S. HRG. 111–1065

AN UPDATE ON THE TARP PROGRAM

HEARING

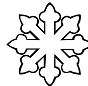
BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED ELEVENTH CONGRESS

SECOND SESSION

JULY 21, 2010



Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE

67–812—PDF WASHINGTON : 2010

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

COMMITTEE ON FINANCE

MAX BAUCUS, Montana, *Chairman*

JOHN D. ROCKEFELLER IV, West Virginia
KENT CONRAD, North Dakota
JEFF BINGAMAN, New Mexico
JOHN F. KERRY, Massachusetts
BLANCHE L. LINCOLN, Arkansas
RON WYDEN, Oregon
CHARLES E. SCHUMER, New York
DEBBIE STABENOW, Michigan
MARIA CANTWELL, Washington
BILL NELSON, Florida
ROBERT MENENDEZ, New Jersey
THOMAS R. CARPER, Delaware

CHUCK GRASSLEY, Iowa
ORRIN G. HATCH, Utah
OLYMPIA J. SNOWE, Maine
JON KYL, Arizona
JIM BUNNING, Kentucky
MIKE CRAPO, Idaho
PAT ROBERTS, Kansas
JOHN ENSIGN, Nevada
MICHAEL B. ENZI, Wyoming
JOHN CORNYN, Texas

RUSSELL SULLIVAN, *Staff Director*
KOLAN DAVIS, *Republican Staff Director and Chief Counsel*

CONTENTS

OPENING STATEMENTS

Page

Baucus, Hon. Max, a U.S. Senator from Montana, chairman, Committee on Finance 1
Grassley, Hon. Chuck, a U.S. Senator from Iowa 3

WITNESSES

Barofsky, Hon. Neil M., Special Inspector General for the Troubled Asset Relief Program (SIGTARP), Washington, DC 5
Warren, Elizabeth, Chair, Congressional Oversight Panel, Cambridge, MA 7
Hillman, Richard, Managing Director, Financial Markets and Community Investment Team, Government Accountability Office, Washington, DC 8

ALPHABETICAL LISTING AND APPENDIX MATERIAL

Barofsky, Hon. Neil M.:
- Testimony 5
- Prepared statement 37
- Responses to questions from committee members 47

Baucus, Hon. Max:
- Opening statement 1
- Prepared statement 59

Grassley, Hon. Chuck:
- Opening statement 3
- Prepared statement with attachments 61

Hillman, Richard:
- Testimony 8
- Prepared statement 77

Snowe, Hon. Olympia J.:
- Prepared statement 99

Warren, Elizabeth:
- Testimony 7
- Prepared statement 101

AN UPDATE ON THE TARP PROGRAM

WEDNESDAY, JULY 21, 2010

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

The hearing was convened, pursuant to notice, at 10:06 a.m., in room SD–215, Dirksen Senate Office Building, Hon. Max Baucus (chairman of the committee) presiding.

Present: Senators Conrad, Nelson, Carper, Grassley, Bunning, and Crapo.

Also present: Democratic Staff: Bill Dauster, Deputy Staff Director and General Counsel; John Angell, Senior Advisor; and Chris Law, Investigator. Republican Staff: Emilia DiSanto, Special Counsel and Chief Investigative Counsel; Jason Foster, Senior Investigative 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.

Walt Whitman wrote that, "to do the labor of a prudent watchman who prevents outrage is one of the proper duties of a government."

Our witnesses today are the sort of folks whom Walt Whitman had in mind. Their hard work and aggressive oversight have gone a long way toward keeping the TARP program relatively efficient and honest.

That is no small task when you look at the size of TARP and the speed at which it was set up. TARP remains one of the largest and most complex programs that the Federal Government has ever created. And that means that it is all the more important that we have the three oversight teams before us today.

I worked hard to create the Office of the Special Inspector General for the TARP back when Congress was developing the program. So I am especially pleased to welcome Mr. Barofsky back to the committee today. So far, the Special IG has done a great job. You are providing critical transparency to the program, developing important studies on specific aspects of the program, and even busting bad guys.

I congratulate Mr. Barofsky and his team for their work on the Lee Farkas case. Mr. Farkas was the head of a private mortgage lending company. He was arrested on June 15 and charged with a $1.9-billion fraud. He and others were charged with scheming to steal $550 million in TARP money. That scheme was stopped dead in its tracks.

The Special IG has conducted independent analysis that has brought critical transparency to the TARP program. An example is the Special IG's report on Monday. In that report, he concluded that the administration's auto task force pressured GM and Chrysler to close many auto dealerships without adequately considering job losses.

This news is quite troubling. In Montana and across the country, our auto dealers are local small businesses and often the heart of the community. I am disappointed to learn that many of the decisions by the auto task force were made without full consideration of the effects on these communities. Fortunately, some auto dealers have successfully restored their franchises, but many others have closed or have been forced to adjust to losing a franchise agreement during the most significant economic downturn since the Great Depression.

Mr. Barofsky, I applaud you for bringing issues such as this to the attention of Congress and the American taxpayers.

Elizabeth Warren of the Congressional Oversight Panel can bring us up-to-date on how small banks are fairing under the TARP program. Her most recent report raises concerns about how fast small banks would be able to pay TARP back.

More than three-quarters of the large banks who received TARP money have already repaid the taxpayers. By contrast, only 10 percent of the small banks who received TARP funds have repaid their money.

There is also interest in an update on the AIG/Goldman Sachs relationship that you reported on earlier this year.

Oversight is sometimes a lonely job. It does not win too many popularity contests. We have all been pleased to witness the perseverance of your three teams for the last year and a half since Congress created the TARP program.

In some respects, the end of the program is in sight, just over the horizon. The Wall Street reform bill that we passed last week bars any new TARP programs and initiatives. It also caps TARP disbursements at $475 billion.

Treasury reported that the total amount repaid to the taxpayers for the government funds used to bail out U.S. companies has surpassed for the first time the amount of TARP's outstanding debt.

Losses from the TARP program are still projected to be high, but the government will not see a $700-billion loss for TARP, as some had said back in the fall of 2008.

A year ago, the losses were projected to be $341 billion. Instead, current loss estimates look to be more in the range of $100 billion, and some are saying that figure could go lower, depending on repayments from AIG and the auto companies.

The debate over the necessity for TARP and its effect on the U.S. economy will continue. I note that our colleague, Judd Gregg, said last week that, "TARP did what it was supposed to do. It basically saved the financial system on Main Street, too." And Alan Blinder, the former Vice Chairman of the Federal Reserve, said TARP "was a necessary evil to save the economy. Think of it as collateral damage in a successful war against financial Armageddon."

What we do know today is that the hard work and sacrifice of our three oversight teams have given the American people a rel-

atively clean, well-run program. I do believe that. I think it is the oversight of you three that is largely the reason why there have not been difficulties, scandals, problems, so forth, because you have worked very hard, all three of you, to exercise very vigorous oversight. I think the American taxpayers are very appreciative of that.

We are grateful for your efforts. We stand ready to help you continue your good work as the TARP program comes to an end—we hope it comes to an end—and we hope that that will be in the very near future.

Senator Grassley?

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

Senator GRASSLEY. I associate myself with the remarks that the chairman just made complimenting you on your oversight, each of you.

We have this $700-billion program. It has been a focus of numerous audits, hearings, and reports; and, at every stage, each of you has brought more transparency and accountability to the activities of Treasury. In short, you have kept Treasury honest, a critical service with so much taxpayers' money at stake.

Each of your organizations has published numerous reports on different aspects of TARP. Just this morning, the Special Inspector General published its seventh quarterly report.

With TARP scheduled to expire October 3, I look forward to hearing each of you update the committee on your activities.

Mr. Barofsky, your office released a report this week describing the process by which the administration forced GM and Chrysler to accelerate the closure of 2,243 dealerships, putting at risk as many as 100,000 jobs, without first determining that the pace and scope of the closures was truly necessary.

While your report is insightful, unfortunately, it comes too late for many car dealers, owners, and suppliers across the country that were forced out of business for very little reason.

It's frustrating to know that, at a time when small businesses are hurting and we are facing record unemployment, this administration was pushing to shut down these dealerships. And your new quarterly report contains a startling observation that, although TARP appears to be winding down, when non-TARP aid is included, the amount of overall government assistance actually grew during the last 12 months.

Last year, you estimated the total amount of taxpayer's money at risk through various programs would be $3 trillion. Your new estimate is $3.7 trillion, a $700-billion increase, and that's as much as the original TARP program was ever expected to be.

I also know that your office has been actively investigating excessive AIG executive compensation payments that have been largely ignored by the Treasury, and I have been continuing my inquiry into the severance package received by a former AIG executive. It seems that the executive received nearly 3 times her salary in severance bonuses, or about $1.4 million. Although she was terminated, her severance was increased, and Treasury could have stopped the payments, but did nothing.

Mr. Chairman, I have documentation on this I would like to put in the record.

The CHAIRMAN. Without objection.

[The information appears in the appendix on p. 64.]

Senator GRASSLEY. For Ms. Warren, last month, your Congressional Oversight Panel reported on AIG bailouts, and we learned that among the ultimate beneficiaries of the tax-funded AIG bailout was not just AIG's counter-party, Goldman Sachs, but also Goldman's counter-parties.

It is estimated that Goldman's counter-parties may have benefitted from the taxpayer bailout of AIG by avoiding as much as $11 billion in losses; and yet, incredibly, we don't know who those counter-parties are. Goldman has refused to provide your panel with the names of those companies.

Mr. Chairman, I have a summary that I would also like to include in the record, as I just asked you to on another matter.

The CHAIRMAN. Without objection.

[The summary appears in the appendix on p. 67.]

Senator GRASSLEY. The Congressional Oversight Panel also issued a report this week about TARP's Capital Purchase Program. It details how Treasury seems to have treated the Nation's largest banks much more favorably than it treated the Nation's smaller banks. Many of the smaller banks now are struggling, and their participation in TARP has neither stabilized the financial system nor increased lending activity.

Let us look at GAO. Mr. Hillman's office also released a report about AIG. One focus of the report is a status of AIG's attempt to repay its debt to the American taxpayer. Over time, the government has exchanged much of AIG's debt for stock, meaning that the government's ability to recoup the billions advanced to AIG will depend, to a large degree, on AIG's ability to sell its business assets as it restructures.

The recent collapse of a $35-billion deal to sell an AIG life insurance subsidiary is an ominous sign that the taxpayers may not get back their money, or at least it may take a long time.

One of the purposes of TARP, of course, was to preserve home ownership and protect home values. Treasury announced the $50-billion Home Affordable Modification Program (HAMP) in March 2009, and all three of the watchdogs on the panel today have issued reports on the program's progress, and that is not good—progress has not been good.

In a program that Treasury said would result in 3 to 4 million modifications, there have been only 340,000 permanent. In fact, there have been 430,000 failed trial modifications, meaning failed modifications vastly outnumber successful ones. And just as I warned, re-defaults look like they will be a real problem.

The debt-to-income ratio for borrowers who have received a mortgage modification is 64 percent, even after modification, a level that all but ensures high default rates. Moreover, Treasury still has not established performance goals or benchmarks for the program, meaning that there is no more effective way for us to know whether this $50-billion program is accomplishing its intended purposes.

That is not accountability, it is not transparency, and it is just more taxpayers' money flying out the window. American taxpayers' investment in the TARP program is unprecedented, and, as good stewards of the taxpayers' money, it is essential that we exercise the highest standard of oversight.

As you present your findings today, panel, I ask that you specifically advise the committee, each of you, of any areas in which your oversight is being limited or constrained by a lack of cooperation from the administration, the Treasury Department, or others, and how best I and this committee can help you.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

I want to thank our witnesses and their teams for their continuing hard work.

Our first witness is Mr. Barofsky, Special Inspector General for the TARP program; the second witness is Elizabeth Warren, Chair of the Congressional Oversight Panel; and the third witness is Rick Hillman, Managing Director of the Financial Markets Community Investment Team at the Government Accountability Office.

Thank you all for your hard work. You are working very hard on behalf of the American people, and thank you again.

I urge you to summarize your statements, because they will automatically be included in the record.

Elizabeth Warren has a commitment. So we are going to try to accommodate that obligation, Ms. Warren.

So why don't you first begin, Mr. Barofsky, and then we will go down the line there.

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

Mr. BAROFSKY. Thank you, Mr. Chairman. Chairman Baucus, Ranking Member Grassley, thank you for giving us an opportunity to come back. It is a privilege and honor to testify once again before this committee to release our most recent quarterly report.*

I do want to thank you and this committee for your tremendous leadership in support of our office. Our ability to accomplish what we do derives directly from the support of this committee. And I am happy to report, Senator Grassley, that we do not have—have not had any issues or problems getting information, in large part, because I think those whom we deal with know that this committee is standing squarely behind us and that the repercussions would be severe.

In our quarterly report, we give an update on this previous quarter, and it has been a noteworthy one, as the chairman and the ranking member have noted, for both TARP and for SIGTARP.

For TARP, as the chairman noted, more money is back than is currently outstanding. The loss projections are going down, and, with Dodd-Frank, the cap is getting smaller.

For SIGTARP, as the chairman noted, I think we have demonstrated this quarter that robust, proactive law enforcement is an

*The SIGTARP Quarterly Report to Congress, dated July 21, 2010, can be found at *http://www.sigtarp.gov/reports/congress/2010/July2010_Quarterly_Report_to_Congress.pdf*.

important part and a vital part of any oversight program. In the case the chairman described, our charges against Lee Farkas, that case was initiated in connection with an application for TARP funds from Colonial Bank, which was affiliated with Mr. Farkas, and received conditional approval from Treasury for $553 million in taxpayer funds.

Through the hard work of SIGTARP's agents and our law enforcement partners, we made sure that money did not go out the door, that that money did not get poured into the gaping abyss of fraud that was Colonial Bank. And as a result, we have assured that this agency, SIGTARP, will have paid for itself over the course of its life by those savings alone.

As the ranking member noted, in our quarterly report we provided an update on what we had done last summer at the request of the chairman—the last time I testified before this committee—of the 50 or so programs in addition to TARP that address the scope of the financial crisis, the government's response in support of the financial institutions and financial markets.

In our report, we summarize each of those 50 programs, and we provide numbers, three key numbers for each one: the total or maximum amount that was pledged or committed by the Federal Government, by the agency, either explicitly or implicitly, for each of those programs; the high-water mark, the maximum amount of money that was out the door either in guaranty or explicit expenditure at any one period, given a time; and what the current outstanding is as of June 30 of this year.

As the ranking member noted, when we compared that number to the same number a year ago, we found that, notwithstanding the reduction in TARP and a lot of the liquidity programs of the Federal Reserve, the increases in other programs designed to help the housing markets and the financial institutions that participate in them far outweighed that, to the tune of the current amount of $3.7 trillion, $700 billion more than the $3 trillion balance last year.

Finally, in our report, we go over our previous audits and outstanding recommendations, including the one mentioned by the ranking member, one of the greatest failures in transparency and accountability in the current program, and that is Treasury's refusal to identify meaningful benchmarks, goals, and expectations for the mortgage modification program.

It is a simple recommendation that we made that Treasury put forth how many people it truly expects to help stay in their houses through permanent modifications. It is a recommendation that all three of us on this panel have made to Treasury and that Treasury has ignored.

In this failure to adopt this recommendation, it fails to recognize the basic tenets of a good government program: clear goals, clear expectations, and clear description of performance against those benchmarks. Its failure to do so has essentially resulted in the Nation's taxpayers having to shoulder an additional up to $50 billion in national debt without being told how many people it is expected are going to actually be helped by this program to stay in their homes; how many people are going to be helped in the various al-

phabet soup of supp programs; and how the money is going to be spent to achieve those benefits.

Treasury's continued indications that this is a successful program, without identifying these goals and benchmarks, is simply not credible, and I fear that the growing public suspicion that this program is an outright failure will continue unless and until Treasury adopts this recommendation and comes clean with what its goals and expectations are.

Mr. Chairman, Ranking Member, members of the committee, again, I cannot thank you enough for your continued support of our office, of all of our efforts. And I look forward to answering any questions you may have about the quarterly report, about our audit that we issued earlier this week on the auto dealership terminations, or any other subject.

Thank you.

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

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

Ms. Warren, you are next.

STATEMENT OF ELIZABETH WARREN, CHAIR, CONGRESSIONAL OVERSIGHT PANEL, CAMBRIDGE, MA

Ms. WARREN. Thank you. Thank you, Chairman Baucus, Ranking Member Grassley, and committee. I want to start with a reminder that I am the Chair of a bipartisan, 5-member panel. So, while I will do my best to summarize the work of the Congressional Oversight Panel, any additional sentences are my own, and my colleagues may have different views, different nuances that they bring to things. So I want to make that disclaimer.

Since we last met before this committee, much has changed in the financial markets and in TARP. A year ago, our country was in the midst of what seemed to be a deepening financial crisis, on the edge of economic collapse.

It is easy now to forget the panic that gripped the markets in the fall of 2008; a very real threat that it would spread to the broader economy, devastating families, small businesses, and communities.

TARP has had a profound effect as part of a coordinated government response to bring our economy back from the brink of collapse. And everything I say and the work we do in oversight is in that context.

I also want to say at the beginning, we raised issues from our very first report, which was in December of 2008, about accountability and transparency. Difficulties we were having at the time with Treasury, and what we thought we brought to oversight by trying to bring these issues forward.

After we met with this committee, things changed substantially. And so I come here, in part, on behalf of the Congressional Oversight Panel, to thank this committee for your ongoing support.

I recall, in particular, a conversation in which Mr. Grassley said, "If there is anything you cannot get, Professor Warren, you let me know, and the two of us will walk over to Treasury and see if we can find what we need."

Senator Baucus, your office has been enormously helpful. That has made a real difference in what has happened in our oversight

efforts. We have been tough on Treasury, but there really has been a great deal more transparency, a great deal more openness with Treasury about the information we need.

Our oversight panel has been in effect for 20 months. We have issued 20 monthly reports and two special reports. We have hit the range from dollars-and-cents reports on the value of bank warrants that Treasury was selling under the Capital Purchase Program, to a review of the government's investment in specific companies, such as GM, Chrysler, AIG, and GMAC.

All of the reports, along with videos, summaries, backup documents, are available online at *cop.senate.gov*. We are part of the Senate website and glad for anyone to come and see what we have.

I am going to just give a very brief summary of two of our most recent reports. The small banks program, you mentioned that, Senator Baucus, in your opening remarks. It reminds us that TARP money went to 707 banks. The 17 largest banks got 81 percent of the money, and they got it fast; 76 percent, as you noted, have now repaid and are reporting substantial profits.

The 690 smaller banks had a very different experience. They got their money more slowly. Only 10 percent have repaid; and, more worrisome, 15 percent have already missed at least one of their dividend repayments. The small bank troubles are many. There is a coming crisis in commercial real estate. The value of assets held by these banks will decline by the end of this year by an estimated 50 percent compared with the peak when many of these loans were made; and 1,688 smaller and intermediate-size banks have, by their own auditors' admission, deep concentrations in commercial real estate.

These banks also have limited access to capital, and, if they do not find a way to pull themselves out of the TARP program in a few years, their dividend will go up from 5 percent to 9 percent, which will put even further pressure on them.

The reason I mentioned this report in particular is, it is both our most recent, but it is also because the health of the small banks is directly related to the health of small businesses. Small banks that are constrained, small banks that are under financial pressure, are not small banks that are able to support small business lending. So we have a problem that gets in the way of restarting the economy.

We have also talked recently about AIG, about the small business credit crunch, and the foreclosure mitigation program.

I am here to answer questions as best I can on any of our reports and to say, again, that the Congressional Oversight Panel very much appreciates the support we've gotten from this committee.

[The prepared statement of Ms. Warren appears in the appendix.]

The CHAIRMAN. Thank you, Ms. Warren. Mr. Hillman, you are our wrap-up here.

STATEMENT OF RICHARD HILLMAN, MANAGING DIRECTOR, FINANCIAL MARKETS AND COMMUNITY INVESTMENT TEAM, GOVERNMENT ACCOUNTABILITY OFFICE, WASHINGTON, DC

Mr. HILLMAN. Chairman Baucus, Ranking Member Grassley, members of the committee, I commend you for holding this hearing

today, and I am pleased to be here to discuss our work on the Troubled Asset Relief Program.

My statement today draws primarily on seven reports that we issued since October 2009. Specifically, this statement focuses on the nature and the purpose of activities that have been initiated under TARP and their ongoing challenges, the process for making decisions related to unwinding TARP programs, and indicators of the credit conditions in markets targeted by TARP programs.

Regarding our first objective, Treasury has initiated a number of programs under TARP, some of which have ended or are being unwound, others, especially those involving AIG, the automobile industry, preserving home ownership, and encouraging lending to small businesses, may continue for some time.

Many participating institutions have repaid the funds they received, reducing the Federal Government's exposure under TARP. Since TARP was authorized, Treasury has disbursed $385 billion in loans on equity investments. As of June 30, 2010, Treasury had received almost $25 billion in dividends and interest payments and warrant repurchase, as well as more than $198 billion in repayments.

Although Treasury has received significant repayments of the funds that it provided to the financial institutions, some institutions and loans could still result in substantial losses to the government. We have been monitoring TARP programs since their inception, including the financial condition of those institutions that have received significant assistance. In particular, Chrysler and General Motors Company have shown some indications of progress toward returning to profitability, such as doing better than they had initially projected in terms of revenue, operating earnings, and cash flow.

However, the extent to which the Federal Government will fully recoup its investment in the auto industry is uncertain, and the companies face several challenges in the coming years, including returning to and sustaining strong growth and profitability.

Since early 2009, we have also been monitoring the status of the Federal assistance to AIG and its financial condition, using indicators we developed.

In April 2010, we reported that our indicators showed that AIG's financial condition had remained relatively stable, largely due to the Federal assistance provided by the Federal Reserve and Treasury. But the extent to which the Federal Government will recoup its investment remains uncertain and will not only depend on the long-term health of AIG, but also on the company's success in selling businesses as it restructures, and other market factors, such as the performance of the insurance companies and the insurance sector, and the credit derivatives markets, that are beyond the control of AIG or the government.

Many of our reports have also highlighted the challenges facing TARP programs, and we have made recommendations to enhance the transparency and accountability of programs. For example, in a recent report on the Home Affordable Modification Program, we stated that the program has made limited progress in preserving home ownership, has suffered from inconsistent program implementation, and continues to confront additional challenges. This in-

cludes converting trial modifications to permanent status and ensuring program stability and effective program management.

We reported that, while Treasury has taken some steps to address these challenges, it is urgently needed for Treasury to finalize and implement the various components of the HAMP program, and ensure the transparency and accountability of these efforts.

We will continue to monitor these programs, and have ongoing work on several facets of TARP, including those initiatives that have a small business focus.

We have also received and reviewed Treasury's framework for deciding to extend TARP beyond December 31, 2009 and found that the process was sufficient, but could be strengthened for similar decision that will need to be made in the future.

Specifically, we found that the extent of coordination could be enhanced and formalized between Treasury and the Federal Deposit Insurance Corporation, and recommended that Treasury formalize coordination with FDIC for future decisions. Going forward, Treasury will continue to face decisions on winding down programs, and many of these decisions will require interagency coordination, because TARP will be unwinding concurrently with other important regulatory interventions. Decisions about the sequencing of the exits from the programs will require regulators to work closely together.

We also noted that Treasury could strengthen its analytical framework for identifying clear objectives for small business initiatives and explaining how relevant indicators motivated TARP program decisions.

Regarding our last objective on the indicators of credit conditions in markets targeted by TARP programs, we have noted in the past that some of our anticipated effects of TARP on credit markets and the economy had materialized and that some securitization markets had experienced a tentative recovery.

Indicators we have been monitoring suggest that the credit markets have been able to sustain their recovery, despite the winding down of key programs initiated by the Federal Reserve, Treasury, FDIC, and others. For example, the cost of credit and perceptions of risk, as measured by premiums over Treasury securities, have fallen in interbank lending, mortgage lending, and corporate debt markets.

Further, the volume of credit as measured by new mortgage loans and asset-backed securities has improved since the first TARP program. Unfortunately, by any measure, foreclosures and delinquency statistics for residential housing remain well above the historical averages, despite programs such as HAMP. Full recovery will take some time, given the buildup of imbalances in the real estate, fiscal, and household sectors over several years.

Finally, because any new TARP activity will be limited to home ownership preservation and small business lending programs, we will also be continuing to monitor indicators, such as the foreclosures and delinquency rates, as potential measures of the TARP program's success.

Mr. Chairman and members of the committee, I appreciate the opportunity to discuss these issues. I would be happy to respond to any questions.

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

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

I might say to my colleagues here that Ms. Warren does have to leave soon, in about 10–15 minutes. So I am going to confine my questions to her so that she can leave early, and so we will then ask other questions of other witnesses, if the committee does not mind.

Senator GRASSLEY. If we do not use up our 5 minutes and we can reserve the time.

The CHAIRMAN. Yes, that is correct.

Ms. Warren, I would just like your thoughts on the HAMP program, why it is not working very well. Mr. Barofsky suggests some better benchmarks, more standards, and so forth.

The front page, as I recall, of the *Wall Street Journal* today is about housing markets not doing too well.

So if you could just tell me, what are your thoughts and what is your advice for small banks, community banks; what needs to be done here?

Ms. WARREN. Thank you, Senator. We have now written three reports about the home ownership mortgage foreclosure program, and we said in our second report, which was 9 months ago, that the program was too small, it was too slow, and it was not putting enough people into permanent modifications.

We said at the time and we urged Treasury to design a program that could be ramped up quickly and get ahead of the problem. Instead, the position we are in now is that we continue to trail the problem.

Fifteen months into this program, for every one family that appears to have made it to a permanent modification that is likely to stabilize that family in that home, 10 more have been moved out through foreclosure.

This is a program that is just behind the curve.

The CHAIRMAN. Why is it not working well?

Ms. WARREN. It is too small, it is too slow. The program is based on the assumption that we will get the servicers, we will pay the servicers a bribe to make a deal that works between the home owner and the investor, who is still holding the paper. And it has not worked well.

In many cases, the servicers can continue to make more money if the family goes through foreclosure. It is just not a program that is working for home owners. It is not a program, in some cases, that is working for investors. And most importantly, it is not a program that is working for the economy overall.

The CHAIRMAN. Mr. Barofsky, your thoughts on this program and what needs to be done? And, if you could amplify a little more on your statement that we need more benchmarks.

Mr. BAROFSKY. I think that is absolutely essential, though that does not ultimately get to the heart of why more people are being helped. The numbers that Treasury has put out, as dismal as they seem, when you dig deep behind them, in a way, it gets almost worse.

What we have done in this quarterly report for the first time, and what is not reported in Treasury's number, is we actually disaggregate two aspects of the HAMP program.

So part of it is done by TARP-funded modifications. The other parts are done by Fannie and Freddie. And the $50 billion of TARP money is only for those TARP modifications.

When it was originally announced, I think it was—basically, you could just go by the numbers, $50 billion for TARP, $25 billion for Fannie and Freddie. It was anticipated that there would be probably a roughly 2-to-1 ratio.

Well, when you break out the most recent numbers of about 390,000 permanent mods, only 165,000 of those have come from TARP. So, if you look at it over the last 16 months, that is about 10,000 permanent mods a month that are being funded through TARP. This is part of the transparency that we try to bring by breaking these numbers out so we can really look at the TARP piece of the program.

The problems, as Professor Warren has noted, are all valid. Part of it is we have made some recommendations on vulnerability to re-default and to make these programs more effective and more attractive.

One thing the Treasury has done, which I think is a step in the right direction, is to finally address the issue of principal reduction, which is, I think, a vital issue. All the predictors of re-default, whether it is the Federal Reserve or Moody's or S&P, we cite a bunch of studies, all point to negative equity as being a major issue.

So they roll out some significant programs, but even those are somewhat flawed.

The CHAIRMAN. What do you want the Treasury to do?

Mr. BAROFSKY. Well, I think one thing that we point out is that they should make the principal reduction program mandatory. As it is now, the servicers basically get to pick and choose and decide whether or not they want to give home owners the benefit of principal reduction.

