

TARP OVERSIGHT: A 6-MONTH UPDATE

HEARING
BEFORE THE
COMMITTEE ON FINANCE
UNITED STATES SENATE
ONE HUNDRED ELEVENTH CONGRESS
FIRST SESSION

—————
MARCH 31, 2009
—————



Printed for the use of the Committee on Finance

—————
U.S. GOVERNMENT PRINTING OFFICE

64-387—PDF

WASHINGTON : 2009

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	CHUCK GRASSLEY, Iowa
KENT CONRAD, North Dakota	ORRIN G. HATCH, Utah
JEFF BINGAMAN, New Mexico	OLYMPIA J. SNOWE, Maine
JOHN F. KERRY, Massachusetts	JON KYL, Arizona
BLANCHE L. LINCOLN, Arkansas	JIM BUNNING, Kentucky
RON WYDEN, Oregon	MIKE CRAPO, Idaho
CHARLES E. SCHUMER, New York	PAT ROBERTS, Kansas
DEBBIE STABENOW, Michigan	JOHN ENSIGN, Nevada
MARIA CANTWELL, Washington	MICHAEL B. ENZI, Wyoming
BILL NELSON, Florida	JOHN CORNYN, Texas
ROBERT MENENDEZ, New Jersey	
THOMAS R. CARPER, Delaware	

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, Neil, Special Inspector General, Troubled Asset Relief Program, Washington, DC	5
Warren, Elizabeth, Chair, Congressional Oversight Panel, Boston, MA	7
Dodaro, Gene, Acting Comptroller General, Government Accountability Office, Washington, DC	9

ALPHABETICAL LISTING AND APPENDIX MATERIAL

Barofsky, Neil:	
Testimony	5
Prepared statement with attachment	33
Responses to questions from committee members, with attachment	48
Baucus, Hon. Max:	
Opening statement	1
Prepared statement	77
Dodaro, Gene:	
Testimony	9
Prepared statement	80
Responses to questions from committee members	94
Grassley, Hon. Chuck:	
Opening statement	3
Prepared statement	105
Letter from Senator Grassley to Treasury Secretary Paulson and Federal Reserve Chairman Bernanke, dated November 12, 2008	107
Warren, Elizabeth:	
Testimony	7
Prepared statement	112

TARP OVERSIGHT: A 6-MONTH UPDATE

TUESDAY, MARCH 31, 2009

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

The hearing was convened, pursuant to notice, at 10:42 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Max Baucus (chairman of the committee) presiding.

Present: Senators Rockefeller, Conrad, Kerry, Lincoln, Wyden, Schumer, Stabenow, Nelson, Menendez, Carper, Grassley, Hatch, Snowe, and Crapo.

Also present: Democratic Staff: Bill Dauster, Deputy Staff Director and General Counsel; John Angell, Senior Advisor; Vincent Mascia, Fellow; and Miki Hanada, Fellow. Republican Staff: Emilia DiSanto, Special Counsel and Chief Investigator; Jason Foster, Investigative Counsel; and Jim Lyons, Tax Counsel.

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

The CHAIRMAN. The hearing will come to order.

In 1989, in an interview, our former colleague Congressman Jim Leach said, "The banks use rather surreal accounting practices." Since then, the world of banking and financial oversight has become, if anything, yet more surreal. One of our witnesses today, the Special Inspector General for the Troubled Asset Relief Program, has calculated that in the TARP and associated programs, taxpayers are potentially at risk for as much as \$2.9 trillion. Two-point-nine trillion dollars is just short of what the entire Federal Government spent in fiscal year 2008. It is like having a second U.S. Government budget dedicated solely to saving the financial system, and that is truly surreal.

The chart behind me outlines what makes up the \$2.9 trillion. That \$2.9 trillion does not include the \$400 billion that the Treasury Department has pledged in support of Fannie Mae and Freddie Mac. That \$2.9 trillion does not include the resources that the Federal Reserve is dedicating to shoring up the financial system in addition to the programs with the TARP. Those additional accounts will come up to about \$3 trillion, and that \$2.9 trillion does not include the second TARP, that request for \$750 billion in the President's budget.

If all of these additional amounts materialize, taxpayers could be on the hook for a total of more than \$7 trillion. This is a huge, unprecedented financial commitment. It strains the comprehension of taxpayers and policymakers alike. It has been nearly 6 months

since Congress created the TARP program. Almost all of that \$700 billion has been committed, so it is time for the Finance Committee to survey the many oversight issues related to this new Treasury Department program.

I worked hard to create the Office of Special Inspector General for the TARP. It is something I wanted. I pushed for it strongly. There was some resistance in the former administration, but we finally got the provision in there. I am very proud we do have the Office of Special Inspector General for the TARP.

I am very pleased to welcome Mr. Barofsky to the committee today, and so far as the Special IG, in my judgment, he has done a good job.

The latest controversy involving the TARP program centers on the AIG bonuses paid from taxpayer money. Senator Grassley and I introduced legislation to reclaim those bonuses for the taxpayers, and we are looking forward to bringing that legislation to the Senate floor. I am pleased that the Special IG is conducting his own full investigation of how those bonuses got out the door.

But the AIG fiasco is just the tip of the iceberg. There are many, many tough oversight issues connected with this new program. Today we will look at 12 major areas of TARP involvement, and we hope to get an update on each area from our oversight teams.

The 12 areas are: (1) the capital investment program for large banks; (2) the capital investment program for small banks; (3) Citigroup; (4) Bank of America; (5) AIG; (6) the Term Asset-Backed Securities Loan Facility, otherwise known as TALF; (7) General Motors; (8) GMAC; (9) Chrysler; (10) the mortgage relief program; (11) the small business program; and (12) the bad assets program announced just last week. I hope that at least one of our witnesses can comment on each of these 12 program areas.

We will also survey some other key issues on which our oversight experts have been focusing during the past 6 months. For one, I am pleased that improving transparency has been a priority for the Special IG. It is very important.

Mr. Barofsky recommended that the TARP post all TARP agreements, whether they are with recipients or with its vendors, on the Treasury website, and the Treasury Department has agreed.

The Special IG also successfully pushed for oversight language in the Citigroup and the Bank of America agreements that requires those banks to account for and report on their use of TARP funds.

