would not have a significant impact on the stability of financial institutions or significantly alter the risk that government outlays will be needed to cover future losses." That's not just me saying it, that's the nonpartisan CBO saying it. If the United States imposes a TARP tax and other countries don't, it will make our financial institutions less competitive than their foreign competitors. Of the G-20 countries, Australia, Canada, Japan, Russia, and Brazil are opposed to a bank tax, and South Africa doesn't want its banks taxed. I look forward to hearing the testimony from the witnesses today.

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CONGRESSIONAL TESTIMONY

The Financial Crisis Responsibility Fee: The Wrong "Solution"

Testimony before Committee on Finance United States Senate

May 11, 2010

David C. John
Senior Research Fellow
The Heritage Foundation

Good morning. I am David C. John, the Senior Research Fellow in Retirement Security and Financial institutions at The Heritage Foundation. The views I express in this testimony are my own, and should not be construed as representing any official position of The Heritage Foundation.

First allow me to clarify a bit of terminology. The proposed "Financial Crisis Responsibility Fee" is a tax on major financial entities, pure and simple. If it were a fee, it would be assessed on those who caused the losses to the TARP program. As I will discuss in a moment, CBO estimates show that losses from the TARP program for the most part come from other programs and industries. It is also important to remember that while the top banks all received money from TARP, the largest of them received it under duress at the insistence of former Secretary Hank Paulson. There is a bit or irony that certain banks were forced to take taxpayer dollars and are now taxed for taking it.

The "fee" is about revenue raising today

Willie Sutton would be proud. When President Obama announced the details of the original version of his Administration's plan, he said, "We want our money back, and we are going to get it." The Treasury desperately needs revenue to reduce the nation's massive budget deficits. If the Administration wanted to be candid about their reasoning for placing a "fee" on big banks, they would quote famed bank robber Willie Sutton, who, when asked why he robbed banks, purportedly answered, "Because that's where the money is."

Taxpayers can be justifiably angry with financial institutions that took huge amounts of taxpayer dollars and are paying huge bonuses for some of the very behavior that contributed to the 2008 financial crisis. However, this new tax has nothing to do with that situation, and its enactment would not discourage such bonuses in the future. Nor would it change the way that financial institutions operate.

The case for believing that the proposed tax has more to do with raising revenue than for having anything to do with TARP is reinforced by its timing. Section 134 of the Emergency Economic Stabilization Act of 2008 required the president to propose a way to repay TARP's losses in 2013, and not in 2010. Obviously, we will have a better idea of those losses then than now, and the major companies that caused those losses, may be able to repay their share of the losses.

How the "fee" would work

The structure of the proposed "fee" has changed since it was first announced back in January. As announced, the new bank "fee" would apply to all financial institutions with more than $50 billion in assets. This includes about 50 firms that either own insured depository institutions or are broker-dealers. About half are banks, with the rest being insurance companies and other types of financial institutions. About 10–15 are U.S. subsidiaries of foreign firms, the rest being domestic financial institutions. A key factor

is that the tax would apply to only the US assets of foreign firms, but it would apply to worldwide assets of US firms.

The original structure would have required each affected financial institution to pay an annual fee equal to 0.15 percent of its liabilities. This would be calculated by taking the firm's total assets and subtracting both its Tier 1 capital and any deposits that are insured by the FDIC. Thus, firms that have high levels of insured deposits, such as those with extensive bank branch networks, would pay less than those that rely largely upon borrowed money and other assets. About 60 percent of the revenue from the fee is expected to come from the 10 largest financial institutions.

Now, however, the Administration proposes a sliding scale whereby riskier assets would result in a higher fee, while lower risk assets would cause a lower fee. A financial institution would pay a fee that reflects a blend of its asset portfolio rather than a flat fee. This could cause some interesting problems.

First, since commercial loans have a higher risk weighting than other types of assets, this fee appears to contradict Treasury Secretary Geithner's May 4 statement that "This fee is designed to limit the risk of any adverse impact on lending." Quite the contrary, the fee may have the result of discouraging certain commercial loan activity if the transaction is marginally profitable. Although smaller banks do make significant loans to large and small business, the result is likely to be a slight reduction in the supply of loans to commercial borrowers.

Second, the proposed structure only seems to apply to the way that banks are regulated, as there is no comparable standard that applies to insurance companies and other types of financial institutions. Further, it would make little sense to tax what is effectively another arm of the government, Fannie Mae and Freddie Mac, unless and until they or substantial portions of them are privatized. Otherwise, the net result appears to be nothing less than increasing the federal bailouts that both have received.

Third, and most important, the new structure clashes with the inevitable new capital standards that are to be applied to financial institutions. Given that for banks, the same structure for determining the proposed tax payments will also be used to determine increased capital standards, there is a very real question about how the tax will interact with capital requirement.

Will the combination of the two serve to over increase the impact of the two on certain asset classes? Will there be any coordination of the two at all, or will two separate agencies determine tax levels and capital? If there is coordination and tax payments are subtracted from the new capital standards, the net result would be to take money that could be used to provide a higher safety margin for the bank, and transfer it to the Treasury, thus reducing the safety level and making future bailouts more likely.

Details are very important. These are questions that can be answered, but not until the details of how this tax will be set and collected are released and studied. Until then, the committee should delay taking any action.

Additional problems with the proposed "fee."