We have been in a back-and-forth, which is laid out in our report. We have asked them, preliminarily, what are your arguments; why are you doing this? We found them to be completely unconvincing. And I think as it currently is planned to be, it could end up in random——

The CHAIRMAN. Professor Warren, what would you have Treasury do?

Ms. WARREN. I think that Special Inspector General Barofsky is in the right direction. We cannot have a program in which, in effect, we put incentives on the table paid for by the taxpayer to say, "Please do the right thing here."

We have a crisis, and the consequences of not having cooperation from the servicers are not just felt by the investors who are harmed and by the home owners who are harmed; they are felt by this entire economy.

We need a program with far more urgency and some real teeth in it.

The CHAIRMAN. Thank you.

Senator Grassley?

Senator GRASSLEY. I am just going to ask one question now of Professor Warren. And then, if my colleagues want to ask her, I will not use up other people's time or keep her from going.

In your report on the AIG bailout, you indicated that Goldman declined to provide the panel with the names of the entities that insured Goldman against AIG bankruptcy. You call these unnamed insurers "indirect beneficiaries of the government's rescue."

Earlier I placed in the record a summary of your attempts to get information from Goldman that would explain who these indirect beneficiaries were, and, as I understand it, about $11 billion of taxpayers' money provided to AIG ultimately benefitted companies or individuals who remain unknown.

So to you, Professor Warren, can you explain why Goldman will not provide this information, and why should the public not know who these ultimate beneficiaries of taxpayer support actually are?

Ms. WARREN. Thank you, Senator. I assume that the reason that Goldman will not provide this information is it does not want the public to know.

Let me make it clear. We are looking for information about both the counter-parties to the financial transactions and, also, information about who the alleged insurers were.

That is, when Goldman says, "We had no exposure in this, we were completely neutral," it was because they claimed to have bought, in effect, insurance policies from third parties. Obviously, when AIG was rescued, they did not have to pay off.

We want to know the identity of those parties, partly just to know where American taxpayer dollars went, but partly to assess Goldman's claim. If we cannot see who the parties are and cannot see what the transactions are, we cannot evaluate the credibility of their claim that they had nothing at stake one way or the other in the AIG bailout.

Senator GRASSLEY. Mr. Chairman, since the Congressional Oversight Panel has been unable to get this information, I would like to suggest to you that we consider the committee asking for it, and, if Goldman Sachs does not respond, then we should consider issuing a subpoena to require that the information be provided.

The CHAIRMAN. Well, Senator, I think you make a good case, as does Professor Warren, that this information should be available. So why don't you and I talk about that and find a way to proceed?

Senator Bunning?

Senator BUNNING. Thank you. This is a follow-up to Chuck's question.

In late June, the *New York Times* reported on the latest AIG outrage. As part of an agreement to cancel its derivatives deals and pay the counter-parties off at par, AIG also waived all legal rights to sue Goldman Sachs, Merrill Lynch, and others for fraud or other reasons on the mortgage-backed securities they issued and AIG issued.

Since that deal was partly funded with TARP money, have any of you looked into this latest giveaway to the big banks at the taxpayers' expense?

Ms. WARREN. Senator, it is not part of our AIG report, because our AIG report came out before some of those documents.

Senator BUNNING. But is it now being looked at?

Ms. WARREN. We are looking into it, Senator. Yes, we are. Thank you.

Senator BUNNING. If you are, do you have any idea how much money each of you expects the taxpayer to lose on that TARP investment?

Ms. WARREN. That is a very difficult question, Senator. The consequence of giving up one's right to pursue legal remedies when the other party to the transaction may have made misrepresentations, may have otherwise misbehaved, it is very difficult to assess, and I do not want to be in the position of over-promising.

Senator BUNNING. I do not want you to, either. I mean, is there a reasonable chance of us finding out, without getting the papers that Chuck and the chairman have talked about, to know exactly how much TARP money is at risk?

Ms. WARREN. I am going to say this the other way. The consequence of waiving the right to pursue remedies, so that AIG would have at least potentially been able to sue other parties and draw more funds back into AIG, which, in turn, could be used to repay the taxpayer, that is the transaction we are talking about.

I want to be honest, Senator. I am not sure we would ever be able to put a dollar figure on that. What we will try to do, what we can try to do is at least track down where the waivers are and get some assessment of what their value might have been.

But we cannot promise beyond that because, when the lawsuit does not go forward, the data are never discovered, the facts never come forward to know exactly what happened.

Senator BUNNING. You pointed out in your testimony the different effects TARP had on the large banks and the small banks.

As it has played out, the large banks have benefitted the most and gotten larger at the expense of the small banks.

Have any of you found that Treasury or anyone else is worried about that impact or that it was even considered when TARP funds were being handed out?

Ms. WARREN. Senator, there is no doubt that there has been increased concentration in the banking industry since TARP dollars were put into the system, and we are very concerned that the numbers indicate that there will be even more concentration as smaller banks under great economic stress either fail or are gobbled up by larger banks.

We can find no evidence that at the time the initial TARP program was designed and money was put into these banks that the Treasury was concerned about the increasing concentration. No, sir.

Senator BUNNING. All right. Go ahead.

The CHAIRMAN. Thank you, Senator Bunning.

Senator Carper?

Senator CARPER. Thanks, Mr. Chairman.

To our witnesses, thank you all for joining us today. I have a question, Ms. Warren. I want to go back to something that I——

The CHAIRMAN. Senator, if you might just suspend briefly.

Professor Warren, do you have to leave? I have been told that you had to leave at quarter of to go to the White House. So just for a couple, 3 minutes, could you let Senator Carper ask a couple, 3 questions?

Senator CARPER. Are you able to do that?

Ms. WARREN. Of course.

Senator CARPER. Thanks. First, before I ask about the small bank situation, with respect to the Home Affordable Mortgage Program, I think you used the word "bribe" in conjunction with servicers.

I sat through hearings when I was on the Banking Committee. We were trying to figure out why the mortgage modification programs were not working, and part of the testimony that we heard was that, of all the key stakeholders we need cooperation from, one is we needed the cooperation of the servicers.

They were being asked to do work in conjunction with modifying these mortgages. They were in danger of being sued by investors for the work that they were doing, and they were not getting any compensation for it. So here they were being asked to do work and they were in some jeopardy, they felt, of being sued for their involvement.

If you want to incentivize them to be part of the solution, compensate them for the work they are being asked to do.

So I do not know that I would use the term "bribe." That is where we ended up—and then, again, it was Treasury and a number of other folks who thought that they deserved some kind of compensation in order to participate.

Let me ask you a question about the small banks, if I can. And thank you for bearing with us here.

I think you have expressed here, maybe just before I arrived, concern about the small banks' ability to repay their TARP obligations, and, in fact, as you note, a number of small banks have missed the required dividend payments.

Let me just ask. What is your recommended solution to that problem?

Ms. WARREN. Well, I always want to be modest. We can go as far as our data take us and try to point out where the problems are.

I will say, in the case of small banks, we have been urging Treasury for, I think, more than half a year now to get ahead of the coming problems with commercial real estate. They are disproportionately—those loans are disproportionately concentrated in intermediate-size and smaller banks, and they are not evenly spread among those banks. They concentrate within that in certain banks, and that is going to create additional profound stresses on the financial system.

So I am afraid I am going to have to go back to our role that we are not policymakers, but where we have urged Treasury to move is in that direction, to try to start wrestling now before the crisis is upon us with commercial real estate loans.

Senator CARPER. Can you just summarize your answer in like one or two sentences in terms of what is your recommendation for solving this problem? Summarize just very briefly.

Ms. WARREN. Fair enough. I am sorry, sir. It is that we acknowledge and deal with the obvious coming problem in commercial real estate, that Treasury work with the small financial institutions to develop a plan for how they are going to pay their way out of TARP, and that Treasury establish a program to deal with the

number of small banks who are not able to make their TARP repayments.

Senator CARPER. All right. Thanks very much.

Ms. WARREN. Thank you, sir.

The CHAIRMAN. Thank you, Senator.

Thank you, Professor Warren, very, very much. We deeply appreciate your service. We understand your other obligations, and the committee will continue hearing from Mr. Barofsky and Mr. Hillman. Thank you very much.

Ms. WARREN. I apologize for leaving, and thank you all very much.

The CHAIRMAN. Mr. Barofsky, if you could elaborate a little bit more on your report about the GM/Chrysler dealership dismissals by the administration and the resultant job loss and other consequences, if you felt they acted too speedily. And I do not want to put words in your mouth, but you felt that there was—it is not as appropriate as it should have been.

Could you expand on that, please?

Mr. BAROFSKY. Sure. And I would also note that I think that as a result of the—based on the White House's reaction to our report, there is little chance that I will be called away by an invitation to the White House anytime soon to have to miss this hearing. [Laughter.]

Essentially, what we tried to do in this audit report is, with respect to——

The CHAIRMAN. What I like about you is, you call them as you see them.

Mr. BAROFSKY. With respect to the Treasury piece of this report, what we tried to do was, we looked at the process. What was the process that the auto team used in making its ultimate decision to reject the pitch by GM that they were going to terminate their dealerships over the course of 5 years, and its response and its viability determination that it needed to accelerate that process, which ultimately resulted with Treasury's encouragement of using the bankruptcy process to basically get around the State franchise laws to terminate them all at once?

What GM did was, they actually terminated the ability of those dealers to get new cars for about 18 months and allowed them to wind down. Well, Chrysler, also taking the queue, just within 3 weeks, knocked them out with immediate terminations.

What we found was that, when engaging in this process, there were several flaws in that process, that decision-making process.

First of all, the diligence that you would expect in making a decision of this consequence, particularly given the timing—we are obviously in the midst of the greatest recession in generations. They did not do any of the modeling that you would expect, the analytical review that you would expect.

Essentially, they talked to a number of industry experts, mostly Wall Street analysts, and asked them their opinion, and the opinion that came back was generally, yes, it is important to reduce the dealer networks, that there is some degree of competition, too much competition, particularly in metro areas and city areas.

But basically, that opinion was not universal. There is at least one expert whom Treasury spoke to and others whom we spoke to

who dissented from that opinion. But there really wasn't, until after the decision was made, any other diligence or work done.

Second, there was no consideration of the projected cost savings to the dealerships. It was not a factor at all, and, again, that was not done until afterwards in response to an inquiry from Congress.

Then third, which I think we found was the biggest flaw in this decision-making process, there was apparently no consideration given whatsoever to the fact that those decisions were going to involve potentially shuttering thousands of small businesses, putting tens of thousands of jobs in jeopardy, given the timing, at the very time when we had such a jobless epidemic. We were looking, in early last year, at 700,000 jobs lost per month, and that, I think, is one of the big flaws of this process.

Now, it may very well have been that, having analyzed all of that data and looked at the benefits to GM and Chrysler versus the job losses and the broader economic impact, perhaps they may have come to the same decision. But from what we saw, we did not see the evidence to support the idea that these dealers—that GM and Chrysler would have foundered or gone out of business had they not accelerated termination. We saw no evidence to support that, and we certainly did not see any evidence of the necessary balancing that the government must do, we believe, before making a decision like this.

The CHAIRMAN. The good news is the TARP losses are less and less. But still that implies that there are going to be some resultant losses. And the question is, where are the losses going to be coming from, and what can be done to minimize them?

Mr. BAROFSKY. Treasury's most recent estimate put the losses at a total of $105 billion. Again, this is their estimate: $45 billion from AIG; $25 billion from the auto industry, including their auto financing arms; and the modification program, that is $50 billion.

Now, nothing can be done about that, because that program is a subsidy. There is no intention, there is no way to recoup any money from there.

For the auto companies and AIG, the horse has probably left the barn. Our ability to—the decisions that were made, the terms that were provided, the amount of money that was provided, is essentially money that is out the door.

The best that we can do is hope that, given the restructuring of these companies, that they return to profitability, that their market capitalization increases.

There certainly are plans with respect to GM for an IPO. It has been announced, hopefully in the fourth quarter. That will hopefully get the ball rolling. AIG can successfully liquidate its assets. There are plans now for an IPO for one of its subsidiaries.

Hopefully, if the economy continues to improve and market conditions continue to improve, hopefully these numbers will come down even further.

But the bottom line is that, if people get more jobs, if housing markets rebound, and the economy improves, we are going to really improve our ability to get this money back.

The CHAIRMAN. All right. My time is expiring. But there are conditions that require the money be repaid—what, conditions where

the economy is doing better, they are having greater sales? Under what conditions?

Mr. BAROFSKY. We are just about down to equity investments in the auto companies and in AIG. There is some outstanding debt that is associated with it, as well, but the lion's share is equity.

So basically, we are going to have to liquidate our ownership interest at some point, and that only is going to happen if these companies go public or—AIG is public, but if it has and is able to shed enough assets to be able to pay off its Federal Reserve obligations first, because, again, Treasury does not get a nickel until all the various Federal Reserve support for AIG is taken care of, and only at that point.

And for the auto companies, it really is a question of how successful and profitable they are and how Treasury can liquidate its investment.

The CHAIRMAN. Senator Grassley, you have 5 minutes, plus 2 minutes, 2½ minutes. You have a lot of time.

Senator GRASSLEY. Thank you very much. I probably will not take it, because I have to go over to Agriculture to ask questions over there.

First of all, I am glad that Senator Baucus asked the question that he did about car dealerships. I would have asked a similar question. But let me follow-up about a specific inference you made about General Motors not consistently following its stated criteria and that there was little documentation of the decision-making process to terminate or retain dealerships.

I heard from dealerships that strongly believed that there was little rhyme or reason to their termination notices.

Some believed that the rationale was always evolving, meaning that the criteria were very subjective.

Could you elaborate on this point and tell us what you learned by looking at General Motors' data?

Mr. BAROFSKY. What General Motors originally said, and originally said to Congress, was that it was going to pursue an objective criterion. They actually made comments to Congress that they did not want to have the dangers of a subjective process, of case-by-case basis, but they wanted it to be an objective process.

So they put out some metrics, and they described those metrics to us, different scoring, the internal scoring method that they used, and other types of objective data.

The problem is, when we reach behind that data, they did not always follow it. In fact, in some cases, there were some pretty significant variances from what the objective data indicated versus the actual decision-making process.

So in phase one, the first phase of their termination, they said that certain criteria—if the score was below 70, then that meant that dealership was going to be terminated.

But 40 percent of the dealerships that were below that number were actually retained. So that suggests that it was done on a more case-by-case basis.

So we went back and we asked GM for explanations, and the explanations we got were general.

They acknowledged, first of all, that it was, in fact, that the objective criteria were more of a guideline and that there was some degree of case-by-case looking at it.

So one of the things they came back to us with was, well, when we looked at this number, we decided to keep some of the dealers in our rural networks because our dissenting experts on the whole auto team's theory pointed to the fact that the American auto dealerships and manufacturing companies have a competitive advantage in rural areas.

So again they told us that. But then when we looked at what the ultimate number of determinations were, nearly half of them were in rural areas, which was in contrast to GM's original pitch.

So we asked for documentation. We asked for, all right, let us see the backup, and there was not any.

Basically, the explanations that we received were after the fact, reconstructed. At times, it took them weeks to get back to us to try to reconstruct and give us an explanation why a particular dealership was terminated.

So basically, we had a process that lacked transparency, it lacked accountability. And one of the things that we fought the auto team for is having put the wheels in motion for these terminations, these accelerated terminations within the chaos of a bankruptcy, that they had some obligation to then oversee that process, and we think that they abdicated that responsibility, and it resulted in what we saw with GM.

And in Chrysler, which was a much more subjective process up front, and they were upfront by saying, hey, we used a very subjective process, but they didn't have the basic process of an appeal process.

And we fought the auto team for not following up and providing that oversight once they set the wheels in motion.

Senator GRASSLEY. Last week, the Securities and Exchange Commission announced that it settled with Goldman for $550 million. The SEC alleged that Goldman misled investors by telling them that the pool 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.

While these particular transactions did not involve AIG, there were reports that similar deals did. At our last hearing, I asked you if you were examining whether AIG may have been similarly misled by Goldman.

Since AIG is a TARP recipient, losses on the securities may have contributed to the need for taxpayer bailout of AIG.

Could you explain or could you give an update on your independent assessment of whether any AIG taxpayer-subsidized payments to Goldman were based on this kind of fraud and, if so, whether any of the fraud can be recovered from Goldman?

Mr. BAROFSKY. We have opened a broader investigation looking into exactly these issues. We have actually assembled an internal mini-task force which combines elements from our investigations, as well as our audit division.

I put my chief of staff in charge of it, because I think it is an important priority for our organization, and we are looking at pre-

cisely these issues. Whether or not the taxpayer has a remedy, potential civil remedy, either through AIG or through the Federal Reserve and through its Maiden Lane facilities, because to the extent that—I am sorry, not through its Maiden Lane facilities—but through its credit line, and as well as the TARP money backstop to see whether there are any potential civil remedies here.

And we are also looking at Maiden Lane II. We started taking a look at that and seeing if there were any potential civil remedies on behalf of the Federal reserve or on behalf of the taxpayer, if there is, in fact, fraud underling these.

Our investigation is in its pretty initial stages. It is a lot of information and a lot of documents, but we are working on it.

Senator GRASSLEY. Thank you, Mr. Chairman. I am going to yield back my time.

The CHAIRMAN. Thank you, Senator.

Senator Bunning?

Senator BUNNING. Thank you, Mr. Chairman.

Mr. Barofsky, I have a few questions about the auto bailouts and the report you issued on Monday.

First, were you able to tell if dealership closures will do anything to increase the profitability of GM or Chrysler?

Mr. BAROFSKY. All I can tell you, Senator, is that is the basis of the theory that the auto team was working under. It is a theory that is shared by a number of financial analysts on Wall Street.

Generally speaking, even those experts whom we spoke to who dissented from the auto team's overall strategy did believe that it was important overall for some of the dealerships in metro areas, where there might be oversaturation.

The reason being basically, if two dealers are close to each other and competing with one another, that drives prices down. So the idea is that prices will go up, the consumer will pay more for a car, and that where GM and Chrysler will save money is that they will have to have fewer incentive payments to the dealerships. That is the theory. We have not done any work to test that theory going forward and to see what happens.

Senator BUNNING. Second, when looking at the dealership closing plans, in general, or at any individual closures, did you find anything to suggest that either the car companies or Treasury gave any consideration to the fact that many of the dealerships that were closed were profitable for themselves and for GM and Chrysler?

Mr. BAROFSKY. For Treasury, it was not a consideration at all. For the companies themselves, they acknowledged that they closed profitable dealerships.

Senator BUNNING. I am going to give two examples that are right in my backyard. And I am in a Cincinnati metro—being on the short side of the Cincinnati metro area, being over in northern Kentucky.

I went to high school with a young man by the name of Zimmer. They had Zimmer Chrysler-Plymouth, but they did not have Jeep. Zimmer Chrysler-Plymouth, and they had it for 90 years.

Robke Chevrolet, they had just invested $8 million in a new plant—I mean, a new showroom, and they had been profitable for

the 60 years of their existence. Zimmer had been profitable for all 90 years of their existence.

Both of those places were closed, because they had to compete with all of the other major Chrysler dealerships and General Motors dealerships in the metro area of Cincinnati, and they were on the wrong side of the river.

Now that, to me, is kind of the most unfair thing I've ever witnessed in American business. When you are running a profit, and, no, it was not a small profit, they just were not selling enough cars, 450 cars in one and 600 in another.

When you consider the big picture of the metropolitan area, they were at the lower end, as you were saying, they were 70 percent. And I cannot understand that. How is that going to help Chrysler and General Motors make a profit?

Mr. BAROFSKY. Senator, it is entirely counterintuitive and, indeed, in our report, we cite—we took a sample market for a Chrysler dealership, and the dealership that got eliminated was the dealership that sold the most cars in that market. They sold the most—it was a Jeep dealer.

They sold the most cars, more cars than any other Chrysler-Jeep-Dodge dealership in that entire market. Their scores, by every objective criterion, were the highest. It was the best performing dealer. And Chrysler was upfront, they said that the reason that they got rid of them was that he had in his franchise agreement the ability to prevent other Chrysler dealerships from selling Jeeps within a certain radius. He did not play ball, so they got rid of him.

This is a story that we have heard, and we have heard it over and over again, and, to a certain extent, on the GM side, lack of documentation of the process; on the Chrysler side, the lack of an ability to appeal. That has been remedied somewhat by Congress's action, by giving them the right to arbitrate.

Senator BUNNING. Let me ask the last question. I want to get Mr. Hillman in. This is a follow-up on the AIG lawsuit waiver earlier that I asked Professor Warren.

But do either of you—have you looked at this latest giveaway in the form of AIG's legal rights to sue?

Mr. HILLMAN. All our work on AIG has really looked at the indicators of financial performance for itself, its companies, and its ability to restructure itself, sell off its businesses and the like.

We do have an ongoing engagement, though, Senator, that we will be looking into issues associated with decisions that were made with the credit default swaps risk at the AIG Financial Products Division, which was the major cause for the downfall of AIG.

Senator BUNNING. Also, were they returned 100 percent on the——

Mr. HILLMAN. Yes. We are looking at the whole affair, the extent to which the—which parties were in the room when decisions were made, what was the basis for the decisions, what criteria were followed and evaluated.

Senator BUNNING. Thank you both for your questions.

The CHAIRMAN. Senator Carper?

Senator CARPER. Thank you, Mr. Chairman.

Gentlemen, again, welcome and thank you for joining us today and for your testimony and for your responses.

Some of the questions I wanted to ask, particularly with the auto dealers, have been responded to, and I am going to set those aside for now.

I just want to go back up to 30,000 feet and look again at the TARP program, and ask you each for some comments on it.

With respect to, if you will, the capital infusion that we made from the TARP program into the larger financial institutions, their ability to meet their dividends requirements on preferred stock, their ability to buy back their preferred stock, their ability to make payments as we exercised our warrants—how is that going?

Mr. BAROFSKY. I think overall, especially with the larger financial institutions, it is going very well. There has been more money paid back now than is currently outstanding. A lot of the larger players, through the warrants, repurchase an option process. Treasury has seen nice returns.

Our recent report that we did on that process, although we saw some issues about the process that gave us some very serious concerns, as far as the results, they are getting the prices close to the internal estimates, which we all believe are reasonable. And we worked with Professor Warren in looking at that issue.

So I think there is some good news. The problem is, going forward, the strongest have paid back. The most profitable have paid back. Now we are dealing with, in the Capital Purchase Program, those institutions that have not yet been able to pay back.

In our report, we list about 105 institutions that missed dividend payments. We have seen a handful of failures.

Senator CARPER. When you say 105 have missed their dividend payment——

Mr. BAROFSKY. That have missed a dividend.

Senator CARPER. Out of a universe how large, and are these generally smaller institutions?

Mr. BAROFSKY. These are generally smaller. We have the total number of the dollar value. It is not an insignificant amount, about $150 million. But compared to the amount of repay, that has been repaid by the larger institutions, it is somewhat less.

We are also seeing restructuring and recapitalizations, which we go through in this report. And that is when a bank is struggling—a bank that has received TARP funds is struggling and frequently on the verge of failure, and Treasury is on the verge of basically getting wiped out with a complete loss to the taxpayer, they have been agreeing to restructure, often by taking a haircut on the value of a taxpayer investment to help the bank draw and attract more private capital, to changing the ratios, usually dropping from preferred status, dropping down the ladder to common or mandatory convertible stock.

That is another area where we are seeing some losses, but Treasury is trying to get some value out of it, and I think that is a process that is a complicated process and one we are going to be looking at more closely through our audit process.

Senator CARPER. With respect to the auto companies, GM and Chrysler, my recollection was that GM made some repayments of, I want to say, $6 billion or $7 billion. There was some assertion that I heard, they were like taking money out of one pocket and sort of like paying Peter with Paul's money.

Can you just refresh my memory on that? But, also, talk with us about the IPO process, which I think is going to begin at least with GM later this year, and hopefully with Chrysler next year.

Mr. BAROFSKY. Essentially, with respect to debt repayment, Treasury provided GM with about $49.5 billion. It was done in a number of different payments through it bankruptcy process. But a chunk of that was put into an escrow account. It was GM's escrow account, and it was part of that support.

And for a while, GM could not access money from that escrow account without Treasury's permission.

They would have to send a memo and say, "Dear Treasury, we want to access this money, and we want to use it for X or for Y."

Part of that $49.5 billion, we received equity in return, part of it was preferred shares, and part of it was approximately a $7-billion loan. That loan was repaid by money that came out of that TARP escrow account.

So the money had gone over to GM, so it was in GM's possession as part of the bailout, but it was a segregated account of TARP funds.

So GM sent a series of memos over to Treasury which said, "Dear Treasury, we would like to take money out of the escrow account of TARP funds and use it to pay back the TARP loan." The Treasury said all right.

Senator CARPER. Talk to us about the initial public offerings. GM has suggested that they hope to have at least one later this year to begin, I think, buying out the Federal Government, the taxpayers, for our 60–61 percent equity position.

I met with the CEO of Chrysler a month or two ago, and he indicated the hope to return to profitability by the end of this year and to be able to conduct the first of a series of IPOs. I think we have maybe a 10-percent or a 20-percent equity position in Chrysler.

Can you just give us an update on those two, please?

Mr. BAROFSKY. Sure. Our information is largely from information announcements by Treasury and the companies, but Treasury has hired—they have contracted with Lazard Frères to advise them in the IPO. It is contemplated that there potentially will be an IPO in the fourth quarter of this year of General Motors. There are a lot of variables for that, of course.

I do not think that in that IPO, Treasury will liquidate its entire investment. I think what is being discussed is that it would bring it down so—Treasury right now has a 61-percent equity ownership in GM—that they would sell a portion that would bring them down below majority ownership.

But I think a lot of it is very dependent on a lot of different factors. But I think that they are looking towards—GM and Treasury are looking towards an IPO in the fourth quarter of this year.

Chrysler, I think, Senator, your information is more up-to-date than mine.

Senator CARPER. Mr. Chairman, I would just note, with respect to this IPO, particularly with GM, I am pleased to hear that we are not going to try to recoup the entire 61 percent all at once, but the idea of being a patient investor and hopefully, over time, as the market returns, and GM, which has, frankly, a bunch of good prod-

ucts in the pipeline, including I think the launch of the Volt, that maybe we can recover all that money.

Thanks.

The CHAIRMAN. I have one more question and then I am going to have to leave, and, Senator Carper, if you want to take over, that would be fine.

Mr. Barofsky, I want to explore where we are on the total Federal effort to support the economy. You have done a new calculation of the total Federal effort to support the economy, and you found that the total has actually gone up from, I think, about $3 trillion to $3.7 trillion since last year. That is a new number.

I guess that is the total expended or guaranteed with respect to the Fed, Treasury, and the TARP agencies, like FDIC and FHA.

If you could just expand on that and delineate, frankly, what the components are and why it has grown in the last year.

Mr. BAROFSKY. Sure. The areas that we saw are mostly related to the housing market, really Fannie and Freddie, either direct support of them or support of their product.

So a breakdown—the biggest number is the Federal Reserve's purchase of Freddie and Fannie mortgage-backed securities. That went up about $650 billion in the past year. The Federal Reserve has also purchased directly debt of Fannie and Freddie. That went up about $70 billion. And its program of buying Treasuries, the U.S. Government, that increased about $125 billion.

For HUD, increases in FHA loan guarantees and Ginnie Mae guarantees on mortgage-backed securities, that increased about $500 billion. Again, that is sort of direct support to the housing market, as well as the institutions, obviously, that are receiving those guarantees.

And on the Treasury side, we saw increases in, again, its backstop of Fannie and Freddie, about $85 billion more in purchases of preferred shares in those two entities; about $50 billion more in response to the Euro debt crisis by a commitment to the IMF with respect to the bailout of Greece; and about a $65-billion increase in support of student loans, purchases of student loans, and asset-backed securities involving student loans.

Obviously, those numbers add up to a lot more than $700 billion, and that is because those are offset by the reductions in TARP and in a lot of the Federal Reserve's liquidity programs, which have been closed down entirely.

The CHAIRMAN. That is a big number. So how much of that is real? In the sense of net.

Mr. BAROFSKY. It is all real. The $700-billion increase is all—it is all actually our expenditures and guarantees.

It is not—as we make clear in here, that does not mean that the U.S. Government is at risk of loss of $3.7 trillion.

The CHAIRMAN. That is my question.