In late January, Mr. Barofsky sent each bank participating in the capital investment program a letter asking how they have used TARP dollars. This was a much-needed exercise. It had not been done before. I am so glad that Mr. Barofsky sent that request. Americans want to know how their tax dollars are being spent. That is very much on the minds of American taxpayers.

I understand that all of the 360 banks involved have responded. That is commendable. I look forward to hearing the Special IG's preliminary analysis of the banks reports. What did they say in their responses?

I am also pleased that the Special IG has made progress on civil and criminal law enforcement. I am heartened that he has reached out to the FBI and to U.S. Attorneys around the country to coordinate fraud investigations related to TARP funds. My concern here

is, with such massive amounts of dollars dedicated so quickly, there is bound to be considerable fraud and misuse of funds. There are just so many dollars allocated in such a short period of time.

As Mr. Barofsky has said, of the primary oversight bodies referenced in the TARP, the Special IG stands as the sole TARP oversight body charged with criminal law enforcement authority. The Special IG is literally the cop on the beat.

Finally, the new program announced last week by the administration and Fed Chairman Bernanke represents another huge challenge to our oversight teams. The plan to purchase so-called bad assets will involve up to \$100 billion of TARP funds. It will involve backing from the FDIC and the Federal Reserve. The total commitment for this new program could reach \$1 trillion. The new program presents another very tough task for our three oversight teams. They will have to oversee pricing the assets, what entities are managing the assets, and taxpayers' exposure for each group of bad assets.

I want to thank our witnesses and their teams for their hard work. This is an enormously complicated program. The money involved is mind-boggling, totally mind-boggling. Indeed, the money involved is surreal. I look forward to our witnesses' efforts to help explain their tasks in ways that will make it just a little more real.

I have many questions to ask, Americans have many questions to ask, but I will now turn to Senator Grassley.

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

Senator GRASSLEY. Thank you, Mr. Chairman, for calling this critically important committee meeting and the hearing that is involved on this very important subject.

First of all, so I do not forget it, to each of the three of you, I want to thank you very much for bringing transparency to this issue, bringing out all the facts that need to be brought out to make sure laws are abided by, laws are faithfully executed, and money spent according to the intent of Congress.

I mean that for all three of you, but I want to especially mention Professor Warren because, so many times over the last decade and a half, you and I have been on opposite sides of a very important issue—and we are probably still on the opposite sides of that issue. But you are really boring in on this, and I want you to know that I really appreciate your work. I will probably appreciate your opposition on that other issue more because of the hard work you are doing on this.

It has been a year since the collapse of Bear Sterns and about 6 months since the \$700-billion Troubled Asset Relief Program was created. According to its purpose clause, the act was supposed to help Treasury restore liquidity and stability in the financial system, and to do it in a manner that protects home values, college funds, retirement accounts and life savings, preserves home ownership, promotes jobs and economic growth, maximizes returns to taxpayers, and provides public accountability for the exercise of this authority. We are concentrating on that public accountability.

I had my doubts about the creation of TARP and the way it was raced through Congress. Congressional leaders paired the bill with

hard-fought tax legislation for Midwest flood relief and equity for Midwest flood victims compared to what Washington did for Katrina victims.

I voted against the second round, even though I voted for that first one because of interest in my home State being connected with it. But I voted against the second round because my initial concerns about the rest of the bill were justified, including my concerns that limits on executive compensation were too weak.

As soon as Treasury received the funds, it decided to bail out big banks instead of buying up toxic assets, as they told us. Millions continued to lose jobs and homes, which makes me wonder about the program's effectiveness.

But you cannot measure effectiveness when you do not know what the goals and objectives of the program are or how the program is being run. I am disappointed and frustrated that the administration refused the committee's request for Mr. Kashkari to testify today. It would have been nice to hear how he is gauging the success of the program.

So I ask unanimous consent to enter into the record my letter to Secretary Paulson, dated November 12, 2008. During his confirmation process, I asked Secretary Geithner for his commitment to respond to all my inquiries, including that letter. There are certain answers that only the administration can provide, and I am going to continue to push until we get those answers.

The CHAIRMAN. Without objection, it will be entered.

[The letter appears in the appendix on p. 107.]

Senator GRASSLEY. While the operation of TARP is troubling, it is a small relief to know that the program's watchdogs—you folks—are doing your job. I am proud to have worked with you, Mr. Chairman, to create the Special Inspector General, who will be testifying today, along with the heads of these other agencies and the Congressional Oversight Panel.

These watchdog agencies are vital in helping Congress and the American people keep track of multiple TARP and TARP-related programs that the Treasury Department is initiating. Treasury has announced several new programs just in the last 2 weeks, some of its own and some in partnership with the Federal Reserve. With so much happening so fast and so much taxpayers' money at stake, the need for quality, oversight, and transparency has never been greater.

Unfortunately, despite saying all the right things about open government, the new administration has not made any major changes aimed at making TARP more transparent. Moreover, I have heard about potential problems with access to information from all three of the oversight bodies testifying. The Treasury Department told the Inspector General that it did not want to ask big banks what they did with the taxpayers' money provided through the Capital Purchase Program, so the Inspector General said that he would ask the banks himself.

At first, he faced a few bureaucratic hurdles, but he has now received responses, as the chairman has indicated. Contrary to the claims by some that it was impossible to know how the money was used, I understand that many of the responses provide a very clear understanding of where the money went. I guess the money was

not as fungible as we thought. In fact, if we want to know where the money went, with a little ingenuity you can get a pretty good idea.

The Treasury's recently announced initiatives demonstrate an increasing reliance and partnership with the Federal Reserve. However, these moves threaten the ability of the Government Accountability Office to monitor the program effectively. That is because the GAO is limited by statute from examining Federal Reserve activities. That limitation is aimed at ensuring the Fed's independence in monetary policy. However, its unprecedented actions in the last year have taken it far beyond traditional monetary policy.

From the standpoint of the efforts to ease the credit freeze, the Fed is no longer acting independently. It is an accessory of the Treasury Department and therefore political. Chairman Baucus and I have already introduced legislation to expand GAO's ability to obtain records from TARP recipients, because the bill that created the program failed to grant GAO the authority that it needs.