Although the Treasury Department claims that the new "Financial Crisis Responsibility Fee" is intended to recapture losses from the TARP bailout fund, the reality is very different:

1. First, with one exception, the tax does not apply to the entities that caused most of TARP's losses. As of March 2010, CBO estimates that TARP will lose money on its bailout of AIG, auto companies GM and Chrysler, and the Administration's program to help people refinance mortgages. TARP's other programs actually showed a small profit. Together, CBO estimates that these three will result in $92 billion of the program's total $109 billion loss. (Programs benefiting Citibank and other banks are likely to result in a $7 billion profit to the government.) It is possible that other TARP programs aimed at the financial sector will sustain losses in the future, but that is far from certain. Congress is certainly not going to make those individuals who benefitted from the mortgage refinancing plan repay the losses of that program. The fee would not apply to Chrysler or GM, either. The only entity that caused a loss that will be taxed is AIG, but the fee would just make it harder for the firm to repay its bailout. Until that firm has turned around, taxpayers will get no benefit from AIG being taxed.
2. Second, the new tax is not designed just to recapture some of the profits that financial institutions made last year. Since it is styled as a "fee," it would apply to both profitable and unprofitable financial institutions. This structure would make it even harder for undercapitalized financial institutions to rebuild their financial strength and increase the risk of failure if the economy goes back into recession.
3. Third, despite claims that the tax would be collected only until TARP deficits are "paid for" (about 10 years), history suggests that the fee will become a permanent tax upon large financial institutions.

"Because that's where the money is"

When Congress passed the TARP bill in 2008, it required the Treasury to find a way to recoup any losses by 2013. The time lag was designed to allow Treasury the opportunity to see how the program had performed and to assess those who caused the losses. While the Obama Administration claims that it is fulfilling this requirement three years early, it is really just seeking a new revenue source to try to pay for some of the massive deficits caused by their spending programs.

On balance, the new "fee" bears a striking resemblance to the old motivational technique that called for the beatings to continue until the morale improves. While Administration officials urge banks and other firms to start lending again, the new tax would discourage them from taking risks. The "fee" would apply regardless of a firm's

profitability and would make it even harder for firms recovering from earlier losses to rebuild the capital needed to back up lending.

This is the wrong approach to reducing the swollen deficit and would inevitably cause more problems than it solves. It is a bad idea being used to score political points and should be dropped.

Written Testimony of Nancy L. McLernon
President & CEO
Organization for International Investment

Before the Senate Finance Committee
May 11, 2010

Chairman Baucus, Ranking Member Grassley, and Members of the Finance Committee, I am Nancy McLernon, President & CEO of the Organization for International Investment (OFII). Thank you for the invitation to testify on the Administration's proposed "Financial Crisis Responsibility Fee."

The Organization for International Investment (OFII) is the only business association exclusively representing the U.S. subsidiaries of many of the world's largest international companies – or "insourcing" companies. Insourcing companies directly employ over 5 million Americans and support an annual U.S. payroll of over $400 billion. These American businesses generate 6 percent of GDP, produce almost 20 percent of total U.S. exports, and pay 12 percent of total corporate taxes.

Many of our member companies are household names with historic and substantial U.S. operations. The vast majority hail from European Union countries, such as the United Kingdom, France, Germany, Denmark and The Netherlands, as well as from Japan, Canada, and Australia. A full membership list can be found at the end of my testimony.

On behalf of these companies, OFII advocates for the fair, non-discriminatory treatment of U.S. subsidiaries in the United States. We undertake these efforts with the goal of making the United States an increasingly attractive market for foreign investment, which will ultimately encourage insourcing companies to conduct more business and employ more Americans within our borders.

While OFII member companies include a number of bank and non-bank financial institutions such as Barclays, HSBC, Credit Suisse, Swiss Re, Zurich, Allianz and others, *all* OFII members care deeply about the principle of national treatment. It is the United States' adherence to this principle that has made this country the largest host of foreign direct investment in the world. The United States has a long history of according national treatment to insouring companies, not merely because of its obligations to other countries, but because it is in the best interest of the U.S. economy and its workers.

The global coordination of financial regulatory reform efforts is particularly important to OFII member companies because they operate across borders. To that end, ensuring that any "Financial Crisis Responsibility Fee" is properly structured and coordinated with other developed nations that are contemplating similar actions in the wake of the recent financial crisis is of great importance to OFII and will be the focus of my testimony.

Unilateral U.S. Action Could Have Negative Effects

Were the United States to act alone, or differently than other major financial centers, on a financial institution tax or other measure such as the proposed Fee, it could jeopardize not only global businesses such as the ones OFII represents, but also the broader U.S. economic recovery efforts.

At three separate summits in the past two years, the leaders of the G20 reaffirmed their commitment to coordinate financial regulatory reform efforts, avoid protectionism, and prevent regulatory arbitrage. Coordination will be key on any sort of targeted tax or Fee. Uncoordinated and unilateral action would encourage regulatory arbitrage. It would create incentives for the off-shoring of high risk activities to markets that do not impose a tax on such activities. These dynamics would undermine the effectiveness of any tax that the United States or any other country might impose unilaterally.

Moreover, if agreement on imposing such a tax is reached, there also must be coordination on the scope of a tax in order to prevent multiple taxation on global financial institutions. If this were not to happen, it would remove significant amounts of capital from the system, which would materially diminish the needed lending and could slow worldwide and U.S. economic recovery. While recovery efforts have been effective to date, we are not yet clear of the crisis. Introducing a new, uncoordinated tax would create a headwind in the face of our economic recovery.

Given that financial markets are global, if the United States moves alone on a tax it would also tilt the competitive playing field against institutions and investors located in the United States, including U.S. subsidiaries of companies headquartered abroad. This could discourage investment in the United States and thus further slow our economic recovery efforts.