The Federal Reserve programs are almost entirely securitized—I am sorry—collateralized. Most of these programs are collateralized, and sometimes there is even some double-counting.

My example is that the Fed buys an agency mortgage-backed security that is guaranteed by Fannie and Freddie. Well, it is guaranteed by Fannie and Freddie, so the Federal Reserve is not necessarily at risk of loss there. Now, of course, if there was a loss at

Fannie and Freddie, then Treasury would come in and increase it or purchase more preferred stock to backstop that loss if those securities go back.

Then, of course, standing behind that is the house, which is collateral. That is the protection that Treasury has, and FHFA, which oversees Fannie and Freddie. If there is a default under one of those mortgages that backs the mortgage-backed security, again, there is recourse to collateral.

Similarly, for the asset-backed security program with student loans, there are loans that underlie those, and there would be recourse to that. And, of course, FHA and the Ginnie Mae programs, again, those are all securitized by the actual houses, and there is some overlap in those numbers, because generally Ginnie Mae buys pools and securitizes FHA loans.

The CHAIRMAN. But still the number is up from 3 to 3.7, which indicates greater financial Federal support for the economy, because we are not out of the woods.

Mr. BAROFSKY. No, no, absolutely. And even when it is collateralized and even when there is some double-counting, each of these agencies has felt compelled to increase their amounts and their commitments to these programs by what is a staggering amount of money.

The CHAIRMAN. I am going to have to leave. What is kind of the one thing that you want to leave with this committee at this point in time? I think you have done a great job, but I want to let you say what you want to say, tell us what you think we should know, this committee, at this point.

Mr. BAROFSKY. I think that one of the enduring frustrations that we have is, although Treasury has come a long way in a lot of different areas for transparency and accountability, it still has some ways to go. And I think that transparency is not just for transparency's sake.

And as I said in my opening comments regarding the housing program, it makes the programs better. It makes them more credible. And I think where Treasury falls down on transparency, whether it is in the housing program or its warrant disposition process, by not documenting conversations or having formal processes in those negotiations, or in many other areas, it hurts the credibility of the program in ways that are entirely unnecessary.

The CHAIRMAN. Thank you very much.

Senator Nelson, you are next, and you are in charge.

Senator NELSON [presiding]. Senator, have you been called on?

Senator BUNNING. Twice. We have had two rounds before you showed up.

Senator NELSON. I will call on you in just a minute. Good morning.

Would you tell me, of the $36 or $34 billion that we expect to lose on the automobile bailout, do we expect to get any of that back when GM goes out with an initial offering?

Mr. BAROFSKY. I think the projection for that loss assumes the paying back through the initial public offering. I think the reason why the number is not much higher than that is that these are the estimates that either CBO or OMB or Treasury—they all have different estimates out there, but this is their estimate, assuming that

there is an IPO, assuming that payments are made as a result of what will be left over.

Senator NELSON. How do you break that $34 billion down between Chrysler and GM?

Mr. BAROFSKY. I do not have those numbers. We go off the aggregate numbers that we were provided. Senator, I could go back and ask Treasury for that breakdown and provide it to you.

Senator NELSON. And with regard to the $36 billion that we are going to lose with regard to AIG, can you give any kind of breakdown on that?

Mr. BAROFSKY. Sure. That projection is based on—as AIG liquidates some of its larger holdings and gets cash money back for those holdings—and AIA and Alico have been the ones that have been prominent in the news; we indicate some others in the quarterly report—the first thing that happens is the Federal Reserve gets paid back.

The Federal Reserve has a number of different facilities. For example, when those foreign subsidies are sold, the Federal Reserve owns preferred shares in special purpose vehicles. So that gets paid off first.

Once that gets paid off, then its extended line of credit that it has, that has to get paid off. Then, after all that occurs and the Federal Reserve is made whole, then Treasury gets in line. And our interest right now is in preferred shares, which would presumably get redeemed at that point.

But basically, it is going to only happen through increased profitability and really increased asset sales.

Since the Treasury money really went in in two tranches, both equity tranches, the first one, $40 billion, really went directly to pay down the Federal Reserve's credit line. I don't even know if it actually even passed through AIG.

So it had to tie that to any particular business. And then the additional $30 billion has not been fully drawn. They actually have not taken a drawdown on that since mid-March.

That you could tie to individual activities, because AIG is required to identify how they are planning to use the money each time they come to the till on that.

Senator NELSON. The $36-billion loss is a figure that you are projecting in the future, but conceivably, it could be less if AIG is getting more profitable.

Mr. BAROFSKY. To be clear, the $36 billion is CBO's most recent estimate. Treasury actually has a higher loss of $45 billion in its most recent estimate.

But the projection is that, after all is said and done, after the Federal Reserve is paid off, after Treasury's ownership, which is in preferred, as well as potentially in common, 8 percent of the stock, after all that liquidation is left over, that we are still going to be—that Treasury is still $45 billion in the hole. And to put that in context, I think there's about $47 billion outstanding.

So basically they are looking at what is currently outstanding as potentially a near complete loss.

Senator NELSON. Originally, TARP was looked upon as a program to keep the country from going into financial meltdown. Later

on, it was a program thought to be an assistance to resuscitate back to life the housing market, and that has not worked too well.

Would you give us your comments on that?

Mr. BAROFSKY. I do think that your perception is widely held, and I think that the housing program has been a great disappointment. The numbers just came out officially yesterday, and they are contained in our report. During the 16–17 months since the program was announced, there have been fewer than 400,000 permanent modifications. Of those, only 165,000 are actually resulting from the TARP portion of the program. The rest are being done by Fannie and Freddie, which have slightly different standards, more forgiving standards.

So the numbers have been very disappointing. One of the problems that I highlighted earlier, Senator, is that Treasury still refuses—this is one of the most basic frustrations we have—to give benchmarks.

What are its goals? What is it actually trying to accomplish with this $50 billion that it has asked for? How many people do they really hope to keep in their homes. All they are offering are, frankly, quite meaningless metrics of offers to help 3 to 4 million people.

So I think that, unfortunately, until Treasury comes clean and really acknowledges what its goals and expectations are, it is inevitable that there are going to be perceptions that the program is just an outright failure.

Senator NELSON. Mr. Hillman?

Mr. HILLMAN. We have looked at the Home Affordable Modification Program, as well, as part of our oversight of the TARP program. And one of the major points that we have made is that the program that is up and standing and running today is the first lien modification program, and there are many other programs that Treasury has announced but have yet to be fully designed and implemented.

The first lien program, for example, was announced a year before it was ultimately implemented. That level of urgency contrasts very sharply to the activities of the TARP program as it related to supporting the banking environment.

With the foreclosure issues, it seems that the urgency has not been as similar to what has taken place on the banking side.

One of the issues that we have raised has to do with the level of resources that Treasury has devoted to this area, and we have recommended that Treasury reevaluate the resources that it needs to both design and successfully implement that program.

To date, those efforts have resulted in Treasury reducing its workload in certain areas within the Home Affordable Modification Program, and we think that needs to be revisited.

Senator NELSON. And your estimate is, or someone's estimate is, there is going to be a $20-billion loss on the HAMP program, the Home Affordable Modification Program. Is that right, a $20-billion loss?

Mr. HILLMAN. The amount of expenditures by the HAMP program, up to a commitment of $50 billion, is a total expenditure to the program, with no expectation that there would be any dollars that would be returned.

So whatever is ultimately spent will be considered a loss to the program.

Senator NELSON. Well, I must say that this Senator voted against the first round of TARP. I was persuaded to vote for the reduced tranche of TARP in anticipation that it was going to help the housing crisis, which, in my State of Florida, over 310,000 properties have gone into foreclosure. And in June alone of this year, 51,000 new foreclosures were filed.

So needless to say, I am not very happy with this part of TARP.

Senator Bunning?

Senator BUNNING. Thank you, Mr. Chairman. I want to follow-up on the chairman's questioning of Mr. Barofsky.

Mr. Barofsky, there is a similar pattern in your testimony when you talk about Treasury's handling of different TARP programs. In the HAMP program for modified mortgages, Treasury refuses, as you say, to set benchmarks for success.

When it sold warrants for companies that received TARP funds, Treasury did not document important parts of the negotiations well enough.

Fully 1 year after your office recommended an evaluation system and internal controls for the public-private investment program, Treasury has refused to do so, despite claims that it would, and the list goes on and on.

Mr. Barofsky, why do you feel and why do you think Treasury is so afraid of real transparency and accountability in the handling of TARP money?

Mr. BAROFSKY. Senator, there are some questions I can answer and some that are, frankly, beyond me, and I do not really understand——

Senator BUNNING. I just want you to answer the ones you can.

Mr. BAROFSKY. I do not really understand why it is that they will not provide basic benchmarks. I do not understand why——

Senator BUNNING. Can you not demand that?

Mr. BAROFSKY. All I can do is make recommendations. I have no ability to compel them to do so. I have no idea why they will not commit to fully document every conversation that they have when they are negotiating on behalf of the American taxpayer in the warrant program, where they are providing information inconsistently to different banks.

Some banks get the benefit of knowing what price Treasury is likely to accept. Other banks do not.

I cannot imagine—I truly cannot imagine why they would not immediately come forth and say, "You know what, SIGTARP? You guys are right, we made a mistake." But I will tell you, those are words that we do not hear. We did not hear it with respect to the automobile warrant. We did not hear it when we talked about the negotiations that led to payment of 100 cents on the dollar for AIG.

We never hear any acknowledgement that they are fallible, that they are human. There is a lot of pressure that Treasury has been under.

Senator BUNNING. Let me just remind you that the only thing they need to do to renew TARP to $700 billion, for one, is for the Secretary of the Treasury to write a letter to himself.

There should be more accountability for a $700-billion slush fund that is not being used, as Senator Nelson said, for the purpose for which it was created.

Do you think in one instance that this panel and other Senators would have voted for TARP had they known it was going to the major bankers in New York City?

If Secretary Paulson would have come to this Congress and said, "By the way, we are not going to go after bad assets or toxic assets in the system. We are going to give this money to the bankers and let them work it out." Do you think for one minute that they would have gotten permission for $700 billion?

Mr. BAROFSKY. I certainly understand what your view is on that, Senator.

Senator BUNNING. But the frustration level with the members of Congress at the use of the TARP funds is just so outraged about what they did and how they did it, and the misuse of language when they sold the program to the Congress of the United States.

We want you to do everything in your power to make them accountable. That is why we voted you into that position. And so far, we are pretty pleased with what you are doing, but you can go farther.

You can make them accountable for every penny they spend.

Mr. BAROFSKY. And we will continue to strive to do so, Senator.

Senator BUNNING. Well, thank you very much.

Senator NELSON. Senator Carper?

Senator CARPER. Let me just say to Mr. Barofsky, I have known Senator Bunning for a long time, and that is some of the highest praise I have ever heard him give to a witness.

Mr. BAROFSKY. I do appreciate it.

Senator CARPER. I think his words were "pretty pleased." This is a good day.

Mr. BAROFSKY. Every day I have my job, I consider to be a good day, Senator.

Senator CARPER. I feel that way, too, about mine. I have been talking with Amy Overton, who is my staff person, right behind me, and trying to just look at this again from 30,000 feet.

My recollection is, when the last administration came to us and asked us to fund the troubled asset program, they explained that this was to buy toxic assets thought illiquid, untradeable, and that was a good way to help strengthen the balance sheet of financial institutions that were at risk.

My recollection was that they decided to take this different approach after we provided the approval for the money, because I think some other countries, maybe in Europe, maybe England, had decided to take this approach and thought that it was a smarter approach. Is my recollection faulty or is that true? Either of you, please.

Mr. BAROFSKY. That is consistent. We did a report on the Capital Purchase Program, I think, in November of last year where we talked about the initial decision-making process that led to the Capital Purchase Program and the equity investments.

And one of the things that we found was, that was a factor, what the Europeans were doing. I think another significant factor was the conclusion that setting up the mechanisms for the purchase of

toxic assets was going to take a lot longer, and they felt that the situation—there was a sense of immediacy.

I think Chairman Bernanke thought it would take 3 or 4 months to set up that process, and that there just was not enough time because of the continuing spiraling down of the financial crisis. That is my understanding of part of their explanation.

Senator CARPER. Let me ask Mr. Hillman and you. All of us are better quarterbacks on Monday morning than we usually are on Saturday or Sunday when we are playing the game.

But looking at the decision that was made to not use these funds to purchase these illiquid assets, did we make the right decision?

Mr. HILLMAN. In our view, there are a lot of tradeoffs associated with whether or not you are taking away toxic assets off the balance sheets or putting capital injections into the institutions.

However, in looking at those two options, the option of taking those toxic assets off the balance sheets was an enormous exercise fraught with a lot of problems in valuing those illiquid assets, having those assets be maintained within Treasury for a long period of time to sustain their profitability, and then returning them back to the marketplace.

It would have been an enormous undertaking, fraught with many risks. Providing for capital injections into the institutions, hopefully, increasing their stability, hopefully increasing their ability to lend to businesses and consumers, has, in hindsight, turned out to be a program which has resulted in some profitability thus far for the Treasury and the Federal Government, at least as it relates to the larger institutions that have paid back those purchases of securities.

Whether it turns out to be a positive result for the small banking institutions is something that has yet to be determined. Right now, there are four bank failures within small institutions that received TARP funds. There are 74 institutions that are on the high risk list of the FDIC.

Senator CARPER. Those 74, can you quantify for us, just roughly, how much TARP money is involved with those? Are we talking billions of dollars, tens of billions, hundreds of millions? Just very roughly, for 1 year.

Mr. HILLMAN. Absolutely. It is tens of billions of dollars. The majority of the funding had gone to the larger institutions and is based upon the asset sizes as to what types of capital injections that were made.

Treasury has received back 72 percent of its $204 billion in TARP investments to date, and, if you add the amounts received from interest and dividends and warrants, they have received 80 percent of what they paid out to date. But that remaining 20 percent that the smaller banks are holding is going to be a much more complicated task, in returning those funds, because of the concerns associated with the profitability of those institutions.

Senator CARPER. Can you roughly quantify that 20 percent in terms of how much money we are talking? Is it $20 billion, is it 30? Just give us a ballpark.

Mr. HILLMAN. It is in the $30- to $40-billion range.

Senator CARPER. I think what Mr. Barofsky was saying earlier with respect to—I want to say it was AIG, the amount that we

were on the hook with AIG, I heard it is somewhere maybe between $35 and $45 billion, and we are hearing that we probably will not see that money recovered, at least Treasury does not believe so.

And we are looking at a similar exposure, really fairly similar with respect to the small banks and the question of whether or not we will be able to get recovered. That money is still, I think, up in the air. Is that right?

Mr. HILLMAN. Absolutely.

Senator CARPER. I want to go back to GM and Chrysler. Like some of my colleagues who actually follow the auto industry, Delaware was the last State that had any auto assembly operations on the east coast between Maine and Florida. We lost both our Chrysler plant and our GM plant within the last 18 months. We have worked closely with the auto industry for years.

I am encouraged with GM, with its lineup, and I mentioned the Volt. I call it the most advertised car that has never been sold. But it is about to be sold here in a couple of months, and we will see how it does.

But we have been working with an auto industry—we have an auto industry that historically sold between 15, 16, 17 million units a year. Last year, I think they sold about 10. I think this year, they may be on track to do about 11.

The quality of our cars has improved, and I think the perception that that quality has improved has finally sunk in on the consumer. So I tend to be more optimistic than not with respect—particularly with GM. And Chrysler, I am told, is about to launch—and they have not had a whole lot in the pipeline for the last couple of years—a lot of new products that we should see in the year to come. So we will keep our fingers crossed there.

A last question I want to ask you, if I may. I want to go back to the issue of really compelling financial institutions to modify the principal. Let us just say everybody in this room, we all live in, we will say, the same neighborhood. Those of you at this table and those of us who are privileged to sit on this side of the dais, we have—our mortgages are under water, and we would like for our lender to forgive part of our principal.

Maybe we are working too hard, maybe we are not working hard in order to come up with the money to meet our mortgage payments. Say everybody else in the audience here is doing their dead level best, even though their mortgages might be under water, to meet their obligations.

And there is a concern—I have heard it voiced from others—that if some kind of preference is given in terms of principal forgiveness for those who either are unable or maybe unwilling to do what it takes to meet their obligation, it acts as an incentive to those who are working hard to play by the rules to say, "Well, why shouldn't I just walk away from my obligations, too?" Would you all comment on that?

Mr. BAROFSKY. Sure. This is the classic moral hazard issue with any mortgage modification program—and to be clear, it is not just principal reduction. It is really HAMP as it exists with interest rate reductions. It is all sort of based on the idea that, if someone is in default or in imminent default, they are going to get a benefit,

whereas someone who is continuing to make the payments does not have that, and then that also creates a moral hazard.

I think in a certain way, we have to appreciate the fact that, as a whole, TARP has jumped into the deep end of the moral hazard pool. When we are looking at the bailout for the financial institutions or the home owners, there is going to be a degree of moral hazard that is at play with all of these programs.

Specifically, though, with principal reduction, first of all, based on our recommendation and our discussion back and forth with Treasury that is reflected in our report, principal reduction, basically, as we are discussing it, would only occur if it was in the best interest of the investor. They run the net present value test, and it indicates that the investor will be better off to have a higher return with the principal reduction modification versus an interest-only modification.

For someone to take advantage of this, for the moral hazard issue, in other words, "I am going to intentionally default so I can take advantage of this program," there are a number of roadblocks that would be there in the existing program and with this.

First of all, they have to file a hardship affidavit that shows that there is a legitimate reason why they are defaulting. They have to verify third-party income. So somebody is going out and checking this income.

That would mean that someone who wants to do this is not only willing to scrap their credit history to do that, but they would have to be willing to commit a Federal crime by signing a false affidavit.

Secondly, the payoff is not immediate. It is over the course of 3 years. And third, they would have to have such an intimate knowledge of the net present value test and how it interplays, and the fact that that net present value test would be more positive for them with a principal reduction versus a regular modification.

Now, these tests are not made public. They are complex.

The servicers themselves had a tremendous difficulty implementing them. We are doing an audit just on that process.

So I think, while there is always a moral hazard whenever we are giving benefits to people who basically have been unable or are unwilling to make the required payments, I think the difference between voluntary and mandatory principal reduction is so incremental compared to the broader moral hazard that already exists, and I do think that there are some pretty good safeguards.

And I would say to Treasury, if they are willing to go with us on this and continue to explore this, we will sit down and brainstorm and try to come up with some more protections for moral hazard.

Senator CARPER. Mr. Hillman, closing comment?

Mr. HILLMAN. I think that the description that you provided as to what is happening across the States here in the United States is an accurate one, and it all comes down to an issue of fairness. Is it fair to provide a reduction in a principal payment for one when another is working very hard to maintain the mortgage payment that they have?

I do not think that we would dispute Treasury for the actions that it is taking to develop a Home Affordable Modification Program for its first lien mortgagers. Our view is, though, that there

are a number of other initiatives that Treasury has announced, but they have yet to design and implement, including a second lien mortgage program, alternative to foreclosures, looking at underwater borrowers, and our recommendation is that Treasury urgently needs to complete the design and implementation of those programs to provide the relief that is needed in the market.

Mr. BAROFSKY. I would just add, there is an inherent unfairness in a voluntary program versus mandatory, because the two home owners who make their application to their servicer, if it is in the best interest of the investor and it is not NPV-positive, they should be treated the same. Under voluntary, it is basically up to the discretion of the servicer and, as we know, servicers have a disincentive to reducing principal, because they are paid on the outstanding principal balance of their portfolio.

So I think that mandatory would actually be potentially a much fairer system than a voluntary one.

Senator CARPER. Mr. Chairman, you have been very generous with the time. You are more generous than the other chairman. So thank you for coming in to chair the end of this hearing.

And to our witnesses, thank you so much.

Senator NELSON. Then to summarize on that Home Affordable Modification Program, Mr. Hillman, why don't you comment on why so many borrowers fail to complete the trial modification?

Mr. HILLMAN. One of the major reasons why borrowers are not completing their trial modifications has to do with the level of documentation that was required by Treasury initially in the program.

In order to get individuals into these trial modifications quickly, they did not ask for the level of documentation that is normally anticipated on income and other levels of assets of an individual.

As a result, they would not ask for that information until they were in the trial mod and going into a permanent modification.

Upon checking for those permanent mods, a lot of that information has shown that they were not qualified to be included in the program and, therefore, had to exit the program.

Today, the initial modifications that are being undertaken are requiring this up-front documentation. So you should not be seeing as many trial mods not performing as when the program began.

Senator NELSON. And how about in the whole pipeline, where many of the advisors do not have the wherewithal to demand the transparency of the lenders in the review process?

Mr. BAROFSKY. In our last report, we noted that there really was no effective appeals process for borrowers interested in appealing the decision associated with their joining in with the HAMP program. And the only available recourse was the hotline, and that hotline was not aggressively advertised so that borrowers knew of its existence, and we recommended greater attention being provided to ensuring that all borrowers were aware of that possibility.

Senator NELSON. Either one of you, and we will adjourn this session just momentarily. We are getting ready to consider some legislation that has derisively been designated as TARP Jr. It is about $30 billion that would be anticipated to expand to $300 billion of loans through the small business jobs bill.

What do you think about this capital investment by the Treasury? Does it present different considerations and risks than those of the capital investment made by TARP?

Mr. BAROFSKY. I think one of the concerns, and we have raised this concern in letters to this committee, is that there is a potential increased vulnerability to loss through fraud in the design of this program. I think that vulnerability can be addressed by vigorous oversight.

It is very rare that I look for work, Senator, but we have advocated and we believe that, in the current format of the bill, we are not granted oversight authority over this fund, and I think that would be a mistake.

The program is very similar to the TARP's Capital Purchase Program. There are some differences. But the lessons that we have learned providing oversight, lessons that have resulted already in more than $553 million of savings to the taxpayer, are borne from the experience that we have had in monitoring and providing oversight to this program.

The incentive structure of the program does leave it open for the potential of gaming of the system of financial numbers so that they pay a lower dividend rate as a result. And we do believe that, while this program may have the ability to do some very good and encourage small business lending, if it does not have the proper oversight, it could be all for naught.

So we will continue to encourage the Senate, as it considers this bill, to have us involved in the oversight of the program.

Senator NELSON. Have we learned something from TARP as we approach the small business lending bill that certain regions of the country, namely, an example, my State of Florida—weak real estate market, weak banks, because of bad loans—has TARP had the effect of penalizing those regions of the country? And should we make the modifications on this small business lending bill to address that?

Mr. BAROFSKY. I do think that some of the original goals of TARP to increase lending were not met. In part, that was because there were absolutely no incentives or penalties for banks that did not go out and actually lend the money. And the result is that lending has continued to go down since the original infusion of TARP capital.

Now, Treasury will say, and the banks have told us that that is because the reduction would have been even greater had there not been TARP funding. But there were neither carrots nor sticks with that money.

I think the proposed bill of SBLF has some carrots and has some sticks. I do not want to speak for Professor Warren, because she is not here, but they put out a report that looked at the program and questioned whether the carrots and the sticks, either one of them, are sufficient enough to really compel small business lending.

I recommend that portion of her report, because I think it is very informative and discusses some other issues that the Congressional Oversight Panel has with the structure of this program.

Mr. HILLMAN. Treasury designed its Capital Purchase Program to treat large institutions and small institutions on the same basis.

That was one of their premises in the beginning, and the idea there was to provide fairness across all of our institutions.

However, it is also the case that the larger institutions have been able to repay their TARP funds because they have access to the capital markets and can, therefore, through their shareholders, obtain sufficient funds to repay the TARP program.

The smaller banks do not have that same access to the capital market. They are making profits through lending activities, and there are many local lending issues that are prohibiting smaller banks from making a profitable return.

So the situation for smaller institutions is different than the situation for larger institutions. This lending fund that is being debated within the Senate would provide additional funding to smaller institutions similar to what was done with the Capital Purchase Program, with the intent of enhancing their capital position to allow them hopefully then to lend to more small businesses.

In our view, one of the things that needs to be considered as part of the debate of this legislation is the quality of data that are available to make those decisions as to whether or not an increase in small business lending would actually occur or not.

It is difficult to ascertain whether or not the concerns that we have in today's small business sector are a supply-side weakness or a demand-side weakness, and further exploration of what is really occurring would help inform what the right decision ought to be.

Senator NELSON. Thank you, gentlemen, for your enlightening testimony.

The meeting is adjourned.

[Whereupon, at 11:56 a.m., the hearing was concluded.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

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

July 21, 2010

Chairman Baucus, Ranking Member Grassley, and Members of the Committee, I am honored to appear before you today to discuss SIGTARP's July 21, 2010, Quarterly Report to Congress and its audit concerning the termination of GM and Chrysler dealerships that was released on Monday.

QUARTERLY REPORT

Today, the Office of the Special Inspector General for the Troubled Asset Relief Program ("SIGTARP") issued its seventh quarterly report to Congress, reflecting that it has been a remarkable quarter for the Troubled Asset Relief Program ("TARP") and for SIGTARP itself. An investigation conducted by SIGTARP resulted in criminal charges — in one of the most significant criminal cases to arise from the financial crisis thus far — against the former chairman of one of the largest mortgage lenders in the country for his alleged involvement in a multi-billion dollar fraud that included an attempt to steal more than $550 million of TARP funds, a scheme that was stopped by SIGTARP with no loss to TARP. And the signs of the gradual winding down of TARP are unmistakable: seven of the 13 TARP programs are effectively closed or are closing; this quarter marked an important milestone, with more TARP money having been repaid than is currently outstanding; and pending legislation would both reduce the upper limit of TARP and prevent any new spending except on programs already initiated prior to June 25, 2010.

Notwithstanding this scaling back of TARP, an examination of the broader context demonstrates that the overall Governmental efforts to stabilize the economy have not diminished. Indeed, the current outstanding balance of overall Federal support for the nation's financial system, in actual expenditures and guarantees, including ongoing initiatives run by the Federal Reserve System ("Federal Reserve"), the Federal Deposit Insurance Corporation ("FDIC"), the Department of Treasury ("Treasury"), the U.S. Department of Housing and Urban Development ("HUD"), and other Federal agencies, has actually *increased* more than 23% over the past year, from approximately $3.0 trillion to approximately $3.7 trillion — the equivalent of a fully deployed TARP program, largely without additional Congressional action — even as the banking crisis has, by most measures, abated from its most acute phases.[1] This increase has focused primarily on additional Government support of the still-distressed housing market and the financial institutions whose fate has been so closely tied to it throughout this crisis, with additional support of asset prices and low interest rates (predominantly via the Government's expanded role in the mortgage market through increases in HUD programs and support of Federal National Mortgage Association ("Fannie Mae") and Federal Home Loan Mortgage Corporation ("Freddie Mac")) more than offsetting the decline in amounts outstanding under TARP and in the winding down of several Federal Reserve liquidity programs. Updating work from SIGTARP's July 2009 Quarterly Report, and at the request of Chairman Baucus, Section 3 of today's quarterly report provides this broader perspective and analyzes how the Government's overall financial support efforts have changed over the past year.

---

[1] As explained in further detail in Section 3 of today's report, this number is not intended to indicate the total amount of risk of loss to the Government because, among other things, many of the outstanding expenditures and guarantees are collateralized and there are areas of overlap among the various federal programs described. Please see Section 3, "TARP in Context: Financial Institutions Support and Policies Outside of TARP – 2010 Update" for a complete description of the methodology for calculating this figure.

INCREMENTAL FINANCIAL SYSTEM SUPPORT, BY FEDERAL AGENCY SINCE 2007 ($ TRILLIONS)

	Balance as of 6/30/2009	Current Balance as of 6/30/2010
Federal Reserve	$1.5[a]	$1.7
FDIC	0.3	0.3
Treasury — TARP (including Federal Reserve, FDIC components)	0.6	0.3
Treasury — Non-TARP	0.3	0.5
Other: FHFA, NCUA, GNMA, FHA, VA	0.3	0.8
Total	**$3.0**	**$ 3.7**

Notes: Numbers affected by rounding. Amounts may include overlapping agency liabilities, and does not account for collateral pledged. See the "Methodology for Estimating Government Financial Commitments" discussion in Section 3: "TARP in Context: Financial Institutions Support and Public Policies Outside of TARP — 2010 Update" of this report for details on the methodology of this chart. Other agencies include: FHFA, National Credit Union Administration ("NCUA"), Government National Mortgage Association ("GNMA"), Federal Housing Administration ("FHA"), and U.S. Department of Veterans Affairs ("VA").