The Congressional Oversight Panel has also had problems getting answers from Treasury. According to the panel's most recent monthly report, Secretary Geithner has failed to respond to key questions that have been pending since even before his time at Treasury. I have already complimented Professor Warren. If these oversight efforts are to be successful, Congress must be willing to provide the necessary attention and support. Today's hearing is an attempt to do just that. We want to know whether the Treasury is taking these recommendations seriously and making meaningful changes.

If not, then we need to help follow up and make sure that the problems identified through the process are fixed. It is not about assigning blame, it is about making sure that government works. It is about making sure that the government is accountable to the taxpayers who are footing the bill. With everything that is at stake, we cannot afford to have it any other way.

The CHAIRMAN. Thank you very much, Senator.

I would now like to introduce the panel. Our first witness is Neil Barofsky, Special Inspector General for the TARP; second, Ms. Elizabeth Warren, chair of the Congressional Oversight Panel. Welcome, Ms. Warren. The third witness is Gene Dodaro, Acting Comptroller General.

Our regular practice, as you know, is to have all of your statements introduced into the record, which we will do, and ask each of you to speak for about 5 minutes on your opening statements, and then we will get to questions.

We will begin with you, Mr. Barofsky.

STATEMENT OF NEIL BAROFSKY, SPECIAL INSPECTOR GENERAL, TROUBLED ASSET RELIEF PROGRAM, WASHINGTON, DC

Mr. BAROFSKY. Thank you, Mr. Chairman. Chairman Baucus, Ranking Member Grassley, members of the committee, I am honored to appear before you today. I am particularly honored to appear on the celebration of the chairman's 30th anniversary on the committee.

More than \$300 billion has already gone out the door and, including the recently announced programs, as you noted, Mr. Chairman, we will soon be responsible for overseeing up to \$3 trillion in 12 different TARP programs. Today I would like to talk a little bit about two of the areas that we have been focused on, the TARP recipient's use of funds and our proactive law enforcement efforts.

Back in December, as part of our drive to bring increased transparency to the TARP, we began asking Treasury to require TARP recipients to report on how they are using TARP funds. Other than for Citigroup and Bank of America, Treasury rebuffed our efforts.

In late January, we therefore decided to do it ourselves by conducting a survey of each of the 364 TARP recipients who had received funds by the end of January 2009. As you noted, we have received responses from all of them.

Although it will take us a couple of months to conduct a thorough analysis of that information, one thing is clear: complaints that it was impractical, impossible, or a waste of time to require banks to detail how they use TARP funds were unfounded. While certainly not uniform, a number of banks were able to give us detailed—at times even granular—descriptions of how they used taxpayer money.

For example, some banks described specific loans or lending programs that they could not have done without TARP money. A frequent response was that TARP funds allowed the bank to become, or remain, adequately capitalized so that it could maintain, and not reduce, the level of lending in a down economy.

Others reported using TARP money to pay off existing debt, while one had to change its original plans when another bank called in a loan, requiring the first bank to take substantially all of its TARP funds to meet that obligation. Still others detailed investments that they made with TARP funds; some talked about acquisitions and others kept the money as a cushion against future losses.

There was also a diversity of how banks monitored their use of TARP funds. Some reported commingling the TARP funds with other capital and making no efforts to keep track; others attempted to segregate the funds and took steps such as one bank reported, that it assigned a special TARP manager to keep track of the money.

I believe ultimately the survey strongly supports my earlier recommendation to Treasury. Banks can, and should, be required to report on their use of taxpayer money to provide maximum transparency and not simply be asked to report on the possible impact of the funds, such as giving only lending activity.

The second area I would like to cover is what has been our most recent effort to fulfill our role, as was mentioned, as the only of the four primary oversight bodies with law enforcement authority. I have recently been described as the "TARP cop." To that end, we recently announced our TALF task force.

The TALF has been described as a \$1-trillion Federal Reserve program that will be seeded with about \$80 billion in TARP money. It is intended to lend government money on a non-recourse basis—meaning that the borrower does not have to pay the money back—

to investors to buy both newly issued asset-backed securities, as well as, now, toxic assets, off of banks' balance sheets.

We have been warning of the vulnerability of this program to fraud for several months, and we converted those warnings into action by putting together a team of eight different Federal law enforcement and regulatory investigative agencies, including the FBI, the IRS, the SEC, FinCEN, ICE, the Postal Service, and the Fed's IG, all to address potential fraud.

Our task force had its first formal meeting last week, and our goal for it is not modest. We intend for it to redefine the policing of Federal Government programs by proactively setting up a law enforcement response before fraud occurs. We recognize the inevitability of fraud in large government programs, especially those as complex as the TALF.

The task force will give us an ability to capitalize on the best experience of its members to make better recommendations to prevent fraud before it occurs and to establish a framework of trained experts who will be able to rapidly investigate fraud when it does occur. We are currently discussing expanding the task force to the newly announced programs also dealing with toxic assets.

Finally, I would like to note that there have been some complaints in the media recently that my office's oversight efforts may dissuade participation in TARP programs. Some might take this as a criticism; I do not. If a bank or financial institution does not want to participate in a TARP program because it is unwilling to disclose how it is using taxpayer money or because it is afraid of the vigorous detection programs that we are establishing for fraud, it means we are doing our job. Keeping such participants out of the TARP will only benefit the American taxpayer.

Chairman Baucus, Ranking Member Grassley, members of the committee, that concludes my testimony, and I will be happy to answer any questions that you may have.

The CHAIRMAN. Thank you, Mr. Barofsky.

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

The CHAIRMAN. Ms. Warren, you are next.

**STATEMENT OF ELIZABETH WARREN, CHAIR,
CONGRESSIONAL OVERSIGHT PANEL, BOSTON, MA**

Ms. WARREN. Thank you. Thank you, Chairman Baucus. It is a delight to be here on this celebratory day. Thank you, Senator Grassley, particularly, for the very gracious remarks. We have certainly differed in our approach to some issues, but I assure you, on the issues before us now with the oversight of the \$700 billion and what is happening with the Fed and the FDIC, there are no differences between us. I appreciate your support, and I look forward to working with you. Thank you, committee, for having us here today.

I should start by saying I am not reading from a tight script, and therefore my views are my own and do not necessarily reflect those of my panel members.