Absence of G20 Consensus on Purpose of Financial Institution Tax

Although the G20 has agreed on underlying principles for financial reform, it has not yet achieved consensus on the form, purpose, or use of a tax such as the proposed "Financial Crisis Responsibility Fee". Indeed, the G20 has not yet achieved consensus on whether a financial institution tax is an appropriate element of regulatory reform in the first place.

Last month in Washington, the G20 Finance Ministers discussed developing a global tax. Clear divisions emerged at the Finance Ministers' meeting, and G20 countries' disagreement on the issue continues to be aired in the press. A number of G20 members, including Canada, Australia, Japan, and the BRIC countries (Brazil, Russia, India, China), have expressed strong reservations about the wisdom of a tax. Singapore and Switzerland, two non-G20 countries with major, attractive global financial centers, have also voiced concerns.

Even among those countries that support a financial institution tax or fee, there is no consensus about the type of such a levy. A report sent to the G20 last month from the International Monetary Fund (IMF) highlighted these differences, and various approaches were debated at the April G20 meeting in Washington.

While the competing approaches have yet to be fully spelled out, it is clear that a number of points of disagreement are emerging. For example, there is significant disagreement about the appropriate use of any targeted tax revenues. The United States and others have supported the creation of a "work-out" or "resolution" fund for winding up failing institutions. On the other hand, the United Kingdom and France, among others, have voiced strong opposition to a dedicated fund, fearing that it would exacerbate the threat of moral hazard by insuring the financial markets against their own excessive risk-taking. Not only is there disagreement about the purposes of or uses for any tax, there is also disagreement about which entities should be taxed – whether all banks, large diversified financial institutions, or insurance companies should be included.

Further, this lack of consensus is not limited to G20 discussions. At a recent meeting of the Economic and Financial Affairs Council (ECOFIN) of the European Union, the United Kingdom, France and Austria all opposed efforts by the European Commission to establish a crisis management fund that could be used for the orderly resolution and winding up of failed financial institutions. In fact, only Sweden and Germany supported the Commission's proposal. At the same meeting, the United Kingdom and France expressed support for a tax on financial transactions, while Finland, Sweden, and European Central Bank President Jean-Claude Trichet all opposed such a levy.

As you can see from these examples, there is no consensus even among those countries or institutions that favor some kind of a tax. It is also noteworthy that Canada, Australia, Japan and other major developed countries do not support imposition of a targeted tax at all, and do not intend to adopt one. Likewise, major emerging markets like China, India and Brazil are firmly opposed to burdening their financial institutions with a new systemic tax.

In the face of this lack of agreement, the G20 Finance Ministers decided to defer action until the IMF and other international organizations have time to study more fully the potential effects of such a tax.

Interaction of Any Tax with Other Financial Reform Efforts

It is also questionable whether imposing a new tax is the appropriate next step in financial reform. The leaders of the key institutions charged by the G20 with formulating the new financial reform rules—Mario Draghi, Chairman of the Financial Stability Board (FSB), and Nout Wellink, Chairman of the Basel Committee on Banking Supervision (BCBS)—have encouraged the G20 to undertake further study and to finalize new capital and liquidity rules *before* tackling a tax.

Before the G20 meetings, FSB Chairman Draghi warned that "[t]he cumulative impact on the system of the . . . proposed reforms will need to be carefully considered, in order to lessen the risk of unintended consequences and to counter financial industry claims that the reforms could derail the economic and financial recovery."

Following the G20 meetings, BCBS Chairman Wellink suggested that "[w]hat we should do first is finalize the [Basel] process . . . [T]hen we can ask ourselves if national proposals are still necessary and useful."

Before adopting a tax, the United States and its G20 counterparts need to understand better how the tax would interact with the other financial reform initiatives, such as new capital and liquidity rules that are also being considered.

Scope of U.S. Financial Institution Tax

If the United States nevertheless decides to impose a bank tax unilaterally, despite the known and unknown adverse consequences of uncoordinated action, it is important that the tax be structured carefully. In particular, a tax on insourcing financial groups should be based only on their U.S. operations. If a U.S. tax were to be imposed on the worldwide operations of insourcing financial companies, its negative effect on the competitive and diplomatic position of the United States could be dramatic.

In particular, because other countries such as the U.K. and Germany are considering their own versions of a targeted tax, there is a critical risk of double (or triple or more) taxation if each country were to tax worldwide operations. A failure by the United States to adopt a "water's-edge" limitation on the application of such a tax to insourcing financial groups would inevitably lead to multiple taxation as soon as any other country imposes a tax of its own, even if that country limits itself to taxing activity in that country alone. The problem grows far worse if the other country also imposes the tax on a worldwide basis, and multiplies with every additional country that decides to get into the financial institution taxing game.

Historically, the United States has limited the taxation of all insourcing companies to income derived from, and proportional to, activities that have a nexus to the United States. It has done so for many reasons, including (i) Constitutional

considerations, (ii) the principles of international law, (iii) political and diplomatic imperatives, and (iv) economic theory. For example, U.S. law limits the federal income taxation of insourcing companies to U.S.-sourced income that is effectively connected with the conduct of a U.S. trade or business—all items that have an obvious nexus to the United States. Even the occasional proposals to replace this system with a worldwide unitary approach have recognized the need to prevent double taxation by apportioning the tax based on an insourcing companies' actual connections to the United States.

Because taxes or fees of the type under discussion do not appear to qualify as income taxes, neither the U.S. foreign tax credit system nor the double tax mitigation provisions of U.S. tax treaties would provide any relief from such double or multiple taxation. Importantly, the resulting disproportionate burden on insourcing financial companies would tend to discourage overseas financial institutions from participating in the U.S. lending and capital markets—at a time when both Congress and the Administration are justifiably concerned about a dearth of liquidity. In addition, such disparately burdensome treatment might give rise to plausible claims of prohibited discrimination under the many tax treaties and friendship, commerce and navigation treaties to which the United States is a party.