[a] This amount has changed from last year's report due to a change in methodology in accounting for the Federal Reserve's Maiden Lane facilities. See notes to Table 3.2 in this report for further explanation.

Over time, the shift in emphasis away from bank liquidity and toward housing support has been reflected in TARP as well, with the bank–related programs winding down and TARP funds being repaid. Many of Treasury's recent efforts have focused on the Home Affordable Modification Program ("HAMP") and related foreclosure prevention initiatives. Unfortunately, HAMP continues to struggle to achieve its original stated objective to help millions of homeowners avoid foreclosure "by reducing monthly payments to sustainable levels." Despite a seemingly ever increasing array of HAMP-related initiatives designed to encourage participation in the program, the number of homeowners being helped through permanent modifications remains anemic, with fewer than 400,000 ongoing permanent modifications (only approximately 165,000 of which are in connection with the TARP-funded portion of HAMP), and HAMP has not put an appreciable dent in foreclosure filings. Indeed, the number of trial and permanent modifications that have been cancelled substantially exceeds the number of homeowners helped through permanent modifications. One continuing source of frustration is that Treasury has rejected calls to announce publicly any goals or performance benchmarks for HAMP or its related initiatives concerning how many homeowners it actually expects to help stay in their homes, despite repeated recommendations that it do so from SIGTARP, the Congressional Oversight Panel and the Government Accountability Office ("GAO"). Instead, Treasury clings to its prior statements that it plans to offer trial modifications to three to four million homeowners, a measure that SIGTARP has previously shown to be essentially meaningless. Treasury's refusal to provide meaningful goals for this important program is a fundamental failure of transparency and accountability that makes it far more difficult for the American people and their representatives in Congress to assess whether the program's benefits are worth its very substantial cost. The American people are essentially being asked to shoulder an additional $50 billion of national debt without being told, over 16 months after the program's announcement, how many people Treasury hopes to actually help stay in their homes as a result of these expenditures, how many people are intended to be helped through other subprograms, and how the program is performing against those expectations and goals. Without such clearly defined standards, positive comments regarding the progress or success of HAMP are simply not credible, and the growing public suspicion that the program is an outright failure will continue to

spread. Among other things, Section 2 of today's quarterly report details HAMP and its related programs, and Section 5 describes the status of the numerous SIGTARP recommendations concerning HAMP that remain outstanding. Section 5 also discusses the recommendations made in two SIGTARP audits released this quarter, discussed further below, that also raised important transparency and accountability issues.

As noted above, this quarter has also definitively demonstrated that proactive law enforcement efforts can play a vital role in protecting taxpayer's interests. On June 15, 2010, SIGTARP agents, along with law enforcement partners from several other Federal agencies, executed an arrest warrant for Lee Bentley Farkas, the chairman of Taylor, Bean & Whitaker, formerly one of the largest private mortgage lending companies in the United States, in connection with a scheme involving Colonial Bancgroup ("Colonial"), a large regional bank that was, until its demise in the fall of 2009, TBW's largest lender. Through an application submitted in the fall of 2008 to TARP's Capital Purchase Program ("CPP"), Colonial had been conditionally approved for $553 million in TARP assistance, contingent upon, among other things, raising $300 million in private capital. In April 2009, Colonial announced that it had met this final condition based on Farkas' representation that he led an investment group that had raised the necessary capital. Within days of this public announcement, SIGTARP issued subpoenas to both Colonial and TBW concerning the capital raise, and, over the course of the next several months, SIGTARP and its partners uncovered massive alleged frauds at both Colonial and TBW, notwithstanding apparent attempts by members of the conspiracy to destroy documents called for by SIGTARP's subpoena. SIGTARP alerted Treasury of its investigation, and Colonial did not receive TARP funds.

Farkas was charged in the Eastern District of Virginia in a 16-count indictment, which includes charges related to his attempt to steal $553 million from TARP through Colonial's fraudulent CPP application. Farkas allegedly participated, with co-conspirators at Colonial and TBW, in a massive accounting fraud that resulted in an undisclosed hole in Colonial's books and records and then later caused a false filing by Colonial with the Securities and Exchange Commission ("SEC") that falsely represented that Farkas had raised the $300 million in private financing for Colonial required for Colonial's TARP funding. He was also charged in an alleged fraud scheme involving more than $1.9 billion that contributed to the failures of Colonial Bank and TBW in 2009 and that victimized numerous other public and private institutions. Farkas was also charged by the SEC in a civil complaint with violations of the antifraud, reporting, internal controls, and books and records provisions of the Federal securities laws in connection with, among other things, the false claims intended to cause Treasury to disburse $553 million in TARP funds to Colonial. The Office of the Inspector General for the Department of Housing and Urban Development ("HUD OIG") estimated that HUD losses from the scheme (including payments that had to be made based on Federal Housing Agency guarantees) may be in excess of $3 billion; the FDIC estimated that depositor insurance fund losses from Colonial's failure, to which the scheme contributed, will be approximately $2.84 billion. Because SIGTARP ensured that Treasury disbursed no TARP funds to Colonial, however, TARP suffered no loss.

Program Updates and Financial Overview

Of the 13 implemented TARP programs, seven are already closed or are winding down. As of June 30, 2010, Treasury had expended or committed to expend approximately $498.3 billion through the 13 implemented programs to provide support for U.S. financial institutions, the automobile industry, the markets in certain types of ABS, and homeowners. Of this amount, $386.2 billion has actually been expended. As of June 30, 2010, 87 TARP recipients had paid back all or a portion of their principal or repurchased shares for an aggregate total of $201.5 billion of repayments and a $5.0 billion reduction in exposure to possible further liabilities, leaving $407 billion, or 58.3%, of TARP's current total (subject to the pending legislation) $698.8 billion available for allocation.

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 June 30, 2010, the Government had received $15.7 billion in interest, dividends, and other income, and $7.0 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 CPP participants, 105 have missed dividend payments to the Government, although some of them made the payments on a later date. As of June 30, 2010, there was $157.7 million in outstanding unpaid CPP dividends.

Financial Institution Support and Policies Outside of TARP – 2010 Update

As noted above, Section 3 of today's quarterly report updates a summary of the financial institutions assistance programs created or expanded because of the financial crisis, that was initially presented in SIGTARP's Quarterly Report to Congress dated July 21, 2009 (the "July 2009 Quarterly Report"). TARP was but one component of the Government's broad response to the financial crisis, and, in many instances, TARP worked in concert with other Federal initiatives — either as a direct partner or as another option for the banking sector. Section 3 attempts to place TARP in the broader context of the Government's overall response to the financial crisis. As in the July 2009 Quarterly Report, SIGTARP includes three estimates for each separate Federal Government program that was either initiated or expanded in response to the financial crisis: the program's maximum potential commitment since the onset of the crisis, its high-water mark (the maximum amount expended or guaranteed under the program at any one time), and the current outstanding balance of actual expenditure or guarantees.

Oversight Activities of SIGTARP

Since the April 2010 Quarterly Report, SIGTARP has actively sought to fulfill its audit and investigative functions. Over the past quarter, SIGTARP released two audit reports, plus an audit letter to Treasury, and another audit report was released Monday of this week, as discussed more fully below. A new audit project has been announced during the past quarter, and eight other previously announced audits are in process and will be released in the coming months.

- **Assessing Treasury's Process to Sell Warrants Received from TARP Recipients:** This audit report, developed in coordination with a parallel effort by the Congressional

Oversight Panel, sought to determine, first, the processes and procedures Treasury has established to ensure that the Government receives fair market value for its warrants; and second, the extent to which Treasury follows a consistent and well-documented process in reaching its decision to sell warrants back to TARP recipients. Released on May 11, 2010, the audit found that Treasury generally succeeded in negotiating prices for the warrants at or above its estimated value but identified two broad areas in which Treasury's process for selling warrants directly to financial institutions is lacking in ways that impair transparency and have led to inconsistencies in the process. First, Treasury does not sufficiently document important parts of the negotiation process. Second, Treasury does not have established guidelines or internal controls over how the negotiations proceed, and in particular how much information is shared with recipient institutions about price. Without taking steps to address these issues, Treasury may open itself to criticism that, through TARP, it favors some institutions over others – picking winners and losers – irrespective of whether it had legitimate reasons to take the positions it did.

- **Treasury's Monitoring of Compliance with TARP Requirements by Companies Receiving Exceptional Assistance:** Released on June 29, 2010, this audit report examined the extent to which Treasury follows a clear, consistent and effective process to ensure that companies receiving exceptional TARP assistance adhere to the compliance requirements of their TARP agreements. It complemented other reports previously released as part of an ongoing joint effort between SIGTARP and GAO that touches on various aspects of the Government's involvement in companies receiving exceptional assistance. SIGTARP reviewed Treasury's efforts to ensure that recipients of exceptional TARP assistance comply with the conditions for receiving such assistance and Treasury's progress toward developing and implementing a compliance strategy. SIGTARP found that, although there was some progress, Treasury's implementation of its compliance strategy has been slow and incomplete. As the taxpayer's primary representative with respect to TARP, Treasury bears the responsibility of ensuring that each participant adheres faithfully to its obligations. To date, Treasury has not adequately carried out its responsibility in a number of key respects. First, Treasury's compliance implementation has been too slow. Second, Treasury's compliance procedures rely too heavily on the recipients themselves to abide by their various requirements in a diligent and well-judged manner. Third, Treasury's compliance staffing levels continue to be inadequate. In sum, the audit found that Treasury has not adopted the rigorous approach or developed the professional team necessary to ensure that companies receiving exceptional TARP assistance adhere to the special restrictions that were imposed to protect taxpayer interests.

- **Treasury's Compliance and Internal Controls Program for PPIP:** On July 8, 2010, SIGTARP delivered a letter to Treasury on the topic of compliance and internal controls for the Public-Private Investment Program ("PPIP"). Despite Treasury's assurance that it would adopt SIGTARP's previous compliance recommendation that it define appropriate metrics and implement an evaluation system to monitor PPIP managers' effectiveness and that it was developing such metrics and internal controls, essentially nothing was issued in the nearly one year since. Although Treasury informed SIGTARP in February

2010 that PPIP compliance policies and procedures would be developed within six weeks, in June it indicated that it will not complete these procedures until August. Consequently, SIGTARP has not seen the guidelines. However, SIGTARP made a series of suggestions for Treasury to adopt as it designs its compliance policies and procedures, as specified in the discussion in Section 1 of today's quarterly report.

Section 1 describes each of these audits in further detail, and Section 5 provides updates on the recommendations made in the audits. Section 1 also discusses continuing and recently announced SIGTARP audits.

SIGTARP's Investigations Division has developed into a sophisticated white-collar investigative agency. Through June 30, 2010, SIGTARP had 104 ongoing criminal and civil investigations. Although much of SIGTARP's investigative activity remains confidential, in addition to the Colonial/TBW indictment discussed above, over the past quarter there have been significant public developments in several of SIGTARP's other investigations:

- **American Home Recovery:** As part of the Department of Justice's nationwide "Operation Stolen Dreams" mortgage fraud sweep, on June 17, 2010, the U.S. Attorney for the Southern District of New York charged Jaime Cassuto, David Cassuto, and Isaak Khafizov, principals of American Home Recovery ("AHR"), a mortgage modification company located in New York City, in a complaint with one count of conspiracy to commit mail and wire fraud related to a mortgage modification scam. They were arrested by Special Agents from SIGTARP and the Federal Bureau of Investigation. According to the complaint, salespeople employed by AHR sent unsolicited letters and e-mails offering assistance in securing loan modifications to homeowners who were having difficulty making their mortgage payments. For a fee, AHR offered to renegotiate the terms of the homeowners' mortgages and obtain more favorable interest rates. AHR boasted a 98% success rate in loan modifications and promised homeowners their money back if it was unable to renegotiate their mortgages successfully. The complaint further alleges that, after collecting hundreds of thousands of dollars in fees, AHR in fact did virtually nothing for homeowners and refused to refund the fees, as promised. In June 2009, AHR transferred its hundreds of unfulfilled mortgage modification orders to another individual, indicating that he could attempt to collect additional fees from the homeowners. The complaint concludes that, in this manner, the defendants and AHR defrauded at least 240 victims. The case is pending.

- **Nations Housing Modification Center:** On June 1, 2010, Glenn Steven Rosofsky pled guilty to a superseding information charging him with one count of conspiracy to commit wire fraud and money laundering, one count of money laundering, and one count of filing a false tax return. As reported in SIGTARP's April 2010 Quarterly Report to Congress, on March 19, 2010, Rosofsky was arrested by special agents from SIGTARP and the Internal Revenue Service, Criminal Investigations 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. According to the indictment, Rosofsky 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" they took criminal advantage of the publicity surrounding the Administration's mortgage modification efforts under the TARP-related Making Home Affordable program using fraudulent statements to induce customers to pay $2,500-3,000 each to purchase loan modification services. For example, the indictment alleges that they mailed solicitation letters in envelopes that deceptively bore a Capitol Hill return address (in fact merely a post office box) and that were designed to mimic official Federal correspondence. It is alleged in court documents that the fraud grossed more than $1 million. Rosofsky's sentencing is scheduled for September 20, 2010.

- **Omni National Bank:** Omni National Bank ("Omni") was a national bank headquartered in Atlanta. It failed and was taken over by the FDIC on March 27, 2009. Prior to its failure, Omni applied for, but did not receive, TARP funding. As part of a mortgage fraud task force involving several Federal agencies, SIGTARP participated in several investigations concerning Omni that led to criminal charges. SIGTARP's involvement, including an examination into whether the various frauds had an impact on Omni's CPP application, is ongoing. As a result of the Omni investigation, Mark Anthony McBride pled guilty to mortgage fraud on April 4, 2010, and was sentenced to 16 years in Federal prison. On June 24, 2010, Christopher Loving pled guilty to making false statements to SIGTARP Special Agents about his knowledge of kickbacks to bank officials. This marks the first time that a defendant has been charged and convicted of making false statements to SIGTARP. These results follow up on three previous convictions related to Omni National Bank.

Section 1 of today's quarterly report describes each of these investigations in further detail.

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. Section 5 provides updates on existing recommendations and summarizes implementation measures for previous recommendations.

This quarter, Section 5 features discussion about Treasury's transparency measures and process controls as they relate to two matters: the Government's repurchases of warrants it received from TARP recipients and its responsibility to monitor compliance with TARP requirements by companies receiving exceptional assistance under TARP. On the topic of warrants sales, SIGTARP reviews both its original recommendations and Treasury's subsequent response. Although Treasury has indicated that it will adopt SIGTARP's recommendation that its Warrants Committee meeting minutes capture more detail, it has not committed to detailed documentation of the substance of all communications with recipients concerning warrant repurchases, or to developing and following guidelines and internal controls concerning how negotiations will be pursued. SIGTARP's recommendations on Treasury's monitoring of exceptional assistance recipients' compliance with TARP requirements also highlight the importance of internal controls. Although Treasury has not responded in full, it has indicated that it will reject SIGTARP's recommendations that it swiftly take steps to verify independently these companies'

compliance with the conditions contained in their agreements with Treasury and that it at least establish firm guidelines so that the companies do not have such broad discretion in deciding whether to report a violation or not.

Additionally, Section 5 examines key points of Treasury's response to SIGTARP's recommendations regarding HAMP. SIGTARP reiterates the need for meaningful benchmarks to judge HAMP's effectiveness, particularly in light of the major public expenditure it represents. SIGTARP also examines Treasury's unsatisfactory arguments for its current policy of leaving the availability to borrowers of the recently announced Principal Reduction Alternative ("PRA") to servicers' discretion and its equally unconvincing explanation regarding its policies regarding the length of the minimum term for HAMP's unemployment forbearance program. Finally, SIGTARP reemphasizes the need for a rigorous appraisal process in HAMP, particularly for those aspects of the program most vulnerable to valuation fraud.

AUDIT ENTITLED "FACTORS AFFECTING THE DECISIONS OF GENERAL MOTORS AND CHRYSLER TO REDUCE THEIR DEALERSHIP NETWORK"

On Monday, SIGTARP released an audit report entitled, "Factors Affecting the Decisions of General Motors and Chrysler to Reduce Their Dealership Network," Audit Report No. SIGTARP-10-008.

Pursuant to their loan agreements with Treasury, as a condition of receiving additional TARP funding, General Motors ("GM") and Chrysler were required to submit restructuring plans to the Treasury Auto Team in February 2009. GM's restructuring plan explicitly spelled out its plan to reduce its dealership network gradually, by approximately 300 dealers per year over the next five years. In March 2009, Treasury's Auto Team rejected both companies' restructuring plans. In GM's case, the Auto Team specifically highlighted GM's planned "pace" of dealership closings as one of the obstacles to its viability. In response to the Auto Team's rejection of their restructuring plans and in light of their intervening bankruptcies, GM and Chrysler significantly accelerated their dealership termination timetables, with Chrysler terminating 789 dealerships by June 10, 2009, and GM announcing plans to wind down 1,454 dealerships by October 2010.

The Auto Team's view about the need for GM and Chrysler to reduce their dealership networks and do so rapidly was based on a theory that, with fewer dealerships (and thus less internecine competition), like their smaller networked foreign competitors, the remaining dealerships would be more profitable and thus would permit the dealerships to invest more in their facilities and staff. For GM and Chrysler, the theory goes, this would mean better brand equity and would allow the manufacturers over time to decrease their substantial dealership incentives. In addition, the Auto Team felt the companies' best chance of success required "utilizing the bankruptcy code in a quick and surgical way" and noted further that it would have been a "waste of taxpayer resources" for the auto manufacturers to exit bankruptcy without reducing their networks.

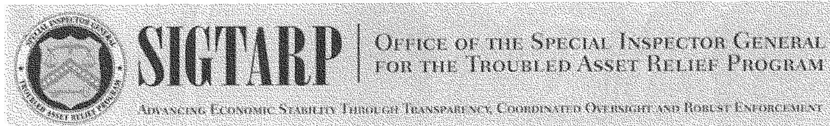
Perhaps only time will tell whether and to what extent the rapid reduction of the number of dealerships will improve the manufacturer's profitability over time; SIGTARP's audit found that there are several aspects of how the Auto Team came to have this view about dealership

reductions that are worth noting. One, although there was broad consensus that GM and Chrysler generally needed to decrease the number of their dealerships, there was disagreement over where, and *how quickly*, the cuts should have been made. Some experts questioned whether it was appropriate to apply a foreign model to the U.S. automakers, particularly in small markets in which the U.S. companies currently have a competitive advantage, and one expert opined that closing dealerships in an environment already disrupted by the recession could result in an even greater crisis in sales. Two, job losses at terminated dealerships were apparently not a substantial factor in the Auto Team's consideration of the dealership termination issue. Although there is some controversy over how many jobs will be lost per terminated dealership, it is clear that tens of thousands of dealership jobs were immediately put in jeopardy as a result of the terminations by GM and Chrysler. Finally, the acceleration of dealership closings was not done with any explicit cost savings to the manufacturers in mind.

Chrysler decided which dealerships to terminate based on case-by-case, market-by-market determinations, and did not offer an appeals process. SIGTARP did not identify any instances in which Chrysler's termination decision varied from its stated, albeit subjective selection criteria. GM's approach, which was conducted in two phases, was purportedly more objective, and it offered an appeals process. However, SIGTARP found that GM did not consistently follow its stated criteria and that there was little or no documentation of the decision-making process to terminate or retain dealerships with similar profiles, or of the appeals process.

Although perhaps it is inevitable that public ownership of private companies will have the effect of blurring the Government's appropriate role, the fact that Treasury was acting in part as an investor in GM and Chrysler does not insulate Treasury from its responsibility to the broader economy. Treasury should have taken special care given that the Auto Team's determinations had the potential to contribute to job losses, particularly given that one goal of the loan agreements was to "preserve and promote jobs of American workers employed directly by the automakers and subsidiaries and in related industries." This audit concludes that before the Auto Team rejected GM's original, more gradual termination plan as an obstacle to its continued viability and then encouraged the companies to accelerate their planned dealership closures in order to take advantage of bankruptcy proceedings, Treasury (a) should have taken every reasonable step to ensure that accelerating the dealership terminations was truly necessary for the long-term viability of the companies and (b) should have at least considered whether the benefits to the companies from the accelerated terminations outweighed the costs to the economy that would result from potentially tens of thousands of accelerated job losses. Moreover, in light of the way in which the companies selected dealerships for termination, in the future, to the extent that Treasury takes action with respect to a TARP recipient that has the potential to affect so many jobs in so many different communities, Treasury should monitor the recipients' actions to ensure that they are carried out in a fair and transparent manner.

Chairman Baucus, Ranking Member Grassley, Members of the Committee, again, it is a privilege to testify before you today, and I look forward to any questions that you might have.



QUESTIONS FOR THE RECORD:
NEIL BAROFSKY,
SPECIAL INSPECTOR GENERAL,
FOR THE TROUBLED ASSET RELIEF PROGRAM

FROM JULY 21, 2010, HEARING

September 24, 2010

Questions for Neil Barofsky, Special Inspector General for the Troubled Asset Relief Program:

From Senator Bunning:

1. Mr. Barofsky, I asked the other two witnesses whether they had looked into reports that AIG had waived its legal rights to sue as part of the agreements to cancel its derivatives deals and pay the counter-parties off at par. Under the agreement, AIG apparently waived all rights to sue Goldman Sachs, Merrill Lynch, and others for fraud or any other reason regarding the mortgage-backed securities they sold and AIG insured. Neither GAO nor the Congressional Oversight Panel had examined this issue, even though TARP funds helped finance the deal. Has SIGTARP looked into this latest giveaway to big banks at taxpayer expense? And if not, does SIGTARP plan to investigate this outrage?

Answer: The Office of the Special Inspector for the Troubled Asset Relief Program ("SIGTARP") has examined and is examining a number of issues related to the credit default swap contracts of AIG Financial Products Corp. ("AIGFP") as they relate to TARP. For example, SIGTARP has opened an investigation relating to credit default swap contracts written

by AIGFP relating to Goldman Sachs' ABACUS synthetic collateralized debt obligations ("CDOs").[1]

As part of our earlier audit entitled, *Factors Affecting Efforts to Limit Payments to AIG Counterparties,*[2] SIGTARP retrieved and reviewed the Credit Default Swap Termination Agreements executed by AIGFP and its credit default counterparties (including Merrill Lynch and Goldman Sachs) in connection with the Federal Reserve Bank of New York's Maiden Lane III transaction. Under the terms of the Maiden Lane III transaction, the counterparties agreed to terminate their credit default swap contracts—insurance-like contracts intended to protect against losses on CDOs—with AIGFP and surrendered the underlying CDOs. In exchange, AIGFP made cash payments and permitted the counterparties to retain $35 billion in collateral payments that they previously had received (effectively being paid par or face value). Also pursuant to these termination agreements, AIGFP waived its right to pursue any past, present, or possible future legal claims against its credit default swap counterparties, to the extent that such claims are related to the underlying CDOs. These waivers, however, would not necessarily protect the counterparties from liability for criminal fraud if it were committed against AIGFP.

2. Mr. Barofsky, we discussed the issue you raised in your recent report of the government insisting that auto companies accelerate the closure of car dealerships. You acknowledged that the Treasury Department and auto companies did not seem to consider the profitability of individual car dealerships when making closure decisions. When you examined closure plans in general or individual closures did you find that Treasury or the auto companies took steps to help the employees and dealers or soften the blow on communities, especially small communities that lost a major employer?

Answer: Our audit found that the impact of job losses was not a significant factor in the U.S. Department of Treasury ("Treasury") Auto Team's finding that GM's proposed pace would be an obstacle to its viability.[3] It was only after the decision was made to close dealerships that the Auto Team considered the impact its decision would have on job losses. While not the focus of the audit, we saw no signs that that Treasury took any steps to minimize the impact of this decision. On the other hand, GM agreed to provide $587 million in compensation to wind down dealerships. GM determined compensation for each dealership using a formula that considered dealership rent, sales, and new vehicle inventory in late May 2009. The dealerships were provided with an initial payment of 25 percent of the total compensation, and will receive the remaining 75 percent upon the completion of various milestones. GM also allowed dealerships

[1] Representatives Elijah Cummings and Peter DeFazio requested that SIGTARP investigate the ABACUS CDOs on April 26, 2010. By a May 12, 2010, letter, SIGTARP advised Representatives Cummings and DeFazio that we had opened the requested investigation.

[2] The audit report is available for inspection at http://www.sigtarp.gov/reports/audit/2009/Factors_Affecting_Efforts_to_Limit_Payments_to_AIG_Counterparties.pdf.

[3] The audit report is available for inspection at http://www.sigtarp.gov/reports/audit/2010/Factors%20Affecting%20the%20Decisions%20of%20General%20Motors%20and%20Chrysler%20to%20Reduce%20Their%20Dealership%20Networks%207_19_2010.pdf.

18 months to wind down their operations. Chrysler, on the other hand, did not pay compensation to its terminated dealers and closed them within 22 days.

From Senator Kyl – Auto Industry

To date, Treasury has committed $80.7 billion in TARP funding to prop up GM and Chrysler. On July 19, 2010, Neil Barofsky, Special Inspector General for the Troubled Asset Relief Program, released a report entitled "Factors Affecting the Decisions of General Motors and Chrysler to Reduce Their Dealership Networks." The report examined Treasury's role in the restructuring of Chrysler and GM in 2009. Specifically, the report found that by requiring GM and Chrysler to accelerate the termination of dealerships in bankruptcy, Treasury did not consider how such a move would impact the economy.

3. In the report, Mr. Barofsky, you found that "...at a time when the country was experiencing the worst economic downturn in generations and the Government was asking its taxpayers to support a $787 billion stimulus package designed primarily to preserve jobs, Treasury made a series of decisions that may have substantially contributed to accelerating shuttering of thousands of small businesses and thereby potentially adding tens of thousands of workers to the already lengthy unemployment rolls – all based on a theory and without sufficient consideration of the decisions' broader economic impact." Can you elaborate on your findings regarding Treasury's actions?

Answer: One of the objectives of our audit was to determine the role of Treasury's Auto Team in the decisions to reduce dealership networks. Our audit found that in response to the Auto Team's rejection of GM's and Chrysler's restructuring plans and its explicit comment that GM's "pace" of dealership closings was too slow and an obstacle to its viability, GM and Chrysler substantially accelerated their dealership termination timetables. In GM's case, instead of gradually reducing its network by approximately 300 dealerships per year through 2014, as GM had proposed in the plan initially submitted to Treasury, GM responded to the Auto Team's decision by terminating 1,454 dealerships' ability to acquire new GM vehicles and giving them until October 2010 to wind down operations completely. For Chrysler (which also had originally planned to terminate dealers over five years), its acceleration was even more abrupt, with Chrysler terminating 789 dealerships (25 percent of its network) within 22 days.