I just want to remind you which one of the three we are with respect to congressional oversight. Our duty, according to the stat-

ute, is to review the current state of the financial markets and regulatory system and to report to Congress every 30 days.

We are the policy and strategic folks for you. We are the smallest. I like to think, though, that does not make us the weakest. We are a fairly tough group. We have done four hearings so far. We have done four monthly reports, and we have done a report on regulatory reform. Our fifth report will be out next week. We work closely with the GAO and with SIGTARP. We coordinate frequently. We try to be very careful to support each other's work and advance each other's work, not to overlap or to duplicate in any way.

I want to start this by raising the central issue that we keep raising, and that is the one of, what is the strategy that Treasury is pursuing? Since our very first report—indeed, the first sentences of our first report—we have asked this question over and over: what is the essential plan here? What is the idea that Treasury is trying to pursue?

With the notion that, if we cannot have a clearly articulated plan and some clearly articulated metrics to see if we are accomplishing those goals, we cannot really engage in serious oversight. So we start at the front end of this process, how it is conceived, what it is that we are trying to accomplish. We have asked, first Secretary Paulson, and then Secretary Geithner, for information, particularly including these strategic questions, and so far we have come up short.

In our April report which will be released next month, we focus on the strategic question. We look particularly at what we can learn from the financial crisis in Japan, in Sweden, from the Great Depression, and from our own experiences with the Resolution Trust Corporation in the late 1980s, all of which we think can help inform us as we face the crisis in front of us.

Now, I just want to briefly mention our earlier report so you have some idea of the content that we have covered. We had a valuation report that we issued in early February. This is a report that started when we did the capital infusion into the financial institutions, effectively the first \$350 billion of TARP assets. At that time, at the very first report from Congressional Oversight, we asked the Secretary of Treasury, what were the terms? Were the taxpayers being fully protected in these investments into the financial institutions?

I received a letter from then-Secretary Paulson who said these transactions occur at or near par, which means, in effect, for every \$100 put in there is \$100 in stock and warrants that were given back to the U.S. Treasury. We decided to do our own independent evaluation of that, lots of number crunching, brought in some academic specialists on valuation, and we found, in effect, that for every \$100 of taxpayer dollars put in we got back about \$66 on that day of stocks and warrants. This does not account for the decline since that time.

Overall, if you do that enough times and with \$350 billion, we believe that we overpaid or subsidized to the tune of an estimated \$78 billion in the first go-round. That was our February report.

I just mention a couple of our other reports. I am glad to go through many of these in detail. We did a foreclosure last month—

our most recent report, our March report—in which we developed a series of ways to evaluate whether or not any foreclosure mitigation efforts are likely to be effective, trying to highlight what the elements are that they need to cover.

We discussed the administration's plan, which we believe covers some of those metrics, but not all of those metrics, and how this may be deeply problematic. We also point out the need for better data, that we cannot evaluate these programs simply by making big announcements. We really have to have data to track to see if they are effective in the ways we hoped and, if they are not, to make appropriate mid-course adjustments.

We currently have under way an inquiry about TALF. We are very concerned about the big down-side risks to the taxpayer and, frankly, the substantial up-side values to a small group of financial insiders. We are also concerned that this continues to subsidize the very kind of financial instruments and arrangements that helped create this mess to begin with, and we are concerned about oversight of that process.

We are concerned about contradictory information on implementation, and we have requested information from Treasury. We are told we will get more information tomorrow on this. We also have inquiries under way about AIG. We have a number of questions about the justification, the costs, the terms, the ultimate beneficiaries. We are particularly concerned about the opaque nature of counter-parties that has, thus far, hampered oversight efforts. We have requested information on many points, including the decision-making process and the risks involved here. We are awaiting a response.

Our bottom line is that, in crisis, the country needs a coherent plan with clearly delineated goals necessary to maintain public confidence and the confidence of capital markets. We believe it is critical to have sophisticated metrics to measure the success or failure of program initiatives. We also believe that transparency and accountability, which we have called for repeatedly from our first report and every subsequent report, are absolutely critical to having a system that is going to work, that is going to help us pull this economy out the ditch.

We are doing our best to press Treasury to provide a clearer strategy, more transparency, and more accountability. We are here as your Oversight Committee to learn from you more about what we should be doing and to try to explain the work that we have done thus far, and the work in progress. I am here to answer any questions. Thank you.

The CHAIRMAN. Thank you, Ms. Warren, very much. That was very helpful.

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

The CHAIRMAN. Mr. Dodaro?

**STATEMENT OF GENE DODARO, ACTING COMPTROLLER
GENERAL, GOVERNMENT ACCOUNTABILITY OFFICE, WASHINGTON, DC**

Mr. DODARO. Good morning, Mr. Chairman. Let me add my congratulations to you on your 30 years of service with this committee.

The CHAIRMAN. Thank you. Thank you.

Mr. DODARO. Senator Grassley, good morning. Members of the committee, good morning to you.

GAO's role under the Troubled Asset Relief Program is really 2-fold. We have responsibilities under the law to review Treasury's implementation of the program and report to the Congress every 60 days, and we also have the role of the financial auditor of the TARP in terms of tracking the money to make sure it is properly accounted for. We have, thus, reported 3 times during the 6 months: once in December, once in January, and our third report is being issued today.*

Now, in those three reports we made a series of recommendations that are designed to improve the transparency and accountability of the Troubled Asset Relief Program. Among the series of recommendations, there are three main themes that I want to touch on this morning.

First is the need for better monitoring and reporting on the uses of the funds under the Capital Purchase Program. Now, we focused on the Capital Purchase Program because so far, as of March 27, \$199 billion of the \$303 billion that has been distributed under the TARP has been through the Capital Purchase Program, so that has been about two-thirds of the money distributed so far.

Our recommendation back in December was that Treasury needed a process to collect information from the financial institutions on how those funds were being used and how it has changed their total lending activities. After initially balking at implementing the recommendation, Treasury then began collecting monthly lending activity information from the 20 largest organizations, financial institutions, receiving the money. We said that was not enough.