An insourcing financial group only benefits from access to the U.S. market, and, in the case of banks, is only subject to U.S. banking regulation, to the extent of its activities within the United States. Its liability for a tax should be similarly limited in order not to fail a standard of fundamental fairness. Thus, it is imperative that if the United States were to adopt some sort of targeted tax, its application should not be based on the worldwide operations of insourcing financial groups.

Next Steps

At this stage, further study by the IMF, FSB and BCBS is needed before the G20 countries consider adopting a global tax. In particular, these institutions need to closely examine the inter-linkages between a tax and other proposed regulatory reforms. Rather than unnecessarily add to the complexity of current reform efforts, the U.S. and the G20 should prioritize and complete the immediate – and difficult – task of establishing new capital and liquidity rules before developing a global tax on financial institutions.

But even if countries decide to proceed with a targeted tax before these other reforms are complete, any tax must be coordinated among them. G20 countries need to come to agreement on the form, purpose, and use of any tax—and that consensus needs to be reached before any individual G20 country adopts such a tax. There can still be room for variation across countries as appropriate, but agreement on the fundamental principles underlying a such a tax is necessary to ensure its effectiveness.

Given the possibilities of regulatory arbitrage, duplicative and contradictory regulations, and adverse competitive impacts, OFII believes that the United States should implement any tax or other fundamental changes only when other major financial centers are prepared also to adopt comparable measures on a coordinated basis. Going it alone is not in the United States' interests in this globally interconnected economy.

ORGANIZATION FOR INTERNATIONAL INVESTMENT
INTERNATIONAL BUSINESS INVESTING IN AMERICA

OFII is the only business association in Washington D.C. that exclusively represents U.S. subsidiaries of foreign companies and advocates for their non-discriminatory treatment under state and federal law.

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ThyssenKrupp USA, Inc.
Tim Hortons
Toa Reinsurance Company of America
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Zurich Insurance Group

Testimony of

John K. Sorensen

On Behalf of the

Iowa Bankers Association

Before the

Senate Committee on Finance

United States Senate

Chairman Baucus, ranking member Grassley, and members of the committee, my name is John K. Sorensen, President and CEO of the Iowa Bankers Association. The IBA exists to assist our members in serving the needs of their customers and communities. The IBA counts 95% of the 386 banks and thrifts in Iowa as members. The median size of an Iowa bank is $100 million in assets. Iowa is primarily a community banking state, but we also have a regional and money center bank presence representing 20% of $64 billion in state-wide deposits. Iowa's financial diversity has benefited consumers and businesses alike.

Financial and Economic Environment

It is a combination of financial diversity, responsible lending and educated consumers that have produced more favorable financial and economic results for our state during this challenging period. Iowa's home ownership rate, at 74%, exceeds the national average. Just 8% of our existing mortgage loans are considered subprime and our rate of foreclosure is less than 1% of all loans. Just 9% of our loans have negative equity and our home values have declined just 4% over the past two

years and are back on the rise. Iowans also have the distinction of having the lowest per capita credit card debt in the country.

Economically, although not without challenges, Iowa has been faring better than most of the country. Our unemployment rate, at 6.7%, is 4th lowest in the country and well below the 9.7% national average. And, our personal income was up 5.7% in 2009. Agricultural land values fell slightly in 2009, reflecting a similar drop in net farm income, although both remain well above historical averages.

Iowa bank performance reflected that of our economy in 2009. Although net income was down 6% from the prior year, nearly 90% of Iowa banks and thrifts were profitable. Our banks remain liquid, well capitalized, and ready and able to lend to credit-worthy borrowers. Despite an uncertain economy, bank lending was off just 2% from 2008 to 2009. And, the recent enhancements to Small Business Administration loan programs have resulted in 174 loans totaling $5.7 million during the first five months of the federal fiscal year.

Despite financial and regulatory pressures, Iowa banks have continued their tradition of providing financial and human resources for economic and community development organizations. A 2008 survey of Iowa banks found that bank staff contributed an aggregate 1.6 million hours in volunteer time and banks contributed another $40 million in financial support to community organizations.

Traditional Iowa bankers continue their work; leading charitable fundraisers, coordinating economic development initiatives, sponsoring little league teams, lending to local businesses, facilitating the dream of homeownership, purchasing local government bonds, and leading financial literacy efforts at local schools. This work happens, not because of a federal mandate, but because a bank's success is tied directly to the creation of a healthy, thriving community. It's the piece of the financial system that doesn't require reform.

The Dubuque Telegraph Herald recently penned an editorial summarizing the importance of their local Iowa banks to the community. In it they said:

> *Healthy financial institutions create and sustain success in all sectors of our community. From their loans toward initiatives vital for economic and civic growth to their charitable donations to their leadership in various community endeavors, our local financial institutions play a significant role in our success. That so many of our institutions have deep roots in this community – with decision-makers here – has helped the tri-state area in incalculable ways.*

Financial Regulatory Reform

Iowa banks are weathering the economic fallout from the financial crisis, the larger question may be can we weather the policy response.

Bank regulators have already reacted in significant and severe ways to rein in certain practices and increase disclosures. Since January 1, 2009, the Federal Reserve alone has issued no less than 31 new or revised regulations. Each carries with it a significant allocation of bank time and money and builds upon volumes of existing regulation. This is putting a strain on bank compliance staff and for smaller banks it is becoming a nearly insurmountable burden.