The Auto Team's view about the need for GM and Chrysler to reduce their dealership networks and do so rapidly was based on the theory that, with fewer dealerships (and thus less internecine competition), like their foreign competitors, the remaining dealerships would be more profitable (through more sales volume and less floor plan financing costs) and thus would permit the dealerships to invest more in their facilities and staff. For GM and Chrysler, the theory goes, this would mean better brand equity (*i.e.*, better consumer perception through more attractive facilities and better customer service) and would allow the manufacturers over time to decrease their substantial dealership incentives (and therefore increase the price consumers pay for the automobiles). In addition, the Auto Team felt the companies' best chance of success required "utilizing the bankruptcy code in a quick and surgical way" and noted further that it would have been a "waste of taxpayer resources" for the auto manufacturers to exit bankruptcy when they knew the networks would still have to be reduced. The Auto Team was so convinced of the need

for the acceleration of dealership closings that it highlighted GM's proposed pace of dealership closings (approximately 300 a year over five years) as one of the obstacles to its continued viability, and required GM to revise its proposal to address the Auto Team's concerns as a condition for receiving additional TARP support that GM believed it needed to survive. Not surprisingly, both GM and Chrysler revised their plans for accelerated terminations. While perhaps only time will tell whether and to what extent the Auto Team's theory proves valid, there are several aspects of the theory and how the Auto Team came to have this view about dealership reductions that are worth noting:

> Although there was broad consensus that GM and Chrysler generally needed to decrease the number of their dealerships, there was disagreement over where, and *how quickly*, the cuts should have been made. Some experts that SIGTARP spoke to in connection with this audit questioned whether it was appropriate to apply the foreign model to the U.S. automakers, particularly in small markets in which the U.S. companies currently have a competitive advantage, a concern apparently not considered by the Auto Team when they adopted this theory. The conclusion that the manufacturers should close dealerships more rapidly than originally planned was also criticized as being potentially counterproductive; one expert opined, for example, that closing dealerships in an environment already disrupted by the recession could result in an even greater crisis in sales. Chrysler officials similarly told SIGTARP that closing dealerships too quickly would have an adverse effect on sales from which it would take several years to recover, and, even then, only if new markets were penetrated by opening new dealerships. Further, the fact that, after the mandatory arbitration legislation was passed, GM offered to reinstate 666 dealerships (with a senior GM official stating that the final number of dealerships would not damage GM's ability to recover or grow the company) and Chrysler offered to reinstate 50 dealerships suggests, at the very least, that the number and speed of the terminations was not necessarily critical to the manufacturers' viability. It is also worth noting that GM's top rival among U.S. automakers, Ford Motor Company, which is also carrying out plans to "aggressively restructure to operate profitably," is closing dealerships at a rate similar to that in GM's original restructuring plan that was rejected by Treasury.

> Job losses at terminated dealerships were apparently not a substantial factor in the Auto Team's consideration of the dealership termination issue. Although there is some controversy over how many jobs would be lost per terminated dealership (the National Automobile Dealer Association's estimate of approximately 50 per dealership is challenged by the manufacturers as too high), it is clear that tens of thousands of dealership jobs were immediately put in jeopardy as a result of the terminations by GM and Chrysler. In the face of the worst unemployment crisis in a generation and during the same period in which the Government was spending hundreds of billions of dollars on a stimulus package to spur job growth, the Auto Team rejected GM's original plan (which included gradual dealership terminations), expressly stated that GM's pace of terminations was too slow, and then encouraged the companies to use bankruptcy to accelerate dealership terminations. Although the restructuring of GM and Chrysler inevitably required an overall reduction in their own workforces (and the termination of a certain number of poorly performing dealerships), it is not at all clear that the greatly

accelerated pace of the dealership closings during one of the most severe economic downturns in our Nation's history was either necessary for the sake of the companies' economic survival or prudent for the sake of the Nation's economic recovery.

The acceleration of dealership closings was not done with any explicit cost savings to the manufacturers in mind. Again, the anticipated benefits to GM and Chrysler from a smaller dealership network were far more amorphous — a better "brand equity" and the potential ability to decrease dealership incentives over time. GM prepared its cost savings estimate only at the request of Congress and only after the decision to accelerate terminations had already been made. Chrysler provided Congress with estimated cost savings that had been developed three years earlier. The disparity in the companies' cost-savings estimates are telling. Chrysler estimated a savings of only $45,500 per terminated dealership. GM, however, estimated cost savings of $1.1 million per terminated dealership. The difference in these estimates alone casts doubt on their credibility. Moreover, despite the fact that Treasury rejected GM's even less optimistic assumptions about their market share and profitability in its Viability Determination, GM's estimate was based on a projection that GM's sales would *double* by 2014. GM acknowledged that its cost savings (assuming the decreases in incentives could be realized) could only be calculated across its entire network and could not be calculated for a single particular closed dealership. Indeed, one GM official emphasized this point by telling SIGTARP that GM would usually save "not one damn cent" by closing any particular dealership.

4. Does it concern you that job losses were not a substantial factor used by Treasury in consideration of the dealership terminations?

Answer: Yes. The audit concluded that Treasury should have taken the necessary steps to ensure that accelerating the dealership terminations was truly necessary for the long-term viability of the companies, and that Treasury should have at least considered whether the benefits to the companies from the accelerated terminations outweighed the costs to the economy that would result from tens of thousands of potential accelerated job losses. We found that Treasury did neither, and this resulted in a decision making process that was flawed.

5. You also stated in your report that "...it is inevitable that public ownership of private companies will have the effect of blurring the Government's appropriate role..." Would it be accurate to say that such a blurring of the Government's role may have led to some unintended economic consequences that Treasury did not consider?

Answer: The audit found that there were certainly consequences, although it is unclear whether they were intended. The Auto Team did not consider the impact on jobs and communities before making the decision to accelerate the closure of dealerships. In the purely private ownership realm this may be appropriate, but Treasury's acting as an investor in GM and Chrysler does not insulate it from its responsibility to the broader economy. Moreover, the audit found that the process under which GM and Chrysler selected dealerships to terminate was far from ideal, and that having set these processes in motion, Treasury should have provided the necessary oversight to ensure that they were carried out in a fair and transparent manner.

From Senator Grassley:

6. Mr. Barofsky, let's look at the housing sector. Section 2 of the Emergency Economic Stabilization Act, which created TARP, outlines the purposes of the Act. It says specifically that the Act is "to ensure that such authority and such facilities are used in a manner that protects home values, college funds, retirement accounts, and life savings; and preserves homeownership and promotes jobs and economic growth." How has TARP protected home values and preserved homeownership?

Answer: Treasury has initiated several programs under TARP that were intended to protect home values and preserve homeownership, including:

The Home Affordable Modification Program ("HAMP") under the Making Home Affordable ("MHA") initiative is intended to encourage loan servicers, through incentive payments, to modify eligible first-lien mortgages so that the monthly payments of homeowners who are currently in default or at imminent risk of default will be reduced to affordable levels;

Home Price Decline Protection under HAMP is intended to encourage additional investor participation and HAMP modification in areas with recent price declines by helping offset any incremental loss in value on homes involving permanent modifications that do not succeed;

Principal Reduction Alternative under HAMP is intended to offer mortgage relief to eligible homeowners whose homes are worth significantly less than the remaining amounts outstanding under their first-lien mortgage loans;

Home Affordable Unemployment Program under HAMP is intended to offer assistance to unemployed homeowners through temporary forbearance of a portion of their mortgage payments;

Home Affordable Foreclosure Alternatives under HAMP is intended to enable servicers and borrowers to pursue short sales and deeds-in-lieu of foreclosure for HAMP-eligible borrowers in cases in which the borrower is unable or unwilling to enter into a modification;

Second Lien Modification program is intended to modify second-lien mortgage loans when a corresponding first lien is modified under HAMP;

Treasury Federal Housing Administration ("FHA") HAMP program, like HAMP, is intended to assist eligible borrowers to reduce their payments on FHA-insured first-lien mortgage loans;

Treasury FHA Refinance program is a joint Treasury-FHA initiative intended to encourage FHA-insured refinancing of underwater first-lien mortgages that are not

insured by FHA. The program provides for partial or full extinguishment of second liens and for Treasury, through TARP, sharing FHA's potential losses on the refinanced mortgage loans; and

Housing Finance Agency Hardest Hit Fund program is intended to fund state-run foreclosure prevention programs in states hit hardest by the decrease in home prices and in states with high unemployment rates.

The impact of HAMP, so far, appears to have been minimal. While Treasury has cited a goal of offering 3 to 4 million borrowers trial modifications by the end of 2012, a goal that we believe is largely meaningless, it has refused to adopt the recommendation of SIGTARP, the Congressional Oversight Panel and GAO that it set forth meaningful benchmarks for the program, including the number of homeowners it intends to actually keep in their homes through successful long-term permanent modifications. Through August 2010, only 448,937 borrowers have obtained and remained in a permanent modification, the stage occurring after the initial trial modification period.[4] At the same time, there have been 663,538 borrowers terminated from trial modifications and another 19,121 terminated from permanent modifications.[5] Many of the other initiatives described above were only recently implemented, so there is limited data to assess their impact. To the extent that HAMP and its related programs are able to avoid foreclosures, they should help preserve home values by reducing the downward pressure that a glut of foreclosure sales has had on housing prices.

7. Do you believe that the efforts to preserve homeownership could have been handled differently and more effectively?

Answer: Treasury has shifted much of TARP's focus to housing initiatives in order to offer economic relief to the broader public. In March of 2009, Treasury introduced the MHA initiative, which was designed to address the growing wave of home foreclosures ravaging many areas of the country. The centerpiece of MHA is 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. SIGTARP has made a series of recommendations and findings with respect to the housing program. Prior to the commencement of HAMP, SIGTARP recommended that:

1. Treasury should require servicers to submit third-party verified evidence that borrowers reside in the subject property before modifying the mortgage.
2. Treasury should require a closing-like procedure where borrowers are warned of the consequences of fraud, identification information is collected, and borrowers are advised of applicable fees.
3. Treasury should adopt procedures to better identify participants and prevent servicers from converting subsidies due borrowers.

---

[4] http://www.financialstability.gov/docs/AugustMHAPublic2010.pdf.

[5] Id.

4. Treasury should require servicers to compare the borrowers' current claimed incomes against those claimed in the applications for the original mortgages.
5. Treasury should require servicers to verify borrower income.
6. Treasury should defer payment of incentives to servicers until after borrowers have made a minimum number of payments under the modified mortgages.
7. Treasury should implement an education campaign to combat fraud aimed at borrowers.
8. Treasury should require servicers to maintain a database of all participants in modification transactions.

When implementing the HAMP program, Treasury adopted SIGTARP's proposals concerning verification of borrower income and educating borrowers about modification/rescue fraud. The remaining recommendations, however, have not been fully adopted. HAMP as implemented has not abated the foreclosure crisis; indeed, the situation has continued to deteriorate since HAMP's rollout. Nearly 2.8 million foreclosures were initiated in 2009. More ominously, 1.6 million filings in the first half of 2010 represent an 8 percent increase over the comparable 2009 statistic, putting the nation on pace to exceed 3 million foreclosure filings over the full calendar year, including more than 1 million bank repossessions.

A SIGTARP audit report published on March 25, 2010, examined the design and operation of HAMP in detail.[6] 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 oral 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. To remedy these shortcomings, SIGTARP recommended:

1. Treasury should rectify the confusion that its own statements have caused for HAMP by prominently disclosing its goals and estimates (updated over time, as necessary) of how many homeowners the program will help through permanent modifications and report monthly on its progress toward meeting that goal.
2. Treasury should set other performance benchmarks and publicly report against them to measure over time the implementation and success of HAMP.
3. Treasury should undertake a sustained public service campaign as soon as possible, both to reach additional borrowers who could benefit from the program and to arm the public with complete, accurate information—this will help avoid confusion and delay, and prevent fraud and abuse.

[6] This report is available for inspection at http://www.sigtarp.gov/reports/audit/2010/Factors_Affecting_Implementation_of_the_Home_Affordable_Modification_Program.pdf.

4. Treasury should reconsider its policy that allows servicers to substitute alternative forms of income verification based on subjective determinations by the servicer.
5. Treasury should re-examine HAMP's structure to ensure that it is adequately minimizing the risk of re-default driven by negative equity, high non-first-mortgage debt, and other risk factors.

Treasury has not implemented the first, second, and fourth of these recommendations, and claims that it is in the process of implementing the third and fifth. Additionally, just days after the publication of SIGTARP's audit report and a subsequent Congressional hearing discussing the report's findings, Treasury 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. While the revisions to HAMP constitute a potentially important step forward in addressing some of the flaws identified in SIGTARP's audit report, the program changes raised several issues that could impede HAMP's effectiveness and efficiency, including 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:

1. 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.
2. Treasury should launch a broader based fraud awareness campaign for HAMP and include fraud warnings when it makes program announcements.
3. To protect against fraud, Treasury should abandon its differing valuation standards across HAMP and adopt FHA's appraisal standard for all HAMP principal reduction and short sale programs.
4. 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.
5. Treasury should reconsider the length of the three-month minimum term of its unemployment forbearance program.

SIGTARP will report on Treasury's progress at implementing these five recommendations, and all other outstanding recommendations, in our October 2010 Quarterly Report to Congress.

8. Another purpose of the Act was to provide public accountability for the exercise of such authority. However, in your testimony, you state "Treasury's refusal to provide meaningful goals for this important program is a fundamental failure of transparency and accountability that makes it far more difficult for the American people and their representatives in Congress to assess whether the program's benefits are worth its very substantial cost." Would you elaborate on this comment?

Answer: As discussed in response to question number 7 above, SIGTARP made several recommendations relative to transparency and public accountability within HAMP. Foremost

among these are SIGTARP's recommendations concerning the lack of meaningful goals. Without meaningful goals for this program it will be difficult to measure its success or failure. Despite repeated recommendations from GAO, the Congressional Oversight Panel, and SIGTARP that it adopt realistic metrics, Treasury clings to its prior statements that it plans to offer trial modifications to three to four million homeowners, a measure that SIGTARP has previously shown to be essentially meaningless.

Treasury's refusal to provide meaningful goals for this important program is a fundamental failure of transparency and accountability that makes it far more difficult for the American people and their representatives in Congress to assess whether the program's benefits are worth their very substantial cost. The American people are essentially being asked to shoulder an additional $50 billion of national debt without being told, more than 18 months after the program's announcement, how many people Treasury expects to actually help stay in their homes, and how the program is performing against that expectation. Treasury's chosen goal—the number of trial modifications offered—is completely disconnected from the actual expenditure of taxpayer money. No HAMP funds will be spent on trial modification offers, but rather on what happens after these offers are made. The measurement of such offers is becoming even more meaningless over time as HAMP expands to provide different kinds of relief to homeowners and as the number of trial modifications canceled continues to skyrocket.

Further, the failure to provide meaningful benchmarks is contributing to the negative public perception of the program. The stated goal for offers of assistance has either been ignored or misunderstood, and, without a clear sense of the program's intended direction, taxpayers and their representatives in Congress are understandably focusing on the program's shortcomings, such as that substantially more trial modifications have failed than have been made permanent, or that foreclosure filings have increased dramatically while HAMP has been in place, with permanent modifications constituting just a few drops in an ocean of foreclosure filings. Moreover, Treasury's continued refusal to provide benchmarks for itself leaves it vulnerable to accusations that it is simply trying to avoid accountability. If Treasury sets no meaningful goals, it cannot be held accountable for failing to meet those goals and instead can continue claiming each incremental increase in participation a success, irrespective of the program's cost or whether it could have been designed to help more homeowners.

9. Mr. Barofsky, a major push by the Administration during the reorganization of the two U.S. auto manufacturers was the closing of thousands of auto dealerships around the country. Can you tell me how the closing of these dealerships has helped the financial status of these auto manufacturers? How has it impacted jobs and specifically the jobs in communities where auto dealerships were lost?

Answer: SIGTARP examined the reasons for the dealership terminations and Treasury's role in those decisions, as discussed in response to questions numbers 3, 4, and 5. SIGTARP did not study the consequences of the decision, which – at least in the case of GM, which allowed dealerships 18 months to wind down operations – may take years to be fully realized.

10. Last year it was estimated that although the TARP program itself amounted to about $700 billion, the total government risk from other programs at the Freddie Mac, Fannie Mae, HUD,

and the Federal Reserve amounted to about $3 trillion. In the last year, this estimate has increased to $3.7 trillion. So, we've added a whole other TARP program worth of risk in the last twelve months in the amount of $700 billion.

How likely is it that taxpayers could start suffering actual losses from this $3.7 trillion in risk?

Answer: As detailed in section 3 of SIGTARP's July 21, 2010, Quarterly Report to Congress,[7] the $3.7 trillion figure represents the actual amount expended or guaranteed by all programs comprising the overall Government response to the financial crisis. The figure only includes explicit guarantees of specific assets and actual expenditures.

The likelihood and the extent that taxpayers will suffer losses on these guarantees and expenditures are difficult to gauge. First, losses on guarantees and expenditures, if any, are dependent of the overall condition of the underlying asset or transaction. Second, the figure represents the raw guarantees and expenditures, and does not account for offsetting assets or collateral, which may be available to mitigate or prevent losses. Third, some of the guarantees and expenditures overlap and therefore may reflect double-counting. For example, a financial institution may be insured against loss on a mortgage by FHA, and appear in the accounting for that program, while that same mortgage may be packaged into a security that is then guaranteed by the Government National Mortgage Association (and also included in the totals). Losses from some programs (such as the likely anticipated losses from support to the GSE's) may be offset by profits from other programs, such as some of the Federal Reserve or FDIC's liquidity programs described in the report.

What are the potential pitfalls that could cause these risks to start causing losses to taxpayers?

Answer: On the macro level, further deterioration of the overall economy could create conditions that lead to losses on the Government's various guarantees and expenditures, particularly those related to the housing markets. On a micro level, however, the answer is more difficult because it is likely that such losses will be largely influenced by the condition of the underlying assets or transactions supporting the various guarantees or expenditures, which have been made in well over three dozen programs. For example, losses on MBS either purchased or guaranteed could result from further deterioration of the housing market nationally or locally, as underwater homeowners walk away from their mortgages. Alternatively, deterioration of the employment market could result in mortgage defaults and subsequent losses.

The last time you testified before the Committee, I asked you about a Wall Street investment firm named Blackrock. I understand your office is auditing or investigating potential conflicts of interest involving this company and the Public-Private Investment Program, the $40 billion TARP program designed to buy toxic assets. 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

[7] This report is available for inspection at http://www.sigtarp.gov/reports/congress/2010/July2010_Quarterly_Report_to_Congress.pdf.

Investment Program to buy toxic assets. What can you tell this Committee about the results of your investigation/review to date?

Answer: SIGTARP currently has underway two audits that in varying degrees relate to BlackRock. With respect to the Public Private Investment Partnership ("PPIP") program, SIGTARP is conducting an audit of the selection of asset managers for the legacy securities portion of the PPIP. BlackRock was selected as an asset manager. The audit team is in the process of drafting a report of this audit, which should be released shortly. Regarding the Term Asset Lending Facility ("TALF"), SIGTARP is performing an audit of the Federal Reserve's valuation determinations used to issue loans under the TALF. The Federal Reserve Bank of New York retained BlackRock to conduct collateral stress valuations after TALF loans were made. This audit is still in the field work stage, and SIGTARP is scheduled to release a report of the audit later this year. Finally, SIGTARP has other audit projects under consideration that will also likely touch on BlackRock's role in the financial crisis.

Your office has been investigating excessive executive severance payments to AIG executives that occurred earlier this year. I have asked you to conduct this investigation because the Treasury Special Master for Executive Compensation has been unwilling to get to the bottom of what happened. You also are investigating potential conflicts of interest within the Special Master's office. Could you please update the Committee on your progress?

Answer: Upon your request, SIGTARP initiated a review of severance payments to AIG executives that occurred earlier this year, and of potential conflicts of interest within the Office of the Special Master. We have researched the relevant statutory and regulatory authority, and met with officials from AIG, Treasury, and the Office of the Special Master. Our field work is nearing completion, and we hope to issue our findings to you in the coming months. As always, my staff is prepared to update your staff on the progress of the audit.

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

COMMITTEE ON FINANCE
NEWS RELEASE

Max Baucus (D-Mont.)
http://finance.senate.gov

**Hearing Statement of Senator Max Baucus (D-Mont.)
Regarding the Status of the TARP Program**

Walt Whitman wrote that: "to do the labor . . . of a prudent watchman who prevents outrage . . . [is one of] the proper duties of a government."

Our witnesses today are the sort of folks whom Walt Whitman had in mind. Their hard work and aggressive oversight has gone a long way toward keeping the TARP program relatively efficient and honest.

That's no small task, when you look at the size of TARP and the speed at which it was set up.

TARP remains one of the largest and most complex programs that the Federal government has ever created.

And that means that it's all the more important that we have the three oversight teams before us today.

I worked hard to create the office of the Special Inspector General for the TARP, back when Congress was developing the program. And so I am especially pleased to welcome Mr. Barofsky back to the Committee today.

So far, the Special I.G. has done a great job. You're providing critical transparency to the program, developing important studies on specific aspects of the program — and even busting bad guys.

I congratulate Mr. Barofsky and his team for their work on the Lee Farkas case. Mr. Farkas was the head of a private mortgage lending company who was arrested on June 15 and charged with a $1.9 billion fraud. He and others were charged with scheming to steal $550 million of TARP money.

That scheme was stopped dead in its tracks.

And the Special I.G. has conducted independent analysis that has brought critical transparency to the TARP program. An example was the Special IG's report on Monday. In that report, he concluded that the administration's auto task force pressured GM and Chrysler to close many auto dealerships without adequately considering job losses.

This news is very troubling. In Montana and across the country, our auto dealers are local small businesses and often the heart of the community. I am disappointed to learn that many of the decisions by the auto task force were made without full consideration of the effects on these communities.

Fortunately, some auto dealers have successfully restored their franchises. But many others have closed or have been forced to adjust to losing a franchise agreement during the most significant economic downturn since the Great Depression.

Mr. Barofsky, I applaud you for bringing issues such as this to the attention of Congress and the American taxpayers.

Elizabeth Warren of the Congressional Oversight Panel can bring us up to date on how small banks are faring under the TARP program. Her most recent report raises concerns about how fast small banks will be able to pay TARP back.

More than three-quarters of the large banks who received TARP money have already repaid the taxpayers. By contrast, only 10 percent of the small banks who received TARP funds have repaid the money.

There's also interest in an update on the AIG-Goldman Sachs relationship that you reported on earlier this year.

Oversight is sometimes a lonely job. And it doesn't win you many popularity contests. We have all been pleased to witness the perseverance of your three teams over the past year and a half, since Congress created the TARP program.

In some respects, the end of the program is in sight, just over the horizon. The Wall Street reform bill that we passed last week bars any new TARP "programs and initiatives." The bill also caps TARP disbursements at $475 billion.

And the Treasury reported that the total amount repaid to taxpayers for government funds used to bail out U.S. companies has surpassed, for the first time, the amount of TARP's outstanding debt.

Losses from the TARP program are still projected to be high. But the Government will not see a $700 billion loss for TARP, as some said back in the fall of 2008.

A year ago the losses were projected to be $341 billion.

Instead, current loss estimates look to be more in the range of $100 billion. And some are saying even that figure could go lower, depending on repayments from AIG and the auto companies.

The debate over the necessity for TARP and its effect on the U.S. economy will continue. I note that our Colleague Judd Gregg said last week that "TARP did what it was supposed to do — it basically saved the financial system on Main Street, too."

And Alan Blinder, the former Vice Chairman of the Federal Reserve, said TARP "was a necessary evil to save the economy. Think of it as collateral damage in a successful war against financial Armageddon."

What we do know today is that the hard work and sacrifice of our three oversight teams has given the American people a relatively clean, well-run program.

We are grateful for your efforts. And we stand ready to help you continue your good work as the TARP program comes to an end. And we hope that will be in the very near future.

###

Opening Statement of Sen. Chuck Grassley
Hearing, "An Update of the Troubled Asset Relief Program"
Wednesday, July 21, 2010

Appearing today before the committee are three of the most important TARP watchdogs: Mr. Neil Barofsky, Special Inspector General of the Troubled Asset Relief Program; Ms. Elizabeth Warren, Chair of the Congressional Oversight Panel; and Mr. Richard Hillman, Managing Director of the Financial Markets and Community Investment Team for the Government Accountability Office. I want to welcome you here today. We are all big believers in oversight, accountability and transparency.

Each of you has been conducting oversight of the Department of Treasury's implementation of TARP since 2008. This 700 billion dollar program has been the focus of numerous audits, hearings and reports. And at every stage, each of you has brought more transparency and accountability to the activities of Treasury. In short, you have kept Treasury honest, a critical service with so much taxpayer money at stake.

Each of your organizations has published reports recently on different aspects of TARP. Indeed, just this morning, SIGTARP published its seventh quarterly report on TARP. With TARP scheduled to expire on October 3, I look forward to hearing each of you update the committee on your activities and outline your concerns about TARP at this critical stage.

Mr. Barofsky, your office released a report this week describing the process by which the Administration forced GM and Chrysler to accelerate the closure of 2,243 dealerships, putting at risk as many as 100,000 jobs without first determining that the pace and scope of the closures was truly necessary. While your report is insightful, unfortunately it comes too late for the many car dealer owners and suppliers across the country that were forced out of business for very little reason. It's frustrating to know that at a time when small businesses are hurting and we're facing record unemployment, this Administration was pushing to shut down dealerships.

And your new quarterly report contains the startling observation that although TARP appears to be winding down, when non-TARP aid is included, the amount of overall government assistance actually grew during the last 12 months. Last year you estimated the total amount of taxpayer money at risk through various programs to be 3 trillion dollars. Your new estimate is 3.7 trillion dollars: a 700 billion dollar increase. That's as much as the original TARP program.

I also know that your office has been actively investigating excessive AIG executive compensation payments that have been largely ignored by Treasury.

And I have been continuing my inquiry into the severance package received by a former AIG executive. It seems that the executive received nearly 3 times her salary in severance and bonuses, or about 1.4 million dollars, although she was terminated, her severance was increased, and Treasury could have stopped the payments but did nothing.

Mr. Chairman, I have documentation of the severance payments here. I ask unanimous consent that it be placed in the record.

Ms. Warren, last month your Congressional Oversight Panel reported on the AIG bailout, and we learned that among the ultimate beneficiaries of the taxpayer-funded AIG bailout was not just AIG's counterparty Goldman Sachs, but also Goldman's counterparties. It is estimated that Goldman's counterparties may have benefited from the taxpayer bailout of AIG by avoiding of as much as 11 billion dollars in losses. And yet, incredibly, we don't know who those counterparties are. Goldman has refused to provide your panel with the names of those companies. Mr. Chairman, I have here a summary of the Goldman's lack of responsiveness to the Congressional Oversight Panel's requests. I ask unanimous consent that it be placed into the record.

The Congressional Oversight Panel also issued a report this week about the TARP Capital Purchase Program. It details how Treasury seems to have treated the nation's largest banks much more favorably than it treated the nation's smaller banks.

Many of the smaller banks now are struggling, and their participation in TARP has neither stabilized the financial system nor increased lending activity.

Over at the GAO, Mr. Hillman's office also released a report about AIG recently. One focus of the report is the status of AIG's attempt to repay its debt to the American taxpayer. Over time, the government has exchanged much of AIG's debt for stock, meaning that the government's ability to recoup the billions advanced to AIG will depend to a large degree on AIG's ability to sell its business assets as it restructures. The recent collapse of a 35 billion dollar deal to sell an AIG life insurance subsidiary is an ominous sign if taxpayers are depending on asset sales to recoup their money.

One of the purposes of TARP, of course, was to preserve home ownership and protect home values. Treasury announced the 50 billion dollar Home Affordable Modification Program (HAMP) in March 2009, and all three of the watchdogs on the witness panel today have issued reports on the program's progress. Progress is not good. In a program that Treasury said would result in 3 to 4 million modifications, there have been only 340,000 permanent modifications. In fact, there have been 430,000 failed trial modifications, meaning failed modifications vastly outnumber successful modifications. And just as I warned, redefaults look like they will be a real problem. The debt-to-income ratio for borrowers that have received a mortgage modification is 64 percent even after modification, a level that all but ensures a high redefault rate.

Moreover, Treasury still has not established performance goals or benchmarks for HAMP, meaning that there is no effective way for us to know whether this 50 billion dollar program is accomplishing its intended purpose. That's not accountability, that's not transparency—that's just more taxpayer money flying out the window.

American taxpayer investment in the TARP program is unprecedented and as good stewards of taxpayer money it is essential that we exercise the highest standard of oversight. As the nation's watchdogs your work is crucial to this effort.

As you present your findings today, I ask that you specifically advise the committee of any areas in which your oversight is being limited or constrained by a lack of cooperation from the Administration, the Treasury Department or others, and how we can best help you.

United States Senate

COMMITTEE ON FINANCE
WASHINGTON, DC 20510–6200

March 23, 2010

Via Electronic Transmission

The Honorable Neil M. Barofsky
Special Inspector General
Office of the Special Inspector General
Troubled Asset Relief Program
United States Department of the Treasury
1500 Pennsylvania Avenue, NW, Suite 1064
Washington, DC 20220

Dear Special Inspector General Barofsky:

I have communicated on several occasions during the last few months with the Secretary of the Treasury and the Special Master for TARP executive compensation to try to get to the bottom of why AIG was allowed to pay excessive severance awards to AIG executives after the passage of the American Recovery and Reinvestment Act of 2009 (Recovery Act). Answers have not been forthcoming and therefore I am writing to ask that you investigate these matters and report your findings to me as soon as possible. I am particularly troubled by a chronology of events that seems to suggest a deliberate decision on the part of Treasury to improperly protect executive severance pay and tie the hands of the Special Master.