In our January report, we said every institution receiving money should be required to report back. Recently, Treasury has agreed with that, and now every institution receiving the funds will be required to provide monthly reports on their lending activities. We also think that this recommendation had an additional benefit in that the announcement for the new capital assistance program, which will emanate after the stress tests are done on the banks going forward, Treasury will require more information up front about planned uses of the TARP funds and require better reporting going forward. So we are pleased that our recommendations have had good effect in this area, and it is very important to have this type of information on a regular basis to adequately assess whether the program is achieving its objectives.

Second, the theme of our recommendations has touched on communications strategy. This program, from the outset, has been plagued by poor communications. I am pleased that it is getting better, but there is still a ways to go. As you pointed out, Mr. Chairman, there are 12 different components to this program. They have evolved, they have changed. The initial intent to purchase toxic assets was changed to the capital injections. The program has continued to evolve.

*For more information, see "Troubled Asset Relief Program: March 2009 Status of Efforts to Address Transparency and Accountability Issues," Government Accountability Office report, March 31, 2009 (GAO-09-504), <http://www.gao.gov/new.items/d09504.pdf>.

I think that the financial stability plan that was announced in February was a good step forward to try to provide some clarity. More details are coming forward on the public/private partnership effort and have been encouraging as well.

Some of the details of these programs still need to be worked out, but the mere fact that there are 12 different programs that they are leveraging in their activities with the Federal Reserve, the FDIC, and other organizations really places a premium on effective communications with the Congress, with the public, and other stakeholders about the details of these programs. So, in our report being released today, we recommend that a more effective communication strategy on the part of the Treasury Department is appropriate and needed in the coming months.

The third main theme has to do with the management structure of Treasury. Now, Treasury's Office of Financial Stability is responsible for managing all these programs, and from the beginning we have been concerned that they needed to hire up with appropriate numbers of staff and people. They have made some progress in that area, but they still need to continue to bring on the proper numbers of people with the right skills. We have made recommendations in the contracting area to strengthen their controls in contracting and internal control mechanisms that are needed to properly track and account for the money and manage conflicts of interest as well.

Now in closing, I would like to thank Senator Grassley, you, Senator Baucus, and Senator Snowe for co-sponsoring the S. 340 bill, which would give GAO additional authority to examine the books and records and talk to recipients of TARP funds. While we have not had a problem to date, given the evolutionary nature of this program, we think this legislation is an important safeguard and needed, and we would encourage the Congress to adopt it.

There are also, as Senator Grassley mentioned, some important limitations on our ability at the GAO to look at activities that are managed under the Federal Reserve's monetary policy and discount window operations that are very important. I am very concerned that, as the TARP has been leveraged to work with the Federal Reserve in these activities, that this is going to limit our ability to provide the Congress with much-needed oversight.

That concludes my opening statement. I would be happy to answer questions.

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

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

The CHAIRMAN. I guess the basic question that the American taxpayers have, and I think everybody on this committee has, is basically, what are the banks doing with the money? We want to make sure the money is spent wisely, fairly, appropriately, and efficiently. As I understand from listening to you, we have some sense of how the dollars are spent, but to you, Ms. Warren, you basically felt that the subsidy had the effect—I think it was \$70-some billion, 66 cents on the dollar, basically, was paid back. The balance, I guess, of the subsidy—

So my basic question is also, how are they spending the money? Basically you have given us some indication about that. Listening to you, Mr. Barofsky, banks did respond to your inquiries, but the

responses are all over the lot. I mean, they spent the money lots of different ways; some responses were very generalized, some were very detailed. So I guess, first, I will ask you then just your general sense thus far as to how they are spending the money.

My second question is going to be, of each of you, what additional powers do you think you need? You talked about more data, you talked about more access, you talked about transparency, all of you. What additional authority do you need? I believe the American public wants to know how these dollars are spent, and they want you, the three of you, to help answer that question.

At the outset, though, I am very pleased, frankly, with what you are doing thus far. I am also very pleased that we did create the Office of the Special Inspector General. I thought of this office because we have a Special IG to look at all the waste in Iraq with all the defense contracting, where tens of billions of dollars were discovered as wasteful. So my thought was, let us get this office set up on the front end rather than the back end, at the beginning of these programs rather than the end of the programs.

So, I think it is having a bit of a salutary effect in that regard, but clearly there are a lot of questions to be answered. My sense is a lot of dollars are not being appropriately spent. But if you could just briefly, Mr. Barofsky, give your general impression on how they are being spent. I will ask each of the three of you, what additional powers do you think are appropriate so you can even more appropriately get the answers to those questions?

Mr. Barofsky?

Mr. BAROFSKY. Thank you, Mr. Chairman. We are going to give you a much better answer once we have had the opportunity to stratify and analyze all the data, but anecdotally I have reviewed a good chunk of the responses. I think what we are seeing is that it really depends on the financial institution as to how they use the money. A good deal of the numbers that I reviewed would not have been adequately capitalized but for the receipt of TARP funds. Some of them were not necessarily where they needed to be at the time they received the funds; others because of losses and the downturn in the economy would not have maintained their levels of capital. As a result, what they have told us is they are able to maintain the same level of lending.

The CHAIRMAN. I guess, a little bit the question that Ms. Warren posed. What is the purpose of all this? I think one has to know the answer to that question to some degree before we can answer the question, was it properly spent? What guidelines were banks given as to how to spend their money, what conditions?

Mr. BAROFSKY. Banks were given almost no guidelines. There were some restrictions on dividend payments. There were some restrictions on stock repurchase and some restrictions on executive compensation. But for the most part it was left up to the banks what to do with the money. I think the responses indicate that lack of freedom of what they had to do with the money was not an issue.

It really covers almost anything that you would expect a financial institution to do. Some did use the money to increase lending according to the responses. Some went into such detail as to actually listing the specific loans that they would not have been able

to make but for the TARP money. Others invested the money and are keeping it either in liquid assets, like mortgage-backed securities, guaranteed assets from the government, waiting to see what happens with the economy, using it as a capital buffer to be able to withstand any downturn in the economy.

We will be able to give you a good analysis, but anecdotally it really does cover across the board. As I mentioned, two banks had plans to increase lending, but then other banks called in their debt so they had to take the TARP money and use it to pay back other TARP banks. So, there is a variety.