It is particularly frustrating to many bankers who entered the field to creatively help people achieve their dreams, only to have more of their time devoted to checking the box on the next mandated procedure. This growing burden threatens the future of community banks and innovation in the industry.

Financial regulatory reform is important and necessary. Many lessons have been learned from the experience of the last two years. We should take steps to close the gaps in financial regulation, better manage risks posed by large systemically important institutions, and develop a government housing policy that doesn't result in undue risk-taking. But, most of all, we should not burden the very institutions who've been responsibly serving their communities.

Proposed "Financial Crisis Responsibility Fee"

The Obama Administration proposes to assess an annual fee on liabilities of banks, thrifts, bank and thrift holding companies, brokers and security dealers, as well as U.S. holding companies controlling such entities as of January 14, 2010. The fee, which would apply to firms with consolidated assets of more than $50 billion, would be approximately 0.15 percent of a firm's total liabilities – excluding deposits subject to assessments of the FDIC and certain liabilities related to insurance policies (in the case of insurance companies). According to the Administration's January 14 press release, the fee would be in place for at least 10 years, but longer if necessary to recoup the costs of the Troubled Asset Relief Program (TARP). The Iowa Bankers Association opposes the fee proposal for the following reasons:

- The projected losses in TARP were from non-bank investments. Banks should not have to pay the cost to support other recipients.
- Actual losses from TARP investments are still unknown.
- Consumers and small businesses will be impacted by the fee.
- The fee fails to help community bank competitiveness.

I will address each of these points in turn.

I. Losses from TARP were from non-bank investments.

The Emergency Economic Stabilization Act (EESA) of 2008 was passed by Congress and signed into law by the President on October 8, 2008. It is important to remember that the legislation contemplated acquisition of troubled assets from financial institutions by the U.S. Treasury, in order to restore liquidity and stability to the financial system. As we now know, the bulk of the TARP program took a very different approach, making preferred stock investments in healthy financial institutions to bolster capital and free up dollars for lending. Many believe the

program was helpful to restoring confidence and stability. If so, the benefits were shared by all participants in the national and global economy.

Of the $245 billion the Treasury invested in banks of all sizes through the Capital Purchase Program (CPP), $176 billion has been repaid and Treasury officials estimate an eventual profit of as much as $19 billion. As of March, the U.S. government had collected $14.5 billion in dividends, interest and other income, along with $5.6 billion in warrant proceeds.

At the end of 2009, Treasury issued a press release stating, "Every one of its programs aimed at stabilizing the banking system.....will earn a profit thanks to dividends, interest, early repayments, and the sale of warrants." According to the Treasury, these bank programs: "that were initially projected to cost $76 billion are now projected to bring a profit of $19 billion". Treasury also said that: "profits could be considerably higher as Treasury sells additional warrants during the weeks ahead."

The Administration created no less than seven additional programs within TARP to accomplish various policy goals. The most significant investments were directed to the Automotive Industry Financing Program (AIFP), AIG and the Home Affordable Modification Program (HAMP). These non-bank investments amounted to $191 billion. Since the first of the year, the Administration has announced two additional TARP programs, the Community Development Capital Initiative (CDCI) to support lending through Community Development Financial Institutions and the Small Business Lending Fund.

As reported by the Special Inspector General to this committee last week, although TARP is expected to result in a loss to the taxpayers ($127 billion according to the Office of Management and Budget as of February 2010), the expected loss is far lower than previous estimates, and is concentrated in the programs designed to support American International Group, Inc (AIG) ($50 billion), the automotive industry ($31 billion), and housing ($49 billion).

To charge banks for losses generated by non-banks would be unfair and, I believe, inconsistent with spirit of section 134 of EESA that costs should be borne by those who benefit from the program investments.

II. Actual losses from TARP investments are still unknown.

Section 134 of the EESA provides that on October 4, 2013, the Director of the Office of Management and Budget, in consultation with the Congressional Budget Office, shall submit to Congress a report on the net amount within TARP. Following such report, the President is to submit a plan to recoup any shortfall.

The Administration's "responsibility fee" comes a full three years before the date contemplated in the statute to assess losses. With the economy showing signs of gradual improvement, Treasury is likely to experience a further appreciation from TARP investments and a corresponding reduction in losses.

The "responsibility fee" proposal also comes prior to a report from the Financial Crisis Inquiry Commission due later this year. The bi-partisan Commission was established to "examine the causes, domestic and global, of the financial and economic crisis in the United States." It would seem logical that any "responsibility fee" be delayed until this panel opines on the root causes of the crisis.

III. Consumers and small businesses will be impacted by the fee.

The Congressional Budget Office (CBO), in their March 4 letter to Senator Grassley, confirmed the cost of the proposed fee would ultimately be borne to varying degrees by an institution's customers, employees, and investors. Even in Iowa, where people invest in banks directly and through their 401k; where two of our largest employers - Wells Fargo and Principal

Financial Group – are impacted; and many Iowans purchase financial products from affected firms; the impact of the proposed fee will be felt. Nationally, at least 70 percent of all financial assets, including 64 percent of loans, were attributable to institutions that are members of affiliated groups with assets over $50 billion.

The CBO also predicts the fee would have a negative impact on the availability of credit to small business. Small businesses are the engine for job growth in our economy. We should avoid any policy that dampens credit availability at this critical time.

IV. The fee fails to help community bank competitiveness.

Some view the proposed fee as being helpful to the competitive position of community banks. Yet, if the fee assessment base were to exclude insured deposits as proposed, any benefit would be at least partially offset by increased competition for insured deposits as large banks more aggressively pursue this funding source.