The Recovery Act required the Treasury Secretary to set standards for appropriate levels of executive compensation at TARP recipients generally. It specifically prohibited the payment of bonuses, retention awards and incentive compensation to the top 25 executives at bailed-out companies like AIG, but then protected many such payments by the controversial "grandfather" provision added late in the drafting process. Consequently, bonus payments, retention awards and incentive compensation based on a contract in existence on or before February 11, 2009, were required to be paid. But the provision did not cover severance pay because severance is not generally understood to be within the meaning of incentive or retention bonuses. That is why I was surprised to learn earlier this year that AIG reportedly paid its former General Counsel $3.9 million and its former Chief Compliance and Regulatory Officer $1 million in severance.

Treasury published regulations on June 15, 2009, implementing the Recovery Act's executive compensation provisions. Treasury also named Mr. Kenneth Feinberg as the Special Master. It appears that, despite the earlier public outcry over the retention bonus grandfather loophole, Treasury's regulation added severance pay to the list of executive compensation items covered by the grandfather. Worse still, Treasury virtually ignored the requirement in section 111(b) (2) of the Recovery Act that the Secretary "shall require each TARP recipient to meet appropriate standards for executive

compensation." Section 111(b) (2) is a general provision and is not limited by the more specific restrictions in 111(b) (3) related to the top 25 executives and the grandfather provision. Nevertheless, this mandated authority was not used to regulate severance pay for executives like the former AIG General Counsel. Therefore, I am asking you, among other things, to evaluate why Treasury did not effectively implement the Congressional mandate in section 111(b) (2) to prevent inappropriate executive compensation, such as excessive severance payments, more broadly.

There is another troubling matter that I am asking you to review. The current Deputy Special Master joined Treasury in May 2009. He told us he participated in drafting the Treasury regulations. Of course, those regulations governed executive compensation at TARP recipients like AIG and Bank of America. The problem is that this attorney worked for the Wall Street law firm Wachtell, Lipton, Rosen & Katz prior to joining Treasury. While at Wachtell, it is my understanding that this attorney represented Bank of America during its acquisition of Merrill, Lynch in the fall of 2008. Also, the Wachtell firm represents the former CEO and former CFO of AIG on executive compensation matters, including severance. In fact, I understand that those executives may still be planning to make claims against AIG for millions of dollars of severance pay.

At a minimum this presents the appearance of serious impropriety. There are several red flags and questions stemming from this information including, for example, why was this Treasury official permitted to work on a regulation that would directly affect his former client and a client of his former law firm? Did he fully comply with the revolving door provisions of the President's Ethics Executive Order, prohibiting appointees from participating in matters involving their former clients? If he was recused, when did the recusal occur and why was it not publicly disclosed? How many other Treasury officials working on executive compensation matters have similarly undisclosed potential conflicts for which recusals have been necessary to ensure compliance with the President's executive order? What are the details of the other potential conflicts, if any? Therefore, I also ask that you examine this situation and report your findings.

Thank you in advance for your attention to this important matter. Please contact my staff at (202) 224-4515 if you have any questions or need additional information.

Sincerely,

Charles E. Grassley
Ranking Member

PATTON BOGGS LLP
ATTORNEYS AT LAW

2550 M Street, NW
Washington, DC 20037-1350
202-457-6000

Facsimile 202-457-6315
www.pattonboggs.com

July 20, 2010

Mitchell R. Berger
202-457-5601
mberger@pattonboggs.com

Jeffrey L. Turner
202-457-6434
jturner@pattonboggs.com

Hon. Charles E. Grassley
Ranking Member
Committee on Finance
United States Senate
219 Dirksen Senate Office Building
Washington, D.C. 20510-6200

Re: American International Group, Inc. ("AIG")—
June 25, 2010 Letter Requests

Dear Senator Grassley:

On behalf of AIG, we are providing the following information responsive to your June 25, 2010 letter to Mr. Robert H. Benmosche, President and Chief Executive Officer of AIG, concerning severance arrangements entered into between AIG and Ms. Suzanne Rich Folsom, the former Chief Regulatory and Compliance Officer and Deputy General Counsel of the company:

a. On December 30, 2009, AIG and Ms. Folsom signed a separation agreement, titled American International Group, Inc. Release and Restrictive Covenant Agreement (the "Agreement").

b. The terms of the Agreement required AIG to pay Ms. Folsom a combined amount of $1,380,000, including severance payments and bonuses.

Respectfully submitted,

Mitchell R. Berger
Jeffrey L. Turner

ELIZABETH WARREN, CHAIR
RICHARD H. NEIMAN
DAMON SILVERS
J. MARK MCWATTERS
KENNETH R. TROSKE

732 NORTH CAPITOL STREET, NW
ROOM C-320
WASHINGTON, DC 20401

Congress of the United States

CONGRESSIONAL OVERSIGHT PANEL

SUMMARY OF REQUESTS FOR INFORMATION FROM GOLDMAN SACHS

The Congressional Oversight Panel has made several requests for information from Goldman Sachs & Co. during the course of the Panel's investigation into the collapse and subsequent government rescue of American International Group (AIG).

Summary of Correspondence

The following is a chronology of the key communications between Panel staff and Goldman's counsel.

- An email dated 3/24/2010 from Sara Hanks (COP) to Michael Pease (Goldman Sachs) requested answers to several questions clarifying the relationship between AIG, Goldman and Goldman's clients. Goldman did not respond in writing to the request.
- An email dated 5/10/2010 from Sara Hanks (COP) to Michael Pease (Goldman Sachs) requested answers to a more detailed list of questions. Ms. Hanks received an email from Mr. Pease stating that Goldman would get back to her with the information. Goldman responded with a letter from Gregory K. Palm dated 5/14/2010, which did not answer the vast majority of the Panel's questions.
- An email dated 5/18/2010 from Sara Hanks (COP) to Michael Pease (Goldman Sachs) requested Goldman provide the information requested on 5/10/2010 with data current as of November 7, 2008. Goldman responded with a letter dated 5/26/2010 with an appendix that, according to Goldman, showed information as of November 7, 2008.

Congressional Oversight Panel Correspondence with Goldman Sachs

Below is the correspondence between the Congressional Oversight Panel and Goldman Sachs. These include the full list of questions asked by the Panel, and the subsequent responses from Goldman.

March 24, 2010 – Email from Sara Hanks (COP) to Michael Pease (Goldman Sachs)

1. Identify the role Goldman played with respect to the CDO CDSs; market intermediary or proprietary trader (or if a mix, in what proportions)
2. Identify Goldman's counterparties/clients to the CDO CDSs. Are they available to speak with the Panel?
3. Provide the CDO CDS contracts.
4. Did the Goldman clients hold the underlying/reference CDOs? How were the CDOs that ended up in Maiden Lane III acquired and from whom?

May 5, 2010 – Email from Sara Hanks (COP) to Michael Pease (Goldman Sachs)

1. How much (in dollar terms) of the CDS position that eventually went to ML3 (ML3 CDSs) was held on behalf of clients?
2. Please explain nature of this relationship. It appears that this is not a riskless principal position: is that right?
3. Were the terms of the CDSs that Goldman Sachs had with AIG "back to back" with the CDSs Goldman Sachs had with its own clients? If not, how did they differ?
4. If AIG had failed, would Goldman Sachs have been on the hook to pay out to its own clients? On what conditions? If not, why not?
5. Did Goldman Sachs have to post collateral to its own clients? If so, upon what events?
6. Please explain the nature of the protection Goldman Sachs had against AIG's failure. Mr. Viniar referred to CDSs "and other credit hedges"; what were they? Who issued this protection? What was the total amount of this protection? Please explain the nature of the collateral that Goldman Sachs received with respect to this protection, and the terms upon which collateral was posted.
7. Mr. Viniar refers to the protection on AIG having netted a gain over time (March 2009 conf call, page 17). What is the amount of this gain?
8. AIG was required to post collateral upon a decrease in the value of reference CDOs and upon a downgrade in AIG's ratings. How much of the total collateral posted at November 7, 2008 related to decreases in value of the reference CDOs, and how much to downgrades in AIG's ratings? Please discuss the triggers for posting collateral. How often were the reference CDOs marked to market?
9. When the ML3 CDSs were closed out in November 2008, did Goldman Sachs continue the CDSs with its own clients, or close them out? If they were closed out, upon what terms?
10. Did Goldman Sachs hold any of the reference CDOs? Did Goldman Sachs' clients? If not, where were they acquired to deliver to ML3, and was the price paid for them the same as the price received from ML3?
11. If Goldman Sachs had voluntarily granted the government a concession upon closing, what concerns would have been triggered? Shareholder suits? Any other issues?
12. What would Goldman Sachs's preference have been if the government had been willing to keep the CDS positions open? Would Goldman Sachs have preferred to continue the contracts or to have them closed out? The FRBNY indicates that some of the ML3 counterparties agreed to the closeout reluctantly.
13. Copies of agreements between AIG and Goldman Sachs, including ISDA Master, credit support agreement, and confirms
14. Documentation of protection that Goldman Sachs arranged against AIG's failure.
15. Confirmation from Goldman Sachs counsel and auditors regarding Goldman Sachs's exposure to AIG failure.

May 14, 2010 – Letter from Gregory K. Palm (Goldman Sachs) to Sara Hanks (COP)

1. How much (in dollar terms) of the CDS position that eventually went to ML3 (ML3 CDSs) was held on behalf of clients?

   Goldman Sachs did not respond to this question.

2. Please explain nature of this relationship. It appears that this is not a riskless principal position: is that right?

Goldman Sachs did not respond to this question.

3. Were the terms of the CDSs that Goldman Sachs had with AIG "back to back" with the CDSs Goldman Sachs had with its own clients? If not, how did they differ?

   Goldman Sachs did not respond to this question.

4. If AIG had failed, would Goldman Sachs have been on the hook to pay out to its own clients (disregarding for this purpose the fact that Goldman Sachs had CDS protection on AIG). On what conditions (i.e., please summarize events that would lead to Goldman Sachs having to pay out to its own clients). If not, why not?

   Goldman Sachs did not respond to this question.

5. Did Goldman Sachs have to post collateral to its own clients? If so, upon what events?

   Goldman Sachs did not respond to this question.

6. Please explain the nature of the protection Goldman Sachs had against AIG's failure. Mr. Viniar referred to CDSs "and other credit hedges"; what were they? Who issued this protection? What was the total amount of this protection? Please explain the nature of the collateral that Goldman Sachs received with respect to this protection, and the terms upon which collateral was posted.

   Goldman Sachs stated that materials enclosed with letter – including a spreadsheet and various emails and other material – describe the nature and dollar amounts of Goldman Sachs's hedges, but not the issuers of the CDS protection. The information provided by Goldman Sachs also showed that the collateral posted by these counterparties was primarily cash.

7. Mr. Viniar refers to the protection on AIG having netted a gain over time (March 09 conf call, page 17). What is the amount of this gain?

   Goldman Sachs did not respond to this question.

8. AIG was required to post collateral upon a decrease in the value of reference CDOs and upon a downgrade in AIG's ratings. How much of the total collateral posted at November 7, 2008 related to decreases in value of the reference CDOs, and how much to downgrades in AIG's ratings? Please discuss the triggers for posting collateral. How often were the reference CDOs marked to market?

   Goldman Sachs did not include a response to this item. From the CDS contracts that were provided to COP, COP was able to ascertain the answer to the questions regarding triggers and frequency of marking to market.

9. When the ML3 CDSs were closed out in November 2008, did Goldman Sachs continue the CDSs with its own clients, or close them out? If they were closed out, upon what terms?

   Goldman Sachs did not respond to this question.

10. Did Goldman Sachs hold any of the reference CDOs? Did Goldman Sachs' clients? If not, where were they acquired to deliver to ML3, and was the price paid for them the same as the price received from ML3?

    Goldman Sachs did not respond to this question.

11. If Goldman Sachs had voluntarily granted the government a concession upon closing, what concerns would have been triggered? Shareholder suits? Any other issues?

    Goldman Sachs did not respond to this question.

12. What would Goldman Sachs's preference have been if the government had been willing to keep the CDS positions open? Would Goldman Sachs have preferred to continue the contracts or to have them closed out? The FRBNY indicates that some of the ML3 counterparties agreed to the closeout reluctantly.

    Goldman Sachs did not respond to this question.

13. Copies of agreements between AIG and Goldman Sachs, including ISDA Master, credit support agreement, and confirms.

    Goldman Sachs did not include a response to this item. Copies of these agreements were ultimately obtained from another source.

14. Documentation of protection that Goldman Sachs arranged against AIG's failure.

    Goldman Sachs enclosed a contemporaneous 2008 spreadsheet and other, related materials. The letter states that the spreadsheet and other materials demonstrate that Goldman Sachs had no material exposure to AIG as of 2008 and provided some information regarding the hedges that Goldman Sachs had against AIG losses. Issuers of this protection are not identified.

15. Confirmation from Goldman Sachs counsel and auditors regarding Goldman Sachs's exposure to AIG failure.

    Specific request regarding counsel and auditors not addressed. Goldman Sachs enclosed contemporaneous 2008 spreadsheet and other, related materials. Letter states that the spreadsheet and other materials demonstrate that Goldman Sachs had no material exposure to AIG as of 2008.

May 18, 2010 – Email from Sara Hanks (COP) to Michael Pease (Goldman Sachs)

1. Please provide the information you provided in your letter of May 14, 2010, current as of November 7, 2008.

May 26, 2010 – Letter from Richard H. Klapper (Goldman Sachs) to Sara Hanks (COP)

1. Please provide the information you provided in your letter of May 14, 2010, with information as of November 7, 2008.

   Goldman Sachs included an appendix that, according to Goldman Sachs, showed "as of November 7, 2008, the notional amount of the credit default swaps between Goldman Sachs International and...[AIGFP], the decline in market value of the securities referenced in those credit default swaps, the collateral received by Goldman Sachs from AIGFP in connection with those credit default swaps, the outstanding collateral calls issued by Goldman Sachs to AIGFP in connection with those credit default swaps, the difference between the decline in Goldman Sachs's determination of the market value of those credit default swaps and the collateral held by Goldman Sachs, and the credit protection that Goldman Sachs owned referencing AIG."

Senator Grassley's Oversight of the Troubled Asset Relief Program (TARP)

In October 2008, Congress passed the Emergency Economic Stabilization Act, authorizing the establishment of a fund to curb the financial crisis. This program, known as the Troubled Asset Relief Program (TARP), was created to give the U.S. Treasury purchasing power of $700 billion to buy up mortgage-backed securities from institutions across the country, in an attempt to create liquidity and ease the flow of credit. Instead, Treasury engaged in an erratic policy of picking winners and losers among companies connected directly, or even indirectly, to our financial markets, such as automakers.

Senator Grassley has conducted some of the most aggressive oversight of the government's implementation of the financial bailout, including executive compensation, severance payouts, and documentation of how taxpayer dollars have been used. Grassley worked to establish an independent inspector general to oversee the program and successfully strengthened the watchdog's power when the program was altered after enactment.

This year, Grassley exposed the fact that General Motors "paid back" its taxpayer-funded loan with other taxpayer dollars from the government's purchase of GM stock. Contrary to an extensive public relations campaign by the automaker and Treasury Department that the bailout had been paid back "in full, with interest, ahead of schedule," most of the government's emergency loan to GM was converted to shares of stock during bankruptcy. That money can only be recovered if the government can sell its shares of GM at significantly higher prices than it is currently estimated to be worth.

Grassley also has voted many times to let TARP expire or block funds and co-sponsored legislation to end TARP. A chronology of highlights follows:

September 25, 2008 – Grassley formalized his call for a special office of inspector general to be established as part of any legislation that Congress considers for the financial system to scrutinize subsequent actions by the Treasury Department. In a letter to congressional leaders signed by 32 senators, Grassley and Senator Max Baucus said, "Congress owes American taxpayers the strongest oversight possible – not just after the task begins, but as it is planned." Senators called for an inspector general office with the power to investigate, audit and issue subpoenas, along the lines of the Special Inspector General overseeing the Iraq reconstruction program.

October 1, 2008 – Grassley pointed out that the TARP bill before the Senate included the core principles he wanted to see, unlike the original Treasury proposal. Grassley said, "This bill is an improvement from the Treasury plan because there's transparency, oversight, and more protections for taxpayers." Improvements included a special inspector general, which Grassley pushed to include, and a Financial Stability Oversight Board responsible for reviewing the exercise of authority under the program.

January 28, 2009 – Grassley and Sen. Max Baucus introduced legislation to strengthen the ability of the Government Accountability Office – the independent auditing arm of Congress – to make its assessments every 60 days of TARP. The bill would require any private entity that

receives federal funds through the TARP to give the GAO access to its books and records. Grassley said, "The original TARP legislation tells GAO to regularly report on the performance of the program, but it doesn't require participants in the program to respond to requests for information from the GAO. The GAO's hands are tied, and that's not good for the taxpayers, who have so much at stake with the rescue effort. Our amendment gives GAO access to information, which means there will be greater transparency and accountability."

January 30, 2009 – Grassley urged the President's director of management and budget to stop any efforts under way or excuses in the works to prevent the TARP special inspector general from initiating letters of inquiry to entities participating in TARP. The Office of Management and Budget created red tape that prevented the inspector general from fully accessing items he needed to do his job.

February 10, 2009 – Grassley wrote to the special inspector general, asking him to conduct an inquiry into the facts and circumstances surrounding the Treasury Department's decisions to provide billions of taxpayer dollars to private financial institutions through the Troubled Asset Relief Program, the Capital Purchase Program, or through any other means. Press reports suggested that decisions about which institutions received federal money may have been influenced by political considerations, such as interventions by elected, appointed, or other officials, rather than objective criteria. Grassley was concerned that the public cannot have confidence in the integrity of the process for dispensing its tax dollars if it believes that government officials, for improper political purposes, are picking winners and/or losers in the marketplace.

March 23, 2009 – Grassley wrote to the special inspector general, asking him to conduct an inquiry into the roles and actions, if any, the Department of the Treasury played in the decision by AIG to pay bonuses of more than $160 million to AIG employees.

March 31, 2009 – Grassley spoke at the Finance Committee hearing "TARP Oversight: A Six Month Update" and urged the TARP special inspector general, whose position Grassley was instrumental in creating, to continue aggressive oversight.

April 24, 2009 – The President signed into law legislation from Grassley and Senator Claire McCaskill to significantly strengthen oversight of TARP by increasing the power and authority of the special inspector general. The new law made clear the IG has authority over all actions taken under the relief plan; gave the IG the authority to hire auditors quickly by granting him temporary hiring authority; required the Treasury secretary to explain to Congress why any IG recommendations are not implemented; required that the IG issue a public report in September of 2009 to Congress analyzing how the program's funds have been spent to date; and made funds for the IG immediately available to allow the IG to set up his office.

May 6, 2009 – Grassley won Senate passage of his amendment to give the Government Accountability Office the authority to access information from the Federal Reserve about its bailout and financial stabilization efforts. Senators voted 95 to 1 for Grassley's initiative to increase transparency in government.

May 20, 2009 – Grassley's provision giving the Government Accountability Office the authority to access information from the Federal Reserve about its bailout and financial stabilization efforts became federal law as part of a housing bill. Also enacted was the Grassley-Baucus bill to strengthen the ability of the Government Accountability Office to report on TARP by requiring any private entity that receives federal funds through TARP to give the GAO access to its books and records.

September 18, 2009 – Grassley joined 39 Senate colleagues to send a letter to the Treasury secretary pushing him to allow TARP to expire at the end of the year. Current law allows the Treasury Department to extend TARP authority for an additional nine months through October 3, 2010.

November 9, 2009 – Grassley called on the Treasury secretary to require TARP participants to report on the actual use of TARP funds, after an October report to Congress from the special inspector general for TARP said the Treasury Department has failed to do so for all but three TARP recipients, despite the urging of the inspector general that it be done.

November 17, 2009 – Grassley joined Sen. John Thune and other colleagues to introduce the TARP Sunset Act of 2009. The legislation had 21 cosponsors as of June 9, 2010.

November 20, 2009 – Grassley sent a letter to the Department of the Treasury and the Federal Reserve regarding the special inspector general's study titled, "Factors Affecting Efforts to Limit Payments to AIG Counterparties." Grassley was alarmed by the report's findings that actions by the government left the American taxpayer with exposure to the risk of massive financial loss. The inspector general report spelled out a lack of "basic transparency" regarding TARP loans to AIG.

December 10, 2009 – Grassley said the Treasury Department has an obligation to track and disclose how TARP dollars are used.

December 24, 2009 – Grassley wrote to the Treasury secretary asking why the 2009 AIG bonuses were not paid back, as promised, and expressing dismay that AIG was planning more bonuses for 2010 and Treasury was not doing anything to stop a second round of AIG bonuses.

January 15, 2010 – Grassley sought a Congressional Budget Office analysis of the President's proposed bank fee to repay taxpayers for TARP.

January 25, 2010 – Grassley again wrote to the TARP special master for compensation, asking more questions about a multi-million severance package for an AIG executive, plus a second AIG executive.

February 2, 2010 – At a Finance Committee hearing, Grassley asked the Treasury secretary why AIG bonuses went out for two years in a row and why Treasury didn't stop them. Grassley said in a statement that more AIG bonuses showed the Administration had been outmaneuvered.

February 3, 2010 – Grassley wrote to the Treasury secretary, seeking to learn whether some AIG bonuses were promised after the bailout began and asking why Treasury did not follow through on the President's promise to pursue every legal means to recover the bonuses.

March 4, 2010 – Grassley released an analysis from the non-partisan Congressional Budget Office showing banks likely would pass the cost of a proposed bank tax to repay TARP on to their customers.

March 15, 2010 – Grassley praised the special inspector general for TARP for filing criminal charges against an individual for attempting to steal from TARP. Grassley said the action showed the importance of having a special, independent TARP watchdog, which he was instrumental in creating.

March 23, 2010 – Grassley asked the special inspector general for TARP to investigate why the Treasury Department did not follow through on the mandate from Congress in last year's stimulus bill to require that all TARP recipients, including AIG, meet appropriate standards for executive compensation. A significant number of TARP dollars went to AIG.

April 28, 2010 – Grassley continued to peel back the layers of taxpayer obligations behind the prior week's claim and fanfare about General Motors repaying its multi-billion dollar loan from TARP. Grassley gave a speech on the Senate floor to release the response he received from the Treasury Department to his earlier inquiry. The response confirmed that taxpayers funded the loan repayment by way of an escrow account containing taxpayer funds used to purchase GM stock. Grassley's work exposed the misrepresentation

May 4, 2010 – At a Finance Committee hearing, Grassley continued to explore the impact of a proposed bank tax to repay taxpayers for TARP losses, expressing concern that the Democratic majority would use any bank tax proceeds for more spending rather than paying back taxpayers.

Grassley Votes to Allow Tarp to Expire or Block Funds

January 15, 2009 – Grassley voted for a joint resolution to disapprove the use of the second $350 billion in TARP funds.

April 2, 2009 – Grassley voted to prevent unbudgeted TARP funds from being used for other purposes.

April 2, 2009 – Grassley voted to take $272 billion of unused TARP funding to reduce the deficit.

April 2, 2009 – Grassley voted to prevent Chrysler and GM from getting more bailout funds.

May 4, 2009 – Grassley voted to let well-capitalized banks pay back their TARP aid.

May 5, 2009 – Grassley voted to prevent repaid TARP program funds from being recycled.

May 5, 2009 – Grassley voted to prevent converting preferred shares bought under the TARP program to common stock.

July 29, 2009 – Grassley voted to prevent any additional TARP funds from being used to aid GM or Chrysler, clarifying that the Treasury had a fiduciary duty to maximize taxpayer return on the aid, and required the government to give the taxpayers its common stock in those companies within one year of their emergency in bankruptcy.

August 6, 2009 – Grassley voted to set a firm expiration date for TARP.

United States Government Accountability Office

GAO

Testimony
Before the Committee on Finance,
U.S. Senate

TROUBLED ASSET RELIEF PROGRAM

Continued Attention Needed to Ensure the Transparency and Accountability of Ongoing Programs

Statement of Richard J. Hillman, Managing Director
Financial Markets and Community Investment

GAO-10-933T

Chairman Baucus, Ranking Member Grassley, and Members of the Committee:

I am pleased to be here today to discuss our work on the Troubled Asset Relief Program (TARP), which Congress established on October 3, 2008 in response to the financial crisis that threatened the stability of the U.S. financial system and the solvency of many financial institutions. Under the original TARP legislation, the Department of the Treasury (Treasury) had the authority to purchase or insure $700 billion in troubled assets held by financial institutions.[1] As we have seen, since TARP's inception Treasury has chosen to use those funds for a variety of activities, including injecting capital into key financial institutions, implementing programs to address problems in the securitization markets, providing assistance to the automobile industry and American International Group, Inc. (AIG), and working to help homeowners struggling to keep their homes. Today, some of these programs have been discontinued and others are winding down, but others—such as homeownership preservation programs—may continue for some time. Treasury has also seen some participating institutions repay their TARP funds as they recover their financial health. The prospect for repayment from some other institutions, both large and small, remains unclear.

The Emergency Economic Stabilization Act (the act) that authorized TARP required GAO to report at least every 60 days on findings from our oversight of actions taken under the programs.[2] We have been monitoring

[1]The Emergency Economic Stabilization Act of 2008 (the act), Pub. L. No. 110-343, 122 Stat. 3765 (2008), originally authorized Treasury to buy or guarantee up to $700 billion in troubled assets. The Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22, Div. A, amended the act and reduced the maximum allowable amount of outstanding troubled assets under the act by almost $1.3 billion, from $700 billion to $698.741 billion. The Dodd-Frank Wall Street Reform and Consumer Protection Act, H.R. 4173, 111th Cong, passed by both the House and Senate and expected to be signed into law by the President this week, would (1) reduce Treasury's authority to purchase or insure troubled assets to $475 billion and (2) prohibit Treasury, under the act, from incurring any additional obligations for a program or initiative unless the program or initiative had already been initiated prior to June 25, 2010.

[2]The act requires the U.S. Comptroller General to report at least every 60 days, as appropriate, on findings resulting from oversight of TARP's performance in meeting the act's purposes; the financial condition and internal controls of TARP, its representatives, and agents; the characteristics of asset purchases and the disposition of acquired assets, including any related commitments entered into; TARP's efficiency in using the funds appropriated for its operations; its compliance with applicable laws and regulations; and its efforts to prevent, identify, and minimize conflicts of interest among those involved in its operations.

TARP programs since their inception and our reports have highlighted challenges facing many of these programs. To date, we have issued over 25 reports and testimonies related to TARP and made over 50 recommendations to improve the transparency and accountability of its operations.[3] My statement today draws primarily on 7 reports we have issued since October 2009.[4] Specifically, this statement focuses on (1) the nature and purpose of activities that have been initiated under TARP and ongoing challenges, (2) the process for making decisions related to unwinding TARP programs, and (3) indicators of credit conditions in markets targeted by TARP programs. To do our work, we reviewed our prior reports and other documents provided by Treasury's Office of Financial Stability (OFS) and conducted interviews with Treasury and OFS officials. In addition, we have updated the program's receipts and disbursements through June 30, 2010, and indicators of credit markets as of July 1, 2010. We conducted these performance audits between July 2009 and June 2010 and updated information in July 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Summary

Treasury has initiated a number of programs under TARP, some of which have ended or are being unwound. Others—especially those aimed at preserving homeownership and encouraging lending to small businesses—

[3]Appendix I lists our reports and selected testimonies since the program was enacted.