The CHAIRMAN. What is your sense on the issue that has been in the press a lot, the AIG issue, where a lot of the TARP money that AIG received went to counter-parties, even though there is no assessment of whether those counter-parties really needed to be paid? Goldman Sachs took \$100 billion. Now they say they want to give \$1 billion back to Uncle Sam. So, are you yet in a position to know who decided that those payments should be made to those counter-parties, and on what basis those decisions were made?

Mr. BAROFSKY. Mr. Chairman, we are announcing an audit this week that answers directly that question. We received a letter from 27 members of Congress last week asking us to look into that issue. Right now, my audit team is preparing the guidelines for that audit, and we are going to announce it this week. We hope to quickly bring an answer to that question of what the decision-making process was.

The CHAIRMAN. Well, my time is close to expiring, and I want to question other panelists.

But Senator Grassley, you are next. Go ahead.

Senator GRASSLEY. I start with the premise that the public's business ought to be public, and the expenditure of this money I have put in the category of "public" except for a few things like military secrets and intelligence, privacy, and a very narrow definition of executive privilege. Outside of that, everything we are talking about Congress ought to have access to under our constitutional responsibility of oversight. That is where I am coming from. So in order to get this information, I need to ask the three of you the same question, but a little bit different, so I will ask you one at a time.

I am going to start with Mr. Dodaro. You know about the bill that Senator Baucus and I introduced to have access to books and records of anybody who receives TARP funds. Our bill has been referred to the Banking Committee; unfortunately, no hearing is set on that. You said in your testimony that you supported that legislation. That would have been my first question.

The second question. Could you explain why GAO needs this additional authority and how it limits your ability to report to us without it? Let me ask a second question right along with that. In your statement, you mentioned that GAO is statutorily prohibited from auditing the Federal Reserve's monetary policy activities. Given the significant emergency authority exercised by the Fed in this crisis, how does this limitation affect your ability to oversee TARP money?

Mr. DODARO. First, on S. 340, the reason that we have a limitation—and that legislation would help—is, under the Banking Au-

ding Act and associated guidelines, we have access at GAO to all the information that the financial regulatory agencies have, but we do not have the ability to go directly to financial institutions to get the information from them.

This, your legislation that you, Senator Baucus, and Senator Snowe have sponsored, would enable us to do that for all TARP recipients. We think that is an important safeguard, particularly given how the program has evolved. Initially, if it was just purchasing the toxic assets, we would have had all the authorities that we needed. Now it has shifted, and it may shift again as things go forward. So this is an important safeguard. We are getting cooperation when we do ask, but as an auditor I would rather have the authority to go behind and be able to get the information.

Senator GRASSLEY. All right.

Mr. DODARO. Now, with regard to the Federal Reserve, that is a very important issue. I am very, very concerned that the limitation that we have, it is one of the very few areas in government that we are statutorily prohibited from addressing.

Now, I understand why it is in the legislation to protect the independence of the Federal Reserve, but that is in normal circumstances, and we are not in normal circumstances right now. As more and more TARP money is partnered with funding and activities of the Federal Reserve, we have no ability to be able to get any information from the Federal Reserve other than publicly available information. That is not satisfactory. If the Congress wants us to basically have this additional oversight role, we need a legislative remedy. We understand it needs to be carefully crafted, and we are willing to work with Congress in doing that.

Senator GRASSLEY. All right.

Mr. Barofsky, I am not going to go through a paragraph or two explaining the problems that you had in getting around the Paperwork Reduction Act, but I do want to point out that a spokesman for Inspectors General generally has supported your efforts in that you should not have to go through that red tape.

If you had been required to go through the normal Paperwork Reduction Act procedures, how much longer would it have taken you to gather the information from the banks on how they use the taxpayers' money? Two, could the Treasury have required that banks provide the same sort of information that you gathered on how they would use the taxpayers' money as a condition of receiving it in the first place, and why did they not require banks to provide the information? Those three questions.

Mr. BAROFSKY. Senator Grassley, I want to thank you personally for helping us cut through that red tape. But the answer is, it would have taken us at least 3 to 4 months to get through the Paperwork Reduction Act by a normal procedure had we not gotten the emergency exception. To answer your second question, yes. Treasury could, can, and should require the banks to report on their use of the funds.

Senator GRASSLEY. And then, can you tell me why the Treasury did not do that?

Mr. BAROFSKY. I think the question would be best posed to Treasury itself. I think Mr. Kashkari has said in testimony that, due to the fungibility of money, that they may have questioned the

usefulness of that exercise. I do not want to speak for him, but I think the response to our survey indicates that not only is it useful, I think it is important.

Senator GRASSLEY. Ms. Warren, has the Congressional Oversight Panel had sufficient access to all the information it needs in order to do its part of overseeing TARP, and what do you need that you have not been provided?

Ms. WARREN. Senator, we are your Congressional Oversight Panel. Our concern right now is that we do not seem to be a priority for the Treasury Department. We have sent letters, we have requested that there be someone named so that we can get technical information, and so far we have not been a first priority. We use what you give us, and we will exercise the leverage given to us by Congress. In part, that is why I am here today. I am here to talk to you about what has happened so far, what we have discovered so far, the inquiries that we have in midstream and for which we continue to await responses. That is where we are, Senator.

Senator GRASSLEY. Thank you.

The CHAIRMAN. Senator Snowe?

Senator SNOWE. Thank you, Mr. Chairman. I want to thank all of you as well for your very substantive and crucial testimony.

What I find absurd, frankly, is the fact that you all really seemingly have to struggle to get and ascertain information in order to fulfill your responsibility in oversight of this critical program that ultimately would yield confidence for the American people if they had transparency and could definitively point to results that had been accomplished as a result of the \$3 trillion that have already been issued.

My concern, as I look from my perspective and the people I represent in the State of Maine, is they do not see the program working as is, with what they have heard about the bonuses, not only AIG. Senator Wyden and I attempted to address that early on through the stimulus package, to address all bonuses committed and issued from 2008 through January of 2009 of \$18.4 billion, including Merrill Lynch, that issued about \$2.5 billion in December, 3 days before they were acquired by Bank of America.