The fee or tax also sets an unwelcome precedent of assessing a "crisis responsibility fee" on institutions Congress deems responsible for a disruption to the U.S. economy or financial markets. Such a determination is subjective at best. Assessing blame in a complex and interconnected world can be difficult enough, let alone when political forces become intertwined. A similar fee on mid-western banks following the agricultural crisis of the 1980s would have exacerbated the economic recovery and caused even more community banks to fail.

The proposed fee could also impact the Federal Home Loan Bank (FHLB) system, an important source of funding for community banks. Large banks subject to the proposed fee currently hold approximately $327 billion in advances, resulting in a fee of $491 million per year on these advances. Because the fee would not be assessed on deposits and repurchase agreements, large banks would have an incentive to shift their funding sources away from advances to deposits.

The shift would increase competition for deposits and reduce earnings at the FHLBs, which are cooperatively owned by more than 6,000 FDIC-insured community banks. The reduction of income would also reduce the FHLBanks' contributions (10% of annual earnings) to the Affordable Housing Program (AHP).

The proposal also arbitrarily applies the fee to an insurance company that happens to have a small bank subsidiary, but exempts an otherwise similarly situated insurance company that does not have a bank subsidiary. This is unfair.

Conclusion

Mr. Chairman, Ranking member Grassley, and members of the committee, it is clear American taxpayers will not incur a loss on their bank investments through the CPP. Rather, Treasury projects a double-digit return on bank investments. Although losses are projected in non-bank TARP investments, even these may subside as we approach the EESA loss assessment date in 2013.

The proposed fee accomplishes little in the way of altering behavior that caused the financial crisis. The country would be much better served by focusing on how we maintain a dynamic and responsible financial sector where the rules of the game are consistently applied to all players.

Thank you for the invitation to testify today.

Senate Finance Committee Hearing
"The President's Proposed Fee on Financial Institutions Regarding TARP: Part 2"
May 4, 2010

Responses to Questions for John K. Sorensen,
President and CEO, Iowa Bankers Association

Questions from Senator Hatch

1. How many banks do you have in Iowa that would potentially be hit directly by the proposed bank tax?

Five.

2. Since most of your banks are community banks, and this proposed tax is targeted at the big boys, wouldn't this be a good thing for your community banks? Wouldn't they be able to gain a competitive edge, as the Administration asserts?

Some view the proposed fee as being helpful to the competitive position of community banks. Yet, if the fee assessment base were to exclude insured deposits as proposed, any benefit would be at least partially offset by increased competition for insured deposits as large banks more aggressively pursue this funding source.

The fee or tax also sets an unwelcome precedent of assessing a "crisis responsibility fee" on institutions Congress deems responsible for a disruption to the U.S. economy or financial markets. Such a determination is subjective at best. Assessing blame in a complex and interconnected world can be difficult enough, let alone when political forces become intertwined. A similar fee on mid-western banks following the agricultural crisis of the 1980s would have exacerbated the economic recovery and caused even more community banks to fail.

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3. What is wrong with the Obama Administration trying to fulfill its obligation under the TARP law three years before it is due? Isn't it smart to be proactive and try to recoup any anticipated losses as soon as possible?

First of all, losses from TARP were from non-bank investments. The Emergency Economic Stabilization Act (EESA) of 2008 was passed by Congress and signed into law by the President on October 8, 2008. It is important to remember that the legislation contemplated acquisition of troubled assets from financial institutions by the U.S. Treasury, in order to restore liquidity and stability to the financial system. As we now know, the bulk of the TARP program took a very different approach, making preferred stock investments in healthy financial institutions to bolster capital and free up dollars for lending. Many believe the program was helpful to restoring confidence and stability. If so, the benefits were shared by all participants in the national and global economy.

Of the $245 billion the Treasury invested in banks of all sizes through the Capital Purchase Program (CPP), $176 billion has been repaid and Treasury officials estimate an eventual profit of as much as $19 billion. As of March, the U.S. government had collected $14.5 billion in dividends, interest and other income, along with $5.6 billion in warrant proceeds.

At the end of 2009, Treasury issued a press release stating, "Every one of its programs aimed at stabilizing the banking system . . . will earn a profit thanks to dividends, interest, early repayments, and the sale of warrants." According to the Treasury, these bank programs "that were initially projected to cost $76 billion are now projected to bring a profit of $19 billion." Treasury also said that "profits could be considerably higher as Treasury sells additional warrants during the weeks ahead."

The Administration created no less than seven additional programs within TARP to accomplish various policy goals. The most significant investments were directed to the Automotive Industry Financing Program (AIFP), AIG and the Home Affordable Modification Program (HAMP). These non-bank investments amounted to $191 billion. Since the first of the year, the Administration has announced two additional TARP programs, the Community Development Capital Initiative (CDCI) to support lending through Community Development Financial Institutions and the Small Business Lending Fund.

As reported by the Special Inspector General to this committee last week, although TARP is expected to result in a loss to the taxpayers ($127 billion according to the Office of Management and Budget as of February 2010), the expected loss is far lower than previous estimates, and is concentrated in the programs designed to support American International Group, Inc. (AIG) ($50 billion), the automotive industry ($31 billion), and housing ($49 billion).

To charge banks for losses generated by non-banks would be unfair and, I believe, inconsistent with spirit of section 134 of EESA that costs should be borne by those who benefit from the program investments.

Actual losses from TARP investments are still unknown. Section 134 of the EESA provides that on October 4, 2013, the Director of the Office of Management and Budget, in consultation with the Congressional Budget Office, shall submit to Congress a report on the net amount within TARP. Following such report, the President is to submit a plan to recoup any shortfall.