[4]See GAO, *Troubled Asset Relief* Program: *One Year Later, Actions Are Needed to Address Remaining Transparency and Accountability Challenges*, GAO-10-16 (Washington, D.C.: Oct. 8, 2009); *Troubled Asset Relief Program: Continued Stewardship Needed as Treasury Develops Strategies for Monitoring and Divesting Financial Interests in Chrysler and GM*, GAO-10-151 (Washington, D.C.: November 2, 2009); *Troubled Asset Relief Program: Treasury Needs to Strengthen Its Decision-making Process on the Term Asset Backed Securities Loan Facility*, GAO-10-25 (Washington, D.C.: Feb. 5, 2010); *Troubled Asset Relief Program: Automaker Pension Funding and Multiple Federal Roles Pose Challenges for the Future*, GAO-10-492 (Washington, D.C.: April 6, 2010); *Troubled Asset Relief Program: Update of Government Assistance to AIG*, GAO-10-475 (Washington, D.C.: Apr. 27, 2010); *Troubled Asset Relief Program: Further Actions Needed to Fully and Equitably Implement Foreclosure Mitigation Programs*, GAO-10-634 (Washington, D.C.: June 25, 2010); *Troubled Asset Relief Program: Treasury's Framework for Deciding to Extend TARP Was Sufficient, but Could be Strengthened for Future Decisions*, GAO-10-531, (Washington, D.C.: June 30, 2010).

will continue. Many participating institutions have repaid the funds they received, reducing the federal government's exposure under TARP. Since TARP was authorized, Treasury has disbursed $385 billion for loans and equity investments. As of June 30, 2010, Treasury had received almost $25 billion in dividend and interest payments and warrant repurchases, as well as more than $198 billion in repayments. Among the programs no longer making commitments are the Capital Purchase Program (CPP) and Targeted Investment Program (TIP), while the Home Affordable Modification Program (HAMP) and new small business lending initiatives are expected to continue for some time. Although Treasury has received significant repayments of the funding it provided to financial institutions, some investments and loans could still result in substantial losses to the government. We have been monitoring TARP programs since their inception, including the financial condition of those institutions that received significant assistance. In particular, Chrysler Group LLC and General Motors Company (GM) have shown some indications of progress toward returning to profitability, such as doing better than they and Treasury had initially projected in terms of revenues, operating earnings, and cash flow. However, the extent to which the federal government will fully recoup its investment in the auto industry is uncertain, and the companies face several challenges in the coming years, including returning to and sustaining strong growth and profitability. Since early 2009, we have also been monitoring the status of federal assistance to AIG and its financial condition using indicators we developed. In April 2010, we reported that our indicators showed that AIG's financial condition has remained relatively stable largely due to the federal assistance provided by the Federal Reserve and Treasury, but the extent to which the federal government will recoup its investment remains uncertain and will not only depend on the AIG's financial condition but also other market factors such as the performance of the insurance sectors and the credit derivatives markets that are beyond the control of AIG or the government.

Many of our reports have also highlighted the challenges facing TARP programs and made recommendations to enhance transparency and accountability of its programs. For example, we have noted several challenges facing HAMP and have reported that the program has made limited progress, has suffered from inconsistent program implementation, and continues to confront additional challenges. These include converting trial modifications to permanent status and ensuring program stability and effective program management. We reported that while Treasury had taken some steps to address these challenges it urgently needed to finalize and implement the various components of HAMP and ensure the transparency and accountability of these efforts. We will continue to

monitor these programs and have ongoing work on several facets of TARP, including those initiatives that have a small business focus.

We have also reviewed Treasury's framework for deciding to extend TARP beyond December, 31, 2009, and found that the process was sufficient but could be strengthened for similar decisions that will need to be made in the future. Specifically, we found that the extent of coordination could be enhanced and formalized between Treasury and the Federal Deposit Insurance Corporation (FDIC) and recommended that Treasury formalize coordination with FDIC for future decisions. Although the authority for TARP is set to expire soon, Treasury will continue to face decisions in winding down programs, and many of these decisions will require interagency coordination. Because TARP will be unwinding concurrently with other important regulatory interventions, decisions about the sequencing of the exits from the programs will require regulators to work closely together. We also noted that Treasury could strengthen its analytical framework by identifying clear objectives for small business initiatives and explaining how relevant indicators motivated TARP program decisions.

We have noted in past reports that some of the anticipated effects of TARP on credit markets and the economy had materialized and that some securitization markets had experienced a tentative recovery. Indicators we have been monitoring suggest that credit markets have been able to sustain their recovery despite the winding down of key programs initiated by the Federal Reserve, Treasury, FDIC and others. For example, the cost of credit and perceptions of risk (as measured by premiums over Treasury securities) have fallen in interbank, mortgage, and corporate debt markets. Further, the volume of credit, as measured by new mortgage loans and asset-backed securities (ABS), has improved since the first TARP program, CPP. Unfortunately, by any measure foreclosure and delinquency statistics for residential housing remain well above their historical averages despite programs such as HAMP. However, a slow recovery does not necessarily mean that TARP is ineffective, because in absence of TARP it is possible that foreclosure and delinquency rates would be higher. Moreover, full recovery will likely take some time given the build up of imbalances in the real estate, fiscal and household sectors over several years. Finally, because any new TARP activity will be limited to home ownership preservation and small business lending programs, we will also continue to monitor indictors such as foreclosure and delinquencies as potential measures of the programs' success.

Some TARP Programs Are Winding Down, but Others Require Continued Attention

Since TARP was authorized, Treasury has implemented a range of programs aimed at stabilizing the financial system and preserving homeownership. As of June 30, 2010, it had disbursed $385 billion for TARP loans and equity investments, and Treasury has already recouped some of these disbursements (table 1). As of June 30, 2010, Treasury had received almost $25 billion in dividend and interest payments and warrant repurchases and more than $198 billion in repayments.

Table 1: TARP Program Disbursements, Repayments, and Additional Proceeds, as of June 30, 2010 (dollars in billions)

Program	Total Cash Disbursed	Repayments[1]	Additional Proceeds[1]
Capital Purchase Program (CPP)	$204.9	$146.9	$17.3
Targeted Investment Program	40.0	40.0	4.3
Automotive Industry Financing Program	79.7	11.2	2.4
American International Group Investments	47.5	0.0	0.0
Home Affordable Modification Program	0.3	N/A	N/A
SBA 7(a) Securities Purchase Program	0.1	<0.1	<0.1
Term Asset-Backed Securities Loan Facility	0.1	0.0	0.0
Public Private Investment Program	12.4	0.4	0.1
Asset Guarantee Program (AGP)[2]	0.0	0.0	0.6
Totals	**$385.0**	**$198.5**	**$24.7**

Source: Department of the Treasury

[1]This table shows the TARP activity from inception through June 30, 2010. Additional Proceeds includes dividends from equity securities, interest income from loans and securities, proceeds from repurchases of warrants and warrant preferred stock, and proceeds from warrant auctions. Treasury has sold 2.6 billion shares of Citigroup common stock for $10.5 billion, of which $8.5 billion is included in "Repayments," and $2.0 billion, which represents gains on the sales, is included in "Additional Proceeds." As of June 30, 2010, Treasury still owned 5.1 billion shares of Citigroup common stock.

[2]The "Additional Proceeds" for AGP include dividends relating to Citigroup preferred securities received in consideration for an asset guarantee, and a $276 million fee received from Bank of America relating to the termination of a potential loss-sharing agreement. On December 23, 2009, the Citigroup asset guarantee was terminated. Accordingly, as of June 30, 2010, TARP has no asset guarantee outstanding. Pursuant to the Citigroup asset guarantee termination, Treasury retained $2.2 billion in Citigroup trust preferred securities, and subject to certain conditions, the FDIC may transfer $800 million of additional Citigroup trust preferred securities to Treasury at the close of Citigroup's participation in the FDIC's Temporary Liquidity Guarantee Program.

Some programs have been terminated, such as the bank capital programs, while others are ongoing and could continue for some time. Furthermore, Treasury's investments in some financial institutions could still result in losses to the government.

Bank capital programs. Bank capital programs authorized under TARP, such as CPP, TIP, and the Capital Assistance Program (CAP), were established to help stabilize the financial system and ensure the flow of credit to businesses and consumers. Treasury is no longer disbursing funds through these programs because according to Treasury, they have largely achieved their goals of both stabilizing the financial system and individual institutions.

- CPP was intended to restore confidence in the banking system by increasing the amount of capital in the system. Treasury provided capital to qualifying financial institutions by purchasing preferred shares and warrants or subordinated debentures. Under the CPP, Treasury disbursed about $205 billion to 707 financial institutions nationwide from October 2008 through December 2009. Treasury has received about $147 billion in repayments and about $17 billion in dividend and interest payments and warrant income as of June 30, 2010. In our past reports, we have made numerous recommendations to strengthen transparency and accountability of this key TARP program. For instance, we recommended that Treasury report whether financial institutions' activities are generally consistent with the purposes of program. We also recommended that Treasury consider making the warrant valuation process transparent to the public by disclosing details regarding the warrant repurchase process. In both of these areas, Treasury has addressed these recommendations by releasing bank survey information on lending and detailed reports on warrant repurchases. However, as institutions leave the program, which includes the largest banks, they are no longer required to report information on lending to Treasury.

- TIP was designed to foster market stability and thereby strengthen the economy by investing in institutions that Treasury deemed critical to the functioning of the financial system on a case-by-case basis. Only two institutions—Bank of America Corporation and Citigroup Inc.—participated in this program and each received $20 billion in capital investment. Both institutions repaid Treasury for these investments in December 2009.

- CAP was designed to further improve confidence in the banking system by helping ensure that the nation's largest 19 U.S. bank holding companies had sufficient capital to cushion themselves against larger than expected future losses, as determined by the Supervisory Capital Assessment Program (SCAP)—or "stress test"—conducted by the federal banking regulators. CAP made TARP funds available to any institution not able to raise private capital to meet SCAP requirements. In the end, 9 of the 10 institutions that needed additional capital as a result of SCAP raised over

$70 billion from private sources, and GMAC received additional capital from Treasury under the Automotive Industry Financing Program (AIFP).[5] No CAP investments were made and the program closed on November 9, 2009.

Although these programs are no longer making new investments, the lessons learned from them will be useful in future efforts to stabilize the financial markets and improve ongoing bank supervision. We are currently reviewing the characteristics of firms that received CPP investments and assessing Treasury's procedures for selecting institutions to participate and Treasury's role when institutions elect to repay their CPP investments. We are also evaluating the process that the regulators used to design and implement SCAP, as well as the financial performance of the participating institutions compared to SCAP estimates. As part of this work, we will also assess how regulators and the banks are applying lessons learned from SCAP. We plan to issue reports on CPP and SCAP in the coming months.

Auto Industry Financing Program (AIFP). From December 2008 through June 2009, Treasury committed $81.1 billion to help stabilize the auto industry, including about $62 billion to fund GM and Chrysler while they restructured. In return for the assistance provided to Chrysler and GM, Treasury received 9.85 percent equity in the reorganized Chrysler, 60.8 percent equity and $2.1 billion in preferred stock in the reorganized GM, and $13.8 billion in debt obligations between the two companies. As of June 30, 2010, approximately $11.2 billion of the $79.7 billion disbursed has been repaid to the Treasury.[6] Treasury has stated that it plans to sell its equity in these companies as soon as practicable.

The federal government's ability to recoup its investments will depend on the profitability of GM and Chrysler. Since we last reported on the financial condition of the auto industry in November 2009, Chrysler and GM have shown some indications of progress towards returning to profitability.[7] For example:

[5]On May 10, 2010, GMAC Inc. changed its name to Ally Financial Inc.

[6]This amount includes $413 million repaid under the auto supplier support program and a $1.9 billion repayment from Chrysler Holding (CGI Holding) in settlement of one of the loans that Treasury extended to finance Chrysler LLC, the "Old Chrysler." The CGI Holding payment did not affect the amount of debt owed by the reorganized Chrysler.

[7]GAO-10-151.

- In April and May 2010, both the new GM and new Chrysler released financial statements for 2009 and the first quarter of 2010. Thus far, according to Treasury officials, both companies are doing better than they and Treasury had initially projected in terms of revenues, operating earnings, and cash flow. We are in the process of reviewing the financial statements in more detail for a subsequent report.
- Also in April 2010, GM repaid Treasury the remaining $4.7 billion on the $6.7 billion in debt it owed to Treasury using TARP funds from an escrow account established for the company when it reorganized through the bankruptcy process. According to Treasury officials, GM was legally permitted to keep the remaining $6.6 billion left in the escrow account after this repayment.
- Treasury recently stated that it plans to participate in a GM initial public offering (IPO), in which Treasury, other GM shareholders, and GM will sell a portion of their shares in the company. Treasury stated that it expects the IPO to occur sometime after the third quarter of this year. Treasury has hired the Lazard investment firm to help manage its equity and prepare for the IPO. The proceeds from the sale of Treasury's shares will be used towards repaying the government's initial investment in GM.

While these steps indicate progress in the companies' journey towards profitability, the extent to which the federal government will recoup its investment in the auto industry is uncertain, and the companies' face several challenges in the coming years. For instance:

- In April 2010, we reported on the impact of restructuring on GM's and Chrysler's pension plans.[8] We found that although the new companies had assumed sponsorship of the pension plans, the future of the plans remained uncertain, in part because the companies are legally required to make large contributions to the plans that they will be able to make only if they became profitable again. If the companies are not able to return to viability and their plans are terminated, the Pension Benefit Guarantee Corporation would face the significant financial and administrative costs of taking over these plans.
- While Chrysler and GM sales, and industry sales as a whole, were up substantially in spring 2010 from spring 2009 (up 12 percent for GM and 35 percent for Chrysler), more recent trends are not as positive. For example,

[8] GAO-10-492.

compared with May 2010 levels, June 2010 sales decreased more than usual (13 percent for GM and 12 percent for Chrysler).[9] Industry analysts largely attributed this decline to consumers' wariness about the state of the economy. Improved economic conditions, and in turn, improved vehicle sales, are critical to the future profitability of the companies and the timing and success of an IPO.

To help address these challenges, we made several recommendations in our November 2009 report. For example, we recommended that Treasury ensure that it had adequate staffing to monitor the government's investment in the auto companies and that it communicate to Congress its plans to monitor the companies' performance. In response to our recommendation, Treasury has hired additional staff to monitor the federal government's investment in the auto companies. However, as of July 2010 Treasury had not committed to additional communication with Congress on its future monitoring plans. In addition, we are continuing to monitor the financial condition of the industry and in ongoing work are reviewing the current financial condition and outlook of GM and Chrysler. As part of that ongoing work, we are also reviewing the status of the federal government's efforts to assist workers and communities that have relied on the auto industry for their economic base.

American International Group, Inc (AIG) Investments. One of TARP's earliest programs was designed to provide exceptional assistance aimed at preventing broad disruptions to the financial markets by stabilizing institutions that were considered systemically significant. In particular, in November 2008 Treasury joined the Federal Reserve's effort to provide assistance to AIG, which first began in September 2008 and was restructured in November 2008 and again in March 2009. Since early 2009, we have been monitoring the status of federal assistance to AIG and the company's financial condition using GAO-developed indicators and we have issued two reports that include information on them.[10] In the April 2010 report, our indicators showed that AIG's financial condition had remained relatively stable largely due to the federal assistance from the Federal Reserve and Treasury. AIG is repaying its debt to the federal government, but much of the progress reflects numerous exchanges of

[9]According to Edmunds.com, auto sales typically decrease by approximately 3 percent from May to June each year.

[10]GAO, *Troubled Asset Relief Program: Status of Government Assistance to AIG*, GAO-09-975 (Washington, D.C.: Sept. 21, 2009) and GAO-10-475.

debt that AIG owed the Federal Reserve Bank of New York Revolving Credit Facility for various issues of preferred equity. With this shift from debt to equity, the federal government's exposure to AIG is increasingly tied to the future health of AIG, its restructuring efforts, and its ongoing performance. Similarly, the government's ability to fully recoup the federal assistance is uncertain and will be determined by the long-term health of AIG, the company's success in selling businesses as it restructures, and other market factors such as the performance of the insurance sectors and the credit derivatives markets that are beyond the control of AIG or the government. We will continue to monitor these issues and plan to issue our next report in October 2010.[11]

Home Affordable Modification Program (HAMP). HAMP is Treasury's cornerstone effort under TARP to meet the act's purposes of preserving homeownership and protecting home values and is designed to address the dramatic increase in foreclosures. Treasury announced the framework for HAMP in 2009 and said it would use up to $50 billion of TARP funds to help at-risk homeowners avoid potential foreclosure, primarily by reducing their monthly mortgage payment. Unlike other TARP programs, HAMP expenditures are not investments that will be partially or fully repaid, but rather, expenditures that once made will not be recouped. According to Treasury, $250 million has been disbursed under the HAMP program as of June 30, 2010. In our March 2010 testimony before the House of Representatives' Committee on Oversight and Government Reform, we noted that Treasury continued to face implementation challenges with HAMP.[12] We stated that the program had made limited progress, suffered from inconsistent program implementation, and faced additional challenges going forward. Specifically:

- While the program was anticipated to help 3 to 4 million homeowners, Treasury reported as of the end of May 2010, only 1.2 million homeowners had started trial modifications and 347,000 homeowners had received

[11] In a current study requested by the House Committee on Oversight and Government Reform and the House Committee on Financial Services, we are examining the decision-making process and actions taken by the Federal Reserve in providing aid to the company, as well as considering lessons learned in the federal government's financial rescue of the firm.

[12] GAO, *Troubled Asset Relief Program: Home Affordable Modification Program Continues to Face Implementation Challenges*, GAO-10-556T (Washington, D.C.: Mar. 25, 2010).

permanent modifications. Servicers told us that the continued changes to the program posed significant implementation challenges for them.

- Although HAMP's goal was to create clear, consistent, and uniform guidance for loan modifications across the industry, we reported that there was wide variation in servicers' practices with respect to communicating with borrowers about HAMP, evaluating borrowers who were current or not yet 60 days delinquent on mortgage payments for whether they were in danger of "imminent default," and tracking HAMP complaints.
- Finally, we identified additional challenges that HAMP faced going forward, including converting trial modifications to permanent status, addressing the growing issue of negative equity, limiting redefaults among borrowers who receive modifications, and ensuring program stability and effective program management.

In June 2010, we issued a report that expanded on our March testimony and discussed Treasury's actions to address the challenges that we had outlined in the March hearing.[13] We reported that while Treasury had taken some steps to address these challenges it urgently needed to finalize and implement the various components of HAMP and ensure the transparency and accountability of these efforts. For example, Treasury announced several potentially substantial new HAMP-funded efforts in March 2010, but did not say how many borrowers these programs were intended to reach. In particular, Treasury announced a principal reduction program that could help borrowers with substantial negative equity, but made the program voluntary for servicers. We noted that Treasury needed to ensure that future public reporting on this program provided program transparency and address the potential question of whether borrowers were being treated fairly. In addition, we reported that as Treasury continues with its first-lien mortgage loan modification program and implements other HAMP-funded programs, including the second-lien modification and foreclosure alternatives, it will need to adhere to standards for effective program management and establish sufficient program planning and implementation capacity.

Our June 2010 report contained eight recommendations to Treasury, including that it expeditiously establish specific criteria for imminent

[13] GAO-10-634.

default, specify which HAMP complaints servicers should track, finalize and issue remedies for servicer noncompliance with HAMP requirements, and implement a prudent design for remaining HAMP-funded programs. However, Treasury has yet to fully implement several of the recommendations we made in July 2009 to improve HAMP's effectiveness, transparency, and accountability.[14] For example, we recommended that Treasury consider methods of monitoring borrowers who receive HAMP mortgage loan modifications and continue to have high total household debt (more than 55 percent of their income) to determine whether they obtain the required HUD-approved housing counseling. While Treasury has told us that monitoring borrower compliance with the counseling requirement would be too burdensome, we continue to believe that it is important that Treasury determine whether borrowers are actually receiving counseling and whether the counseling requirement is having its intended effect of limiting redefaults. In addition, we recommended that Treasury place a high priority on fully staffing the Homeownership Preservation Office—the office within Treasury responsible for overseeing HAMP implementation—and noted that having enough staff with appropriate skills was essential to governing HAMP effectively. However, Treasury has since reduced the number of staff in this office without formally assessing staffing needs. We believe that having sufficient staff is critical to Treasury's ability to design and implement HAMP-funded programs quickly and effectively. We will continue to monitor Treasury's implementation and management of HAMP-funded programs as part of our ongoing oversight of TARP to ensure that these programs are appropriately designed and operating as intended.

Small Business Initiatives. TARP also includes programs that have a small business emphasis or component. Treasury has announced two new initiatives aimed at small business lending. The Community Development Capital Initiative (CDCI) will provide capital to Community Development Financial Institutions (CDFIs). CDCI is open to CDFI-certified banks, thrifts, and credit unions which have been certified by Treasury's CDFI Fund as targeting more than 60 percent of their small business lending and other economic development activities to underserved communities. The second initiative, the Small Business and Community Lending Initiative, refers to Treasury's SBA 7(a) securities purchase program, which makes

[14]See GAO, *Troubled Asset Relief Program: Treasury Actions Needed to Make the Home Affordable Modification Program More Transparent and Accountable*, GAO-09-837(Washington, D.C.: July 23, 2009).

direct purchases of securitized loan pools guaranteed under SBA's 7(a) small business loan guarantee program.[15] Finally, the Term Asset-Backed Securities Loan Facility (TALF), which is winding down, accepted asset-backed securities (ABS) as collateral for loans to restore liquidity in securitization markets, including securities consisting of SBA-guaranteed loan pools. We are currently reviewing these efforts and our objectives are to assess the data that are available on small business lending and to assess the status of Treasury's actions in meeting its goals for these programs.

Term Asset-Backed Securities Loan Facility (TALF). TARP was also intended to address problems in the securitization markets. TALF was designed to restore the securitization markets and improve access to credit for consumers and businesses.[16] It is administered by the Board of Governors of the Federal Reserve System (Federal Reserve) and the Federal Reserve Bank of New York (FRBNY) and Treasury committed $20 billion of TARP funds for credit protection for TALF assets. The program stopped accepting ABS and legacy commercial mortgage-backed securities (CMBS) as collateral for new loans in March 2010 and new-issue CMBS in June 2010. FRBNY issued about $71 billion in TALF loans, with most of them secured by credit card ABS, legacy CMBS, and auto loan ABS. Our analysis in our February 2010 report suggested that the securitization markets improved for the more frequently traded TALF-eligible sectors after the program's first activity in March 2009.[17] However, we did not find clear evidence that consumer credit rates changed significantly after TALF started. FRBNY officials said that it is possible that without TALF, interest rates on loans to consumers and small businesses could have been much higher.

We reported in February 2010 that TALF contained a number of features to help reduce the risk of loss to TARP funds. Analyses by Treasury and FRBNY project minimal, if any, use of TARP funds for TALF-related losses, and Treasury currently anticipates a profit. We found that CMBS could

[15]Treasury also had plans to purchase securities consisting of SBA 504 loan guarantees but has not made such purchases.

[16]The program provided nonrecourse loans to investors to purchase AAA-rated asset-backed securities (ABS) and commercial mortgage-backed securities (CMBS), which are in turn pledged as collateral for the loans.

[17]GAO-10-25. Given GAO's limitation on reviewing the Federal Reserve's monetary policy activities, we focused on Treasury's role in TALF.

pose a higher risk of loss than ABS, given the ongoing uncertainty in the commercial real estate market.[18] For this reason, we recommended that Treasury give greater attention to risks in commercial real estate and CMBS markets. In response, Treasury developed internal tracking reports to assess these trends.

We also found that at the outset of TALF, Treasury had not fully documented the rationale for final decisions that were made on managing risks associated with TALF—including decisions involving the Federal Reserve. We found that Treasury's analysis of TALF-related risks sometimes differed from FRBNY's and that Treasury lacked clear documentation on how it resolved discrepancies or made final decisions with the Federal Reserve and FRBNY. Documenting such rationales increases transparency and strengthens internal controls for decision making. Since the report, Treasury has created a process document that details how it assesses changes to TALF program terms proposed by the Federal Reserve, including specifying levels of management review and approval. In addition, Treasury has a formal process for assessing outside analyses it may request for assessing risks to TARP.

Finally, while Treasury bears the first-loss risk from assets that TALF borrowers might surrender in conjunction with unpaid loans, it has not developed measures to analyze and publicly report on the potential purchase, management, and sale of such assets. Without such a plan, Treasury may not fully and publicly disclose how such surrendered assets are managed and financed, undermining Treasury's efforts to be fully transparent about TARP activities. We recommended that Treasury review the data it might collect and publicly report on the event that any collateral is surrendered to TALF LLC and Treasury lends to it. To date, Treasury has not provided evidence that it has conducted such a review or established such a plan, though officials stated that they would hire an asset manager to assist in managing surrendered assets in order to protect taxpayer interests and noted that Treasury was committed to transparency regarding such assets.[19]

[18]Commercial real estate values have dropped by about 40 percent since their peak in 2007 and CMBS volumes by number have decreased by about 90 percent since their 2006 year-end peak.

[19]As of July 16, 2010 no TALF assets have been surrendered to TALF LLC.

Treasury's Framework for Deciding to Extend TARP Was Sufficient, but Could be Strengthened For Future Decisions

In anticipation of the upcoming decisions on the future of TARP, the need to unwind the extraordinary federal support across the board, and the fragile state of the economy, we made recommendations to Treasury in October 2009. Specifically, we suggested that any decision to extend TARP be made in coordination with relevant agencies and that Treasury use quantitative analysis whenever possible to support its reasons for doing so. We noted that without a robust analytic framework, Treasury could face challenges in effectively carrying out the next stages of its programs. Subsequently, on December 9, 2009, the Secretary of the Treasury notified Congress that he was extending the authority for TARP provided under the act until October 3, 2010.[20] The extension involved winding down some programs while extending others, transforming the program to one focused primarily on preserving homeownership and improving financial conditions for small banks and businesses. As such, according to Treasury, new commitments through October 3, 2010 will be limited to programs, under the Making Home Affordable Program (MHA), including HAMP, and small business lending programs. The Dodd-Frank Wall Street Reform and Consumer Protection Act, passed by both the House and Senate and expected to be signed by the President this week, would (1) reduce Treasury's authority to purchase or insure troubled assets to $475 billion and (2) prohibit Treasury, under the act, from incurring any additional obligations for a program or initiative unless the program or initiative had already been initiated prior to June 25, 2010.

In reviewing the analytical process underpinning this decision to extend TARP, we reported that Treasury used a deliberative process that included sufficient interagency coordination and consultation and considered a number of qualitative and quantitative factors.[21] However, we noted that the extent of coordination could be enhanced and formalized, specifically with the FDIC, for any upcoming decisions that would benefit from interagency collaboration. Although the economy is still fragile, a key priority will be to develop, coordinate, and communicate exit strategies to unwind the remaining programs and investments resulting from the extraordinary crisis-driven interventions. Because TARP will be unwinding concurrently with other important interventions by federal regulators,

---

[20]Treasury's authority under EESA to purchase, commit to purchase, or commit to guarantee troubled assets was set to expire on December 31, 2009, unless the Secretary submitted a written certification to Congress extending these authorities. EESA § 120, 122 Stat. at 3788 (codified at 12 U.S.C. § 5230).

[21]GAO-10-531.

decisions about the sequencing of the exits from various federal programs will require bringing a larger body of regulators to the table to plan and sequence the continued unwinding of federal support. We also noted that Treasury could strengthen its analytical framework by identifying clear objectives for small business programs and explaining how relevant indicators motivated TARP program decisions. Finally, we recommended (1) formalizing coordination with FDIC for future TARP decisions and (2) improving the transparency and analytical basis for TARP program decisions. Though TARP will soon expire, Treasury will still need to work with other agencies to effectively conduct a coordinated exit from TARP and other government financial assistance.