Well, the list goes on. The fact is, we are not seeing any definitive evidence to suggest that it is working. The credit markets are very, very tight, and the Federal Reserve survey recently indicates that the markets have tightened considerably, and most especially for small businesses that are job generators. What I hear as the common theme among all three of you is that there are no consistent standards for oversight, that you really have to struggle to get information from the Treasury Department, and that there is no clearly articulated goal, as you said, Ms. Warren.

What do we need to do? Besides in the powers issue, what standards should we set in place for TARP recipients, for example, to have to disclose and to document how they are using their funds? And also whether or not they are lending, because that is the other crucial concern—the money is not being used to lend appropriately. Even those healthy banks are not lending, which is also freezing the ability on Main Street to open doors or avert closures and has led to, as we know, historic unemployment rates.

So, Mr. Barofsky, Ms. Warren, Mr. Dodaro, can you answer that question? We need to do something quickly, I believe, because in every testimony that you have given, all three of you, in your perspectives, it is abundantly clear that we have to do something to not only give the enforcement powers, but the standards that essentially have to be agreed to and adhered to by the Treasury Department in implementing this \$3 trillion.

Mr. BAROFSKY. I would say, to begin with, to support us and to continue to press for greater and greater transparency. It is very difficult to make the policy determination without having all of the information. That is one of the things that we have fought to do, is to bring that level of transparency so we can see where the money is going. I think, indeed, Senator, pressing on what is success, what is the measure of success, is an important question that has to be clarified.

Senator SNOWE. Well, I would hope that we could get a list from you of exactly what should be required of Treasury, from each of you, because I really think that we should incorporate that into law so that there are consistent standards.

Ms. Warren?

Ms. WARREN. Yes. Senator, I think you have put your finger on the central problem here. I want to say, this problem starts with Treasury in the following sense. There is not a bank in this country that would loan money under the terms of, take the money and do what you want with it. If they are lending to businesses, they ask businesses what you plan to do, and most importantly, not just what you plan to do, not saying afterwards—although I am very glad that Mr. Barofsky has asked—but in advance, what would be the metrics? How will we know that is what you did?

Senator SNOWE. Exactly. I agree.

Ms. WARREN. Accountability is not just, I used it for all the good things and I used my money for all the bad things. It is to make it clear up front, this is what my books look like now and this is what they look like after I get the money. This will be the difference between the two and this is how you can see how American taxpayer dollars were used. So I am talking about accountability in a very real sense of this word.

As I see it, you really have two options here. Either you get Treasury to get some religion on this point and put their own standards in place, or Congress is forced to step in. We will do everything we can on your behalf as your Congressional Oversight Panel, but what we can best do for you now is to identify and pinpoint that this is precisely where the problem starts, and then the problem has roll-down effects all the way through the system of lack of accountability, complexity, that no one can figure out what is going on, so that we never identify the place where we need to start the solution.

Senator SNOWE. Mr. Dodaro? I could not agree with you more on the metrics issue, absolutely, to measure in advance instead of reacting, but being proactive in having it up front so everybody is on the same page about it.

Ms. WARREN. Yes, ma'am.

Senator SNOWE. Mr. Dodaro?

Mr. DODARO. Our philosophy on this has been 3-fold. Number one, it is Treasury's responsibility, as the disbursing officer of the money, as the manager of the program, to collect this data and to report it publicly and to the Congress. To do that, we have recommended they build upon an already-existing mechanism that the regulators use with quarterly call report data from the financial institutions. They get information every quarter. It is audited. Regulators review it. We suggested, though, that it needed to be collected more frequently, and that is why we suggested monthly information.

Now, they have moved to do that for the 20 largest institutions for the last couple of months. That is good. They have reported that. That is good. They have now extended it to all institutions. Right now there are over 532, I think, institutions that have received money. There are another 1,190 that are with Treasury for decisions, and another 750 that are still with the regulators to recommend to Treasury. So you are going to have hundreds of institutions. If they use or implement our recommendations successfully, this should greatly increase the transparency over this program, and then the call report data that is audited could be used to verify the reporting of the monthly survey information.

Third, we have also collected and started to develop a set of indicators about specific interest rates and also the spread between interest rates and treasuries, which are used to measure credit risk. This market basket of indicators can measure whether or not, in totality, the TARP and other activities are improving the situation. So far, the record has been mixed.

Senator SNOWE. Thank you.

The CHAIRMAN. Senator Stabenow?

Senator STABENOW. Thank you very much, Mr. Chairman. And thank you to each of you for the work that you are doing. We desperately need it. There is no question that the public has a right to distrust this government recovery process that has gone on here because, as you have described, lack of transparency, lack of accountability, institutions that have taken the funds and hoarded them or used them for excessive bonuses to reward failed business models, or otherwise used them for purposes outside the original intent. So this administration has a huge task in front of it, and we urge them all to be moving with full speed. I know they are focused on it, but there is so much that needs to be done.

I want to ask you specifically about one piece of the program and how it compares to others. Yesterday the President announced further sacrifices that are going to be made by people in my State, as well as across the country, in order to create a revitalized auto industry that the President has talked about. These were part of conditions that were placed on GM and Chrysler in order for them to receive the TARP funds. GM has been given 60 days to present a new viability plan, and this will bring it to 5 months since GM became eligible for the TARP funds.

So here we are today, 6 months after funds have begun to be given, to do oversight, yet we have not asked the same requirements of the financial institutions that have been asked of the auto industry. Not only have these institutions not come under the same scrutiny, but they have not provided the information to prove that

when the crisis is over these companies will be viable, will be able to survive future downturns.

So my question is, what should be done to ensure that, at the end of the program, we will have revitalized financial institutions that will be able to make it on their own? What lessons can we learn from the rigorous oversight of the auto industry, to learn from that and place it on the financial institutions that have been receiving TARP funds?

Ms. WARREN. Senator?

Senator STABENOW. Yes. Ms. Warren?

Ms. WARREN. Thank you. I think that this starts at the beginning with a question of policy and approach. With the financial institutions, we could take effectively one of two approaches. We could say we are going to subsidize them, and subsidize them for however long we decide to subsidize them. That gives us no guarantees, other than however we may decide as we go along to put some new strings in place.

The alternative is to say we are going to reorganize them. A reorganization typically means that the senior management may be taken away. It may mean that a lot of stakeholders have to share in the pain, that bond holders are written down and have to bear much of the loss. Of course, at a financial institution, we must protect depositors. We have our insurance guarantees that we have made with FDIC and other institutions.