The Administration's "responsibility fee" comes a full three years before the date contemplated in the statute to assess losses. With the economy showing signs of gradual improvement, Treasury is likely to experience a further appreciation from TARP investments and a corresponding reduction in losses.

The "responsibility fee" proposal also comes prior to a report from the Financial Crisis Inquiry Commission due later this year. The bi-partisan Commission was established to "examine the causes, domestic and global, of the financial and economic crisis in the United States." It would seem logical that any "responsibility fee" be delayed until this panel opines on the root causes of the crisis.

4. Could you elaborate on why you believe the proposed bank tax would impact the Federal Home Loan Bank system? Why does the FHLB play such an important role for community banks and how could this be harmed by this proposal?

See response to question 2 above.

COMMUNICATIONS

Statement of the Investment Company Institute on "The President's Proposed Fee on Financial Institutions Regarding TARP" before the Committee on Finance, United States Senate

May 4, 2010

The Investment Company Institute appreciates the opportunity to submit its views regarding the Administration's proposed "financial crisis responsibility fee."

ICI is the national association of U.S. registered investment companies. ICI members manage total assets of nearly $12 trillion and serve almost 90 million shareholders. Our members include mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs).

While we understand the policy rationale for the proposed fee, we urge that it be structured and applied so as to avoid penalizing registered investment companies and their investors, as discussed below.

The Administration's proposal is not directed at mutual funds and other registered investment companies

The Administration has indicated, both in its January 14, 2010 fact sheet summarizing the proposal and in public statements, that the fee is intended to be levied on the liabilities of the largest, most highly leveraged financial institutions—namely, those with over $50 billion in consolidated assets. The January 14, 2010 fact sheet identifies banks and thrifts, insurance and other companies owning insured depository institutions, and broker-dealers as firms that may be covered by the proposed fee.

These details suggest that the Administration does not intend for this fee to be assessed on mutual funds and other registered investment companies. In our view, this is the correct result, because registered investment companies are not highly leveraged. They are subject to very strict leverage limits under the Investment Company Act of 1940 and must maintain specified asset coverage ratios even as the market fluctuates. Mutual funds, for example, can borrow no more than one-third of their assets. Thus, for every dollar a mutual fund borrows, it must have $2 in equity (resulting in a maximum leverage ratio of 1.5).

The Administration proposes to levy the fee on the "covered liabilities" of financial firms with over $50 billion in consolidated assets. "Covered liabilities," which is defined as assets less Tier 1 capital and insured deposits, is a banking concept with little application to mutual funds and other registered investment companies. Tier 1 capital is, among other things, equity paid in by investors. Mutual funds are composed virtually entirely of paid in capital, which further supports the conclusion that this fee is not intended to apply to them.

The "financial crisis responsibility fee" should not penalize registered investment companies and their investors

The stated purpose of the Administration's proposed fee is to reimburse taxpayers for the expected shortfall from the Troubled Asset Relief Program (TARP). Mutual funds and other registered investment companies did not receive government assistance under TARP.*

Imposing this fee on mutual funds would defeat the purpose of the proposal, by singling out one class of taxpayers. An estimated 87 million individual investors owned mutual funds in 2009 and held over 80 percent of the $11.1 trillion in total mutual fund assets at year-end. These individual investors, many of whom are saving for retirement, would be the ones ultimately to bear costs associated with recouping the TARP shortfall.

Applying the "financial crisis responsibility fee" to mutual funds would have a direct and negative impact on fund investors

If the proposed fee—which the Administration has estimated at 15 basis points—were assessed on a mutual fund having total net assets over $50 billion, the entire fee would automatically pass through to shareholders as a fund expense. The expected impact on mutual fund shareholders would be as follows:

- For all mutual funds with assets of $50 billion or more, the average expense ratio (asset-weighted) is 42 basis points. A 15 basis point fee would result in a 36 percent increase in costs to shareholders.

- Expenses for money market funds with assets of $50 billion or more would rise by nearly 60 percent from an asset-weighted average of 26 basis points to 41 basis points.

- Expenses for equity mutual funds with assets of $50 billion or more would rise by about 25 percent from an asset-weighted average of 57 basis points to 72 basis points.

- Expenses for bond mutual funds with assets of $50 billion or more would rise by 30 percent from an asset-weighted average of 50 basis points to 65 basis points.

The proposed fee also would eat away at benefits from economies of scale that mutual fund shareholders reap as funds grow in size. Fund sponsors may have incentives to close funds so that they do not exceed the $50 billion threshold and cause fund shareholders to incur higher fund expenses.

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* We note that three facilities were created to support the money markets, and money market funds in particular. None of these programs were part of TARP. Only two of the programs were utilized, and each has since been terminated, with net proceeds to the government. For example, money market funds participating in the Treasury guarantee program paid about $1.2 billion in fees to the Treasury and made no claims.

Conclusion

We respectfully urge the Committee to ensure that the proposed financial crisis responsibility fee would not be applied to mutual funds and other registered investment companies. Any other result would defeat the stated purpose of the proposal, by having a class of ordinary Americans—mutual fund investors—bear costs associated with the TARP shortfall. For similar reasons, registered investment company assets should not be included when calculating the consolidated assets of an integrated financial institution that includes one or more registered investment advisers.

Statement of John A. Courson

President and Chief Executive Officer

Mortgage Bankers Association

for the Record of the

Committee on Finance

United States Senate

Hearing on

"The President's Proposed Fee on Financial Institutions Regarding TARP"

April 20, 2010

Chairman Baucus, Ranking Member Grassley, and Members of the Committee, thank you for holding this very important hearing on the impact of the proposed Financial Crisis Responsibility Fee (FCRF). As you develop policy responses to this issue, the Mortgage Bankers Association[1] (MBA) believes that you should consider a number of key points outlined below.