Indicators Suggest a Recovery in Credit Markets, but Isolating the Impact of TARP's Foreclosure Mitigation and Small Business Lending Efforts Will Be Difficult

Many market observers have said that, taken together, the concerted actions by Treasury and others helped avert a more severe financial crisis, although some critics believe that the markets would have recovered without government support. Particular programs have been reported to have had the desired effects, especially if stabilizing the financial system and restoring confidence was considered to be the principal goal of the intervention. In our October 2009 and February 2010 reports we noted that some of the anticipated effects of TARP on credit markets and the economy had materialized and that some securitization markets had experienced a tentative recovery. During our review of the decision to extend TARP, Treasury noted that some programs that it believed had accomplished their goals would be terminated. For example, as noted earlier, Treasury ended CPP and CAP largely because of banks' renewed ability to access capital markets. It also noted improvements in securitization markets and stabilization of certain legacy asset prices as motivating the closing of TALF and the Public Private Investment Program (PPIP).[22] Indicators we have been monitoring suggest credit markets have been able to sustain their recovery despite the winding down of key programs initiated by the Federal Reserve, Treasury, FDIC and others. As shown in table 2 interbank, mortgage, corporate debt, and securitization markets continue to perform better than their pre-TARP lows. The cost of credit and perceptions of risk (as measured by premiums over Treasury securities) have fallen in interbank, mortgage, and corporate debt markets,

[22]"Closed" means no new agreements to undertake transactions will occur through the program, but does not necessarily imply no activity is occurring. Many of the programs have resulted in equity investments, loans, and commitments that remain outstanding.

and the volume of credit, as measured by new mortgage loans and asset-backed securities, has increased since the first TARP program, CPP.

Table 2. Select Credit Market Indicators as of July 6, 2010

Credit market rates and spreads		
Indicator	**Description**	**Basis point change since October 13, 2008**
LIBOR	3-month London interbank offered rate (an average of interest rates offered on dollar-denominated loans)	Down 422
TED Spread	Spread between 3-month LIBOR and 3-month Treasury yield	Down 414
Aaa bond rate	Rate on highest quality corporate bonds	Down 179
Aaa bond spread	Spread between Aaa bond rate and 10-year Treasury yield	Down 85
Baa bond rate	Rate on corporate bonds subject to moderate credit risk	Down 275
Baa bond spread	Spread between Baa bond rate and 10-year Treasury yield	Down 181
Mortgage rate	30-year conforming loan rate	Down 189
Mortgage spread	Spread between 30-year conforming loan rate and 10-year Treasury yield	Down 89
Quarterly mortgage and ABS volumes, and mortgage defaults		
Indicator	**Description**	**Change from 4Q 2008 to 1Q 2010**
Mortgage originations	New mortgage loans	Up $60 billion to $320 billion
Asset-backed security issuance	New securities backed by auto loans, credit cards, student loans, and commercial mortgages	Up $19 billion to $21 billion
Foreclosure rate	Percentage of homes in foreclosure	Up 133 basis points to 4.63 percent

Source: GAO analysis of data from Global Insight, the Federal Reserve, Thomson Reuters, and Inside Mortgage Finance.

Note: Rates and yields are daily except mortgage rates, which are weekly. Higher spreads (measured as premiums over Treasury securities of comparable maturity) represent higher perceived risk in lending to certain borrowers. Higher rates represent increases in the cost of borrowing for relevant borrowers. As a result, "Down" suggests improvement in market conditions for credit market rates and spreads. Foreclosure, asset-backed security issuance and mortgage origination data are quarterly. See previous TARP reports for a more detailed discussion (GAO-09-161 and GAO-09-296).

Unfortunately, rising foreclosures continue to highlight the challenges facing the U.S. economy. By any measure foreclosure and delinquency statistics for residential housing remain well above their historical averages despite programs such as HAMP. However, a slow recovery does not necessarily mean that TARP is ineffective, because in absence of TARP it is possible that foreclosure and delinquency rates would be higher. Moreover, full recovery will likely take some time given the build up of imbalances in the real estate, fiscal and household sectors over several years.

Experience with past financial crises, coupled with analyses of the specifics of the current situation, has led the Congressional Budget Office to predict a modest recovery that will not be robust enough to appreciably improve weak labor markets through 2011. Weaknesses in labor markets will likely weigh on residential housing markets. Given that any new TARP activity will be limited to home ownership preservation and small business lending programs, we will continue to monitor indictors such as foreclosure and delinquencies as potential measures of the efficacy of these programs. Isolating the impact of TARP from general market forces and other foreclosure initiatives will be a challenge. This challenge will be compounded in the area of small business lending because Treasury has yet to set explicit objectives for its small business lending programs and because a lack of comprehensive data on new lending makes assessing credit conditions for small business particularly difficult. In recommending that Treasury improve the transparency and analytical basis for TARP program decisions, we specifically noted the need to set quantitative program objectives for its small business lending programs and identify any additional data needed to make program decisions.

Mr. Chairman and Members of the Committee, I appreciate the opportunity to discuss these critically important issues and would be happy to answer any questions that you may have. Thank you.

For further information on this testimony, please contact Richard J. Hillman on (202) 512-8678 or hillmanr@gao.gov, Orice Williams Brown on (202) 512-8678 or williamso@gao.gov, or Thomas McCool on (202) 512-2642 or mccoolt@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement.

Appendix I: Related GAO Products

Troubled Asset Relief Program: Treasury's Framework for Deciding to Extend TARP Was Sufficient, but Could be Strengthened for Future Decisions. GAO-10-531. Washington, D.C.: June 30, 2010.

Troubled Asset Relief Program: Further Actions Needed to Fully and Equitably Implement Foreclosure Mitigation Program. GAO-10-634. Washington, D.C.: June 24, 2010.

Troubled Asset Relief Program: Update of Government Assistance Provided to AIG. GAO-10-475. Washington, D.C.: April 27, 2010.

Troubled Asset Relief Program: Automaker Pension Funding and Multiple Federal Roles Pose Challenges for the Future. GAO-10-492. Washington, D.C.: April 6, 2010.

Troubled Asset Relief Program: Home Affordable Modification Program Continues to Face Implementation Challenges. GAO-10-556T. Washington, D.C.: March 25, 2010.

Troubled Asset Relief Program: Treasury Needs to Strengthen Its Decision-Making Process on the Term Asset-Backed Securities Loan Facility. GAO-10-25. Washington, D.C.: February 5, 2010.

Troubled Asset Relief Program: The U.S. Government Role as Shareholder in AIG, Citigroup, Chrysler, and General Motors and Preliminary Views on its Investment Management Activities. GAO-10-325T. Washington, D.C.: December 16, 2009.

Financial Audit: Office of Financial Stability (Troubled Asset Relief Program) Fiscal Year 2009 Financial Statements. GAO-10-301. Washington, D.C.: December 9, 2009.

Troubled Asset Relief Program: Continued Stewardship Needed as Treasury Develops Strategies for Monitoring and Divesting Financial Interests in Chrysler and GM. GAO-10-151. Washington, D.C.: November 2, 2009.

Troubled Asset Relief Program: One Year Later, Actions Are Needed to Address Remaining Transparency and Accountability Challenges. GAO-10-16. Washington, D.C.: October 8, 2009.

Troubled Asset Relief Program: Status of Efforts to Address Transparency and Accountability Issues. GAO-09-1048T. Washington, D.C.: September 24, 2009.

Troubled Asset Relief Program: Status of Government Assistance Provided to AIG. GAO-09-975. Washington, D.C.: September 21, 2009.

Troubled Asset Relief Program: Treasury Actions Needed to Make the Home Affordable Modification Program More Transparent and Accountable. GAO-09-837. Washington, D.C.: July 23, 2009.

Troubled Asset Relief Program: Status of Efforts to Address Transparency and Accountability Issues. GAO-09-920T. Washington, D.C.: July 22, 2009.

Troubled Asset Relief Program: Status of Participants' Dividend Payments and Repurchases of Preferred Stock and Warrants. GAO-09-889T. Washington, D.C.: July 9, 2009.

Troubled Asset Relief Program: June 2009 Status of Efforts to Address Transparency and Accountability Issues. GAO-09-658. Washington, D.C.: June 17, 2009.

Auto Industry: Summary of Government Efforts and Automakers' Restructuring to Date. GAO-09-553. Washington, D.C.: April 23, 2009.

Troubled Asset Relief Program: March 2009 Status of Efforts to Address Transparency and Accountability Issues. GAO-09-504. Washington, D.C.: March 31, 2009.

Federal Financial Assistance: Preliminary Observations on Assistance Provided to AIG. GAO-09-490T. Washington, D.C.: March 18, 2009.

Troubled Asset Relief Program: Status of Efforts to Address Transparency and Accountability Issues. GAO-09-417T. Washington, D.C.: February 24, 2009.

Troubled Asset Relief Program: Status of Efforts to Address Transparency and Accountability Issues. GAO-09-359T. Washington, D.C.: February 5, 2009.

Troubled Asset Relief Program: Status of Efforts to Address Transparency and Accountability Issues. GAO-09-296. Washington, D.C.: January 30, 2009.

Troubled Asset Relief Program: Additional Actions Needed to Better Ensure Integrity, Accountability, and Transparency. GAO-09-266T. Washington, D.C.: December 10, 2008.

Auto Industry: A Framework for Considering Federal Financial Assistance. GAO-09-242T . Washington, D.C.: December 4, 2008.

Troubled Asset Relief Program: Status of Efforts to Address Defaults and Foreclosures on Home Mortgages. GAO-09-231T. Washington, D.C.: December 4, 2008.

Troubled Asset Relief Program: Additional Actions Needed to Better Ensure Integrity, Accountability, and Transparency. GAO-09-161. Washington, D.C.: December 2, 2008.

Statement for the Record
Senate Finance Committee
Oversight Hearing on the Troubled Asset Relief Program
Senator Olympia J. Snowe

Mr. Chairman, thank you for holding this critical oversight hearing on the Troubled Asset Relief Program (TARP). Mr. Barofsky, Mr. Hillman, and Ms. Warren, I welcome you here today. Your work overseeing the Treasury Department's implementation of TARP has been critical to fighting fraud, waste, abuse, and misuse of the $700 billion Congress originally allocated to stabilize financial markets.

As a result of the Dodd-Frank "Wall Street Reform and Consumer Protection Act," the TARP program will now end over two months before its scheduled sunset on October 3, 2010. While TARP will still remain in existence and the Treasury Department will continue its efforts to recover funds already obligated, the bill will reduce TARP's authorization from $700 billion to $495 billion and prohibit the allocation of available funds to any new initiatives or programs.

One of the main reasons I supported the Dodd-Frank bill was so that we would never have to repeat the haphazard response to the financial crisis of 2008 which led to the creation of TARP. The Financial Stability Oversight Council established through the Dodd-Frank bill has stated and clear controls over systemically important firms. In addition, the wind down features within the bill will ensure that there is a clearly benchmarked path for the failure of these financial firms. Most critically, the Dodd-Frank bill makes sure that Congress will never again have to use taxpayer dollars to save the American economy from a second Great Depression.

As a result of ending the TARP program, we are now embarking on a new phase of oversight. First, we must examine whether or not TARP actually did what it was intended to do. The TARP program was initially necessary to stave off the collapse of the American economy but its goals also included bringing access to credit to small businesses, stabilizing the housing market and preventing foreclosures, and fostering economic recovery. Unfortunately, looking at the state of the American economy, it is clear that none of these goals has been achieved.

The Congressional Oversight Panel's July 2010 Oversight Report titled, "Small Banks in the Capital Purchase Program," finds, ". . . there is very little evidence to suggest that the CPP led small banks to increase lending." In the broader economy, the Federal Reserve's Senior Loan Officer Opinions Survey reports that a meager 1.9 percent of all banks eased credit for small businesses. I have introduced legislation to use unobligated Stimulus funds to fund fee reductions in the Small Business Administration's (SBA) 7(a) and 504 loan programs and increase the guarantee rate for the SBA's 7(a) program to 90 percent. These programs were initially enacted in the Stimulus and were widely credited with increasing SBA lending over 90 percent nationally and 236 percent in Maine, before they lapsed at the end of May. But TARP now represents a multi-billion-dollar missed opportunity to improve access to credit for small firms.

On the housing front, foreclosure rates continue to skyrocket, and according to RealtyTrac, more than one million American households are likely to lose their homes to foreclosure in 2010. As for the claim that TARP would help foster economic recovery, the facts speak for themselves. An unemployment rate hovering near 10 percent nationally and at 8 percent in Maine is no recovery at all.

As the TARP program begins to reach its conclusion, I commend Mr. Barofsky for his efforts to investigate bank lending and executive compensation, as well as Mr. Dodaro's and Ms. Warren's extensive recommendations on how Treasury could better manage the TARP program and use it to help the American economy recover. The yeoman work of the witnesses here today has most certainly served the American people well and saved them billions of dollars.

As we move forward with this program, two new goals must be clear. First, we must ensure that the TARP does in fact end now. It is said that there is nothing more permanent than a temporary government program. We must ensure that with TARP, this is not the case. Second, the TARP program must continue its efforts to increase recoveries to the Treasury. With the national debt at an astonishing $13 trillion, TARP recipients who have benefitted from the government's help must pay their full fair share. I was encouraged to read that as of July 11, the Treasury Department now has more funds repaid than TARP funds outstanding, but we must not rest until every single penny of tax dollars that can be returned, is returned.

According to the Treasury Department, there are $190 billion in TARP funds outstanding as of July 11. Ms. Warren, over a year ago in March 2009 you framed the challenge of the TARP program, with these words: "Our ultimate question is whether TARP is operating to benefit the American family and the American economy." Now, at this phase of the TARP program, our challenge to help American families and the American economy is to ensure speedy repayment of those funds and maximum returns for the Treasury Department's outstanding investments. Today, I look forward to hearing all of your views on how the Treasury Department can effectively steward these funds.

I would like to thank you again, Mr. Chairman, for holding this vital hearing. As TARP moves onto this new phase, we must continue to exercise vigilant oversight over this program ensuring that its funds are returned back to the Treasury as quickly and completely as possible.

Thank you.

U.S. Senate Committee on Finance
"An Update on the TARP Program"
Testimony of Elizabeth Warren
Chair, Congressional Oversight Panel
July 21, 2010

Thank you Chairman Baucus, Ranking Member Grassley, and members of the Committee for inviting me to testify on the Troubled Asset Relief Program (TARP). My name is Elizabeth Warren and I am chair of the Congressional Oversight Panel established under the Emergency Economic Stabilization Act of 2008 (EESA). The Panel is charged under the statute to report to Congress every 30 days on the Secretary of the Treasury's use of his authority under EESA and the current state of financial markets. We share a commitment to bringing transparency and accountability to TARP, and I am pleased to assist your efforts in whatever way I can.

Before I begin, I should note that although I am the chair of the Panel, I cannot possibly reflect the thoughtful and independent views of each of my four other panelists. The testimony I will give today is my own and is not necessarily a reflection of the views of the entire Panel.

Since I last testified before this Committee, much has changed in both the financial markets and in TARP itself. One year ago, our country and indeed the global economy were in the midst of what we then believed to be a deepening financial crisis.

It is clear now that as part of a coordinated government response TARP had a profound effect bringing our economy back from the brink of collapse. It is easy to forget the panic that pervaded the financial markets in the fall of 2008 and the very real threat that it would spread to the broader economy, devastating families, small businesses and communities throughout the nation.

By the end of last year, however, there still remained the risk of unforeseen shocks to the marketplace that could disrupt the stability created through TARP. In his December 9, 2009, letter to Congress, Secretary Geithner extended TARP through October 3, 2010, noting the continued risks to financial stability as well as the unmet goals established by Congress in authorizing TARP to restart the flow of credit to small businesses and to help families keep their homes by minimizing foreclosures.

To date, the Treasury has committed to spend $520.3 billion under TARP: $249.9 billion in direct support to repair bank balance sheets, $84.8 billion in support of the domestic automotive industry, $69.8 billion in funding to support American International Group (AIG), $50 billion for foreclosure prevention and $65.8 for related financial stability efforts.

Of those funds, $197.1 billion has been repaid, and the taxpayers have seen additional returns in the forms of dividends, warrant repurchases and fees of $22.8 billion. A total of $5.8 billion has been lost under the program due to funds committed prior to the structured bankruptcies of Chrysler and General Motors (GM) and the failure of four banks participating in the Capital Purchase Program (CPP). It is important to remember also that funds used to prevent foreclosures through the Home Affordable Modification Program (HAMP) and other efforts are not intended to be repaid. In the fifteen months that the program has been in effect, however,

only $247.5 million of the $47.9 billion dollars committed to HAMP—less than one-half of one percent—has been spent.

The twin themes of accountability and transparency have driven the work of the Congressional Oversight Panel since our first report to Congress in December 2008. The Panel will continue to recommend that Treasury release more data, establish internal metrics for measuring the success of TARP programs, and describe the legal and policy justifications of their authority in administering the TARP. In our oversight of Treasury there has been progress: Treasury staff now meets with Panel staff in preparation for our reports and Treasury officials now testify before the Panel on a regular basis.

The Panel received a commitment from Secretary Geithner to appear before the Panel quarterly and we hope to hear from him again before our work concludes.

Congress gave Treasury unprecedented authority when it passed TARP, but at the same time it coupled that authority with unprecedented oversight. That oversight has promoted a level of transparency and accountability that has benefited the taxpayers. We work closely with our oversight partners, the Special Inspector General for TARP (SIGTARP) and the Government Accountability Office (GAO), to complement, not duplicate, one another. Our goal is to make the whole of our work greater than the sum of its parts.

Over the past year and a half, the Congressional Oversight Panel has issued 21 monthly reports and two special reports, as required by statute. Our topics have ranged from a dollars-and-cents analysis of the value of the bank warrants that Treasury was selling in the Capital Purchase Program to a review of the government's investment in specific companies, such as AIG, Chrysler and GM, and GMAC. All the reports, along with summaries and videos, are available online at cop.senate.gov. By way of review, I offer a summary of our four most recent reports, then a discussion of the broader themes the Panel has uncovered in our TARP oversight work:

Small Banks in the Capital Purchase Program

The Panel's most recent report analyzed the participation of small banks in the CPP. Under the program, Treasury put money into 707 banks. The Panel found the experience of small banks differed substantially from that of the nation's largest financial institutions. Seventeen of the 19 U.S. banks and bank holding companies, with assets totaling more than $100 billion, received the majority of funds (81 percent), most getting their money within weeks of the announcement of the program. Now 76 percent have repaid their TARP funds and returned to profitability. On the other hand, small banks entered the program more slowly, and ultimately most—about 90 percent—stayed out of TARP altogether. Notwithstanding the fact that those small banks that received TARP funds were required to prove their financial health, fewer than 10 percent have managed to repay their TARP obligations, and 15 percent have failed to pay at least one of their outstanding dividends. Their problems are substantial. Small banks face serious difficulties with the coming wave of commercial real estate loans resets. Moreover, small banks do not have the same access to the capital that larger banks have, and investors know that these regional and

local banks are not too big to fail. Worse yet, if they cannot exit from TARP in the next few years, they face a TARP dividend that will increase sharply from 5 to 9 percent.

The AIG Rescue, Its Impact on Markets, and the Government's Exit Strategy

The Panel concluded in our June report that Treasury and the New York Federal Reserve Bank failed to explore all other options before committing $85 billion in taxpayer funds to rescue AIG. Treasury also failed to address potential and perceived conflicts of interest, giving the impression that accountability and transparency were less important than rescuing Wall Street. Furthermore, the rescue of AIG distorted the marketplace by turning AIG's risky bets into fully guaranteed transactions. Instead of forcing AIG and its counterparties to bear the costs of the company's failure, the government shifted those costs in full onto taxpayers. Even today, nearly two years later, it remains uncertain whether taxpayers will be repaid. Because the rescue of AIG committed taxpayers to pay any price to prevent the collapse of one of America's largest financial institutions, it continues to have a poisonous effect on the marketplace, creating distortions in investment and competitive advantages for some players and disadvantages for others.

The Small Business Credit Crunch and the Impact of the TARP

The Panel's May report examined the impact of TARP on small business lending and found that the program did not significantly increase small business lending. Between 2008 and 2009, large banks cut back on overall lending by 4 percent—but they cut back on small business lending by more than double that amount, 9 percent. Small banks have not been able to fill in the gap; they have also cut small business lending. The many difficulties facing small banks are reflected in their inability to support small business lending. Without access to credit, America's small businesses cannot meet demand or grow, potentially choking off a broader economic recovery. Furthermore, this disproportionate credit crunch risks tilting America's playing field against small businesses and in favor of their larger competitors.

Evaluating the Progress of TARP Foreclosure Mitigation Programs

Our mandate under EESA specifically requires the Panel to report to Congress on the effectiveness of foreclosure mitigation efforts. To that end, the Panel's April report was our third focused on the HAMP program and the health of the residential mortgage market. When I last appeared before this Committee, I testified that the Panel had included in our March 2009 report a checklist of characteristics any successful foreclosure mitigation strategy must include. The Panel was concerned that Treasury's program was too small, that it was too slow and that it did not create permanent solutions. The Panel raised specific concerns about the program's failure to address second mortgages or homeowners who are "underwater"—that is, the balance of their mortgage exceeds the value of their home. While some progress has been made in these and

other areas of the program, HAMP continues to suffer from the constraints the Panel identified at the outset.

Congress was clear when it passed TARP that Treasury should make foreclosure prevention a priority. The Panel found in our April report, however, that Treasury's response is lagging behind the pace of the crisis. For every family that Treasury has helped into a sustainable mortgage modification, ten other families have lost their homes to foreclosure. Foreclosures show no clear signs of abating. Treasury has lost its opportunity to get ahead of the problem. Instead, its programs trail behind, while millions of homeowners continue to receive foreclosure notices and the real estate market shows little sign of recovery.

While we hope the Panel's monthly reports have provided you with important information and critical analysis in your roles as policymakers, I want to highlight some of the broad themes that inform our oversight:

Marketplace Distortion

As I testified earlier, TARP succeeded in preventing the spread of a financial panic. While nothing in my testimony should take away from that monumental achievement, it is important to understand how this result was achieved. The Panel has found repeatedly that market participants believe that TARP and other financial stability efforts signaled that the federal government stood ready, willing and able to ensure that the American taxpayer would pay any price and bear any burden to prevent the collapse of the nation's largest financial institutions. The unfortunate consequence, however, is that this has distorted the financial marketplace and infected pricing and calculations of risk.

One legacy of TARP will be the moral hazard it created among the nation's largest financial institutions. Because the market views these institutions as the beneficiary of an implicit government guarantee—in other words, policymakers fear they are "too big to fail"—market participants will assume greater risks and accept a different price than they would otherwise when transacting with these companies.

A clear example of this implicit guarantee can be found in the credit ratings assigned to the nation's largest commercial bank. On February 10, 2010, Standard & Poor's issued Citigroup's senior debt a credit rating of "A"—three grades higher than it would otherwise—"to reflect the likelihood that if further extraordinary government support were needed, it would be forthcoming."

Citigroup received $49 billion in TARP funds, including a guarantee of a pool of approximately $301 billion in assets, along with access to other government financial stability support. This assistance is already factored into Citigroup's standalone credit profile. It is the market's expectation of additional government support in the future, should it be needed, that allows Citigroup and other institutions to raise capital and conduct other market transactions at a lower cost than they would otherwise. Similarly, AIG received a five-notch upgrade on its senior debt due to the assumption of further government support if necessary.

The opposite effect can be seen in the ability of small banks to raise capital and repay their TARP funds. Unlike their larger counterparts, small banks are not seen as beneficiaries of an implicit government guarantee. In combination with a distressed capital market for these institutions, it is nearly impossible for them to raise the funds in the private capital markets necessary to repay taxpayers and exit the program.

While the Panel has taken no position on a specific remedy for Congress to consider in dealing with the issue of "too big to fail"—including the recently passed Wall Street Reform and Consumer Protection Act—we do believe that a broad consensus exists that we need a new approach to systemic risk regulation.

Weak Banks, Weak Economy

The Panel's reports have also emphasized the interdependence between the health of the financial system and the health of the nation's economy. The legislation authorizing the Secretary of the Treasury to spend $700 billion to stabilize the financial sector does not grant these extraordinary powers for the sake of saving the banks themselves. The purpose of EESA is to save the economy as a whole. Congress certainly understood that, absent the orderly flow of credit and a functioning payments system administered by the nation's financial institutions, the economy would quickly disintegrate, with devastating results for families and businesses. A healthy financial system is not a sufficient condition to ensure the health of the economy as a whole. In fact, the current fragile state of the broader economy continues to present a threat to financial stability, as many of our monthly oversight reports have shown.

TARP gets its name from the so-called "troubled assets" that were weighing down the balance sheets of the nation's financial institutions. The meltdown in the subprime mortgage market—and the eventual spillover effects into the prime and alt-A mortgage markets—saddled banks with assets composed of or derived from residential mortgages. These securities became difficult to price and hard to sell. Nearly one year after the passage of TARP, the Panel reported that these same assets continued to impair bank balance sheets. Today, some of these same assets continue to encumber the balance sheets of many banks—especially smaller banks that are also heavily exposed to commercial real estate assets, as the Panel identified in our most recent report. So long as the residential housing market remains weak and homeowners continue to default on their mortgages and fall into foreclosure, these troubled assets will continue to pose challenges for financial institutions.

When the Panel focused on the commercial real estate market earlier this year, we reported on a similar phenomenon. Commercial real estate loans—mortgages on apartments, office buildings, retail shopping centers and industrial facilities—continue to threaten the solvency of some financial institutions, especially small banks. When commercial properties fail, it creates a downward spiral of economic contraction: foreclosures trigger business failures and job losses, which in turn trigger deteriorating store fronts, office buildings and apartments, which in turn trigger the failure of the banks serving those communities.

In the area of small business lending, the trend continues. As Treasury continues to support the small banks that make the bulk of small business loans they may find that, even if lenders can lend, borrowers won't borrow. After such a severe recession, fewer businesses are creditworthy and looking to take on a loan.

The Value of Transparency

Ultimately, it is the role of policymakers, not the Congressional Oversight Panel and our oversight partners SIGTARP and GAO, to authorize funding and carry out programs to address the challenges still facing the financial system and our broader economy. The Panel has found, however, that transparency has proven to produce better outcomes.

One example is illustrative. The Panel undertook a valuation exercise to determine the value of the securities received by Treasury in exchange for TARP assistance provided to first set of financial institutions. With minimal variation, the Panel's models demonstrated that Treasury made taxpayer money available at a substantial discount. Treasury received securities that at the time were worth substantially less than the amounts it had paid in return, given the financial condition of the institutions involved. In all, we documented in our February 2009 report that Treasury had overpaid by an estimated $78 billion. By the time the financial analysis could be undertaken, the money had already gone out the door and it was not possible for the taxpayers to get a better deal in those transactions.

Six months later, however, the Panel undertook a similar valuation analysis of the warrants received under TARP. As the big banks recovered and began repurchasing their warrants, we swung into action. We released our results after only 11 smaller banks with an average TARP investment of $75 million had repaid their CPP investments and repurchased their warrants. After we crunched the numbers, we concluded that the Treasury had received approximately 66 percent of our best estimate of the value of TARP warrants for these banks.

Shortly after the Panel issued its report, the negotiations shifted. JPMorgan Chase announced it would allow their warrants to be sold at public auction. Eight large banks, including Goldman Sachs and Morgan Stanley, repaid their TARP funds at dramatically higher prices, with Goldman Sachs, for example, paying slightly more than we had estimated was due. In total, Treasury has received $7.2 billion from the disposition of its TARP acquired warrants, $3.12 billion from negotiated repurchases and $4.08 billion from auctions. The total received represents slightly more than 98 percent of our best estimate of the value of the warrants at the time they were sold or auctioned.

In short, transparency works. It adds up to savings for the taxpayers, as well as confidence in the programs. Our mandate under EESA specifically requires the Panel to report to you on "the extent to which the information made available on transactions under the program has contributed to market transparency." The work of our Panel has demonstrated that when Treasury has been forthcoming with goals for their programs, established metrics for determining success and provided verifiable data for assessing the results, transparency has produced better outcomes.

Conclusion

TARP has become a pejorative four-letter word in the American lexicon. The program is better known across the country as the "Wall Street bailout." Never before has the public been forced to bear the burden of a huge financial wreckage caused by private actors.

TARP succeeded in pulling the economy back from the brink, and the program has worked very well for the nation's largest financial institutions. For small banks, small businesses and American homeowners, however, the results have been far more limited.

The Congressional Oversight Panel will continue to conduct vigorous oversight of Treasury's administration of TARP. We hope our reports have shed some much needed light on this extraordinary commitment to stabilize the financial system and put forward concrete steps to minimize the costs to taxpayers and maximize the benefits. Notwithstanding our efforts to push Treasury for a better program, nothing in this should take away from TARP's extraordinary achievement: ending a financial panic that very well could have led to economic collapse.

Thank you again for the opportunity to testify and I would be happy to answer any questions you may have.