The Fee

On January 14, 2010, President Obama proposed assessing a fee on the largest banks and Wall Street firms as a method for offsetting funds disbursed under the Troubled Asset Relief Program (TARP). The fee would be in place for ten years and would provide the U.S. Government up to $117 billion from financial institutions with greater than $50 billion in consolidated assets. The fee would be assessed at 0.15 percent of covered liabilities defined as:

Covered Liabilities = Assets minus Tier 1 capital minus
FDIC-assessed deposits (and/or insurance policy reserves, as appropriate)

Covered liabilities would be reported by regulators, but the fee would be collected by the Internal Revenue Service. Revenues would be contributed to the Treasury general fund to reduce the deficit.

Direct Impact on Mortgage Market

There are many households that cannot qualify for single family conventional mortgage loans eligible for delivery into securities issued by Federal National Mortgage Corporation (Fannie Mae) or Federal Home Mortgage Corporation (Freddie Mac) or for FHA or VA loans eligible for mortgage-backed securities (MBS) guaranteed by the Government National Mortgage Association (Ginnie Mae). These households include but are not limited to foreign national residents and households requiring loan amounts higher than the Fannie Mae, Freddie Mac or Ginnie Mae maximum levels. They also include families with prior credit history resulting from past unemployment or large medical bills needed to fight life-threatening illness or injury. In the past, these individuals were served by financial institutions who securitized these loans into private label residential MBS (RMBS).

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[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,400 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

Likewise, many multifamily housing projects cannot be financed through the Fannie Mae, Freddie Mac, or Ginnie Mae multifamily programs. Further, much of the funding for warehouses, office buildings, retail, and other commercial properties has traditionally been financed using private label commercial MBS (CMBS).

The following are the direct impacts to the mortgage market:

- The fee imposes a tax primarily on non-depository liabilities of banks. These liabilities would include the hundreds of billions of dollars of liabilities that returned to banks' balance sheets January 1, 2010 as a result of Statement of Financial Accounting Standards No. 166, Accounting for Transfers of Financial Assets, an Amendment of FASB Statement No. 140 (FAS 166) and Statement of Financial Accounting Standards No. 167, Amendments to FASB Interpretation No. 46(R) (FAS 167). These pronouncements require financial institutions to include in their consolidated balance sheets assets that they do not own and liabilities that they do not owe. As a result of the interaction of the proposed FCRF and FAS 166 and FAS 167, large financial institutions may be discouraged from entering into new residential or commercial mortgage backed security (MBS) transactions — especially transactions that would require consolidation of a securitization's assets and liabilities on-balance sheet. It would also impose a stiff tax on liabilities not owed by the bank. MBA believes that assets and liabilities that are linked, such as MBS transactions, should be excluded from the proposed FCRF's assessment base.

- The FCRF would dramatically reduce the profitability of private label MBS servicing. For example, if a bank is required to capitalize under FAS 167 a securitization liability because of its role as servicer, it would put the mortgage principal in its consolidated assets and the outstanding MBS in its liabilities. The primary revenue from these additional assets and liabilities is the servicing fee. Assuming a normal servicing fee of 0.25 percent, the proposed tax would reduce that fee by 60 percent.

<u>MBA's Other Observations and Concerns</u>

The following are MBA's other observations and concerns with respect to the proposed fee:

- Financial institutions already are subject to a pro rata corporate income tax on their earnings. If a bank's profits increase, its taxes increase. Assessing the FCRF on top of the corporate income tax is tantamount to an industry-specific penalty for being profitable. If the FCRF is intended to serve as a penalty for inappropriate risk-taking, MBA believes regulatory modifications to financial

institution risk-based capital standards are a better and more appropriate means of influencing inappropriate risk taking than ad hoc tax penalties.

- If the proposed FCRF is not passed on to consumers, every dollar impact the FCRF has on bank capital reduces the bank's lending capacity tenfold. Thus, a $90 billion FCRF impact could reduce loans to consumers and small businesses by $900 billion.

- The tax is likely to reduce new loans available to consumers and businesses as regional banks fight to keep assets below the $50 billion threshold.

- A significant portion of the potential losses to the Troubled Asset Relief Program (TARP) fund relate to TARP funds advanced to the automotive industry. Yet there is no fee on liabilities proposed to recover those losses. Most banks have paid back the TARP funds with interest, and the U.S. government has earned a profit on that segment of the TARP. The tax is punitive in nature to large financial institutions. This comes at a time when economic recovery is dependent on the health of these industries.

- The FCRF is an ex post facto change to the terms of the TARP agreement financial institutions entered into with the government. When banks agreed to participate in TARP, the upside to the U.S. Government was in the form of stock warrants. TARP recipients did not sign up for the added burden of the proposed FCRF.

- The imposition of the tax on foreign financial institutions could lead to U.S. financial firms facing similar taxes around the world, compounding the above impacts.

In summary, MBA recommends that the Senate Finance Committee should not approve the proposed FCRF. MBA believes the FCRF will reduce the availability and increase the costs of real estate loans to consumers and small businesses. The FCRF also would discourage large financial institutions from entering into new, private label commercial mortgage backed securities (CMBS) and residential mortgage backed securities (RMBS) transactions and significantly reduce the profitability of non-agency servicing.

MBA appreciates the opportunity to present the above points for your consideration and we look forward to working with you as you evaluate and implement policy responses.