But this very real difference starts right at the beginning, and it then colors everything that happens after that. We had hearings last week at the Congressional Oversight Panel talking about what had happened during the RTC, for example, the crisis in the late 1980s.

In the late 1980s, the position with financial institutions was very straightforward. The financial institutions that were in trouble were liquidated. The people in charge lost their jobs. Debt holders took some substantial losses. The equity was wiped out and the depositors were fully protected. That is one approach. It is an approach that was also used in Sweden. There was real confidence in the system about those that remained. Indeed, those that remained were able to pick up the business of those who were failures and were ultimately able to thrive.

Taking the different approach, and that is continuous subsidization without rigorous oversight, is precisely what has led to the difference now that we are seeing between the approach with the auto industry, which is much more modeled on a reorganization approach, and the approach that is being used throughout the financial services industry, and that is a straightforward subsidization.

So I see this as an issue that starts right back at the beginning. Which of the two plans that Treasury is putting in place, which of the two strategies it is following—and this is the debate we need to have, quite frankly, Congress with Treasury, and we are part of this debate as well.

Senator STABENOW. Right.

Ms. WARREN. To say, this is the real question: do we think that subsidies lead us to the right place or do we think reorganization does that?

Senator STABENOW. Well, if I might just say that on the one hand you missed—and just to add to the group of people being hurt, the main people being hurt are the people who are losing their jobs—

Ms. WARREN. Of course.

Senator STABENOW [continuing]. And the communities where the plants are being closed. Reorganization in my State means job loss and means plant closings. So there are very real efforts and very real sacrifice going on.

What I see on the other side are banks that have been given money and are not giving the loans, as Senator Snowe was talking about. Small businesses are losing their lines of credit in Michigan. People who have paid on time forever cannot get a loan. Suppliers cannot get a loan to be able to do business with the auto companies as they normally would do. So, huge discrepancies.

Mr. Chairman, I look forward to working with you further to look at the two models being used here in terms of accountability on one side and total lack of accountability on the other side. Thank you.

The CHAIRMAN. I think you make a point, Senator. I do think part of it is a cultural difference. New York establishments, the financial establishments, but generally with the financial establishments in Washington, DC, is a totally different culture from the manufacturing and other economy establishments. I do think that is one reason why each is being treated a bit differently, and I think it is an issue.

Senator STABENOW. And if I might, just one more editorial comment. If we do not make things in this country, we will not have an economy. So, thank you.

The CHAIRMAN. Senator Lincoln?

Senator LINCOLN. Thank you, Mr. Chairman.

I certainly want to align myself with comments from Senators Stabenow and Snowe about the importance in terms of where these resources are going and who is actually benefitting. I know that the multiple small businesses that call me are saying the same thing: we are long-time customers, we have good accounts. These financial institutions are not loaning the kind of resources that we need for operating budgets and other things like that, and it is just not reaching down.

I agree wholeheartedly with the chairman, it is a cultural difference, there is no doubt about it. If you look at how this country was established, the success of business 60 years ago was determined by whether the business was creating jobs and whether it was reinvesting in its company and whether it was reinvesting in its community.

Right now, obviously the problems we see from Wall Street are not the fact that nobody up there is reinvesting in themselves, they are just leveraging and leveraging, and that has become a real issue. So we appreciate the chairman bringing us together on this hearing and certainly appreciate all of you all and hope you will not go far, because we will need you as we continue.

I think the other thing is building confidence and trust, which is a huge part of this equation, among investors and among working families across this country. I mean, that is a task that humanity has dealt with for eons. It is going to be something we are going

to have to work from the economic side, but also in terms of the humanity side, of whether people are willing and ready to be more confident and trusting of the system that we put together. That is going to be a critical part of it.

Professor Warren, I just wanted to highlight a point that you made in your testimony. You said Congress has given Treasury substantial discretion, as befits this fast-moving crisis. That happened to a lot of us. Last fall, we were approached by the Secretary of Treasury and others who said the sky was falling and this crisis is going to happen tonight if you all do not do something. But you continue in your testimony that that discretion carries within it an equivalent obligation to explain in real time why the discretion is exercised as it is. I could not agree more.

One of the things we continued, even before we voted for the first TARP, and even after many of us have continued to, is to talk about how important it is to have accountability and transparency and to understand what the plan is. If there is not a plan and we cannot describe it to our constituencies, we cannot defend the government playing a role in it.

The stakes are high and people need a better understanding of how and why their taxpayer dollars are being used, and we cannot expect confidence to return if people cannot understand the steps that are being taken to combat the crisis. That is a real issue, and I hope Secretary Geithner will take that to heart and do more to explain, on a real-time basis, what he and his people are doing and why. I think they have a responsibility to the American people. I know he is a technical person who is extremely bright and smart, and I think can be very helpful. But without a doubt, conversation and communication are going to be critical in terms of building that trust and that confidence.

Professor Warren, you mentioned AIG. From the sound of your testimony, you still have a lot of questions about that assistance. When do you anticipate that you will receive the information that you have sought from Treasury and the Fed regarding AIG, and are they being forthcoming? If not, what do you need us to do to compel that information to be forthcoming?

Ms. WARREN. Well, Senator, I do not want to over-promise here. We have been told that we will receive this information shortly, but we are a panel that has lived on “you will receive this information shortly.” So I am not without hope, and I am hopeful that our conversation may find its way to people who are responsible for getting back to us on this. But we have substantial questions about AIG. We have substantial questions—I just want to be clear here—about the TALF—

Senator LINCOLN. Yes.

Ms. WARREN [continuing]. About TARP 2, the CAP (the Capital Assistance Program). How many acronyms can you do here?

Senator LINCOLN. Which most average Americans do not understand.

Ms. WARREN. Well, but that is the point. I want to stop here for a second on exactly that point. When we have enough complex programs that have lots of wires and bells and whistles with no articulation of what they are supposed to accomplish and how we are measuring whether or not they accomplish that, with no underlying

discussion about, hey, this is a subsidy—you know, Secretary Paulson wrote me a letter that said, as flatly as you can, “this is not a subsidy.” When we scratched the surface, it was absolutely clear \$1 out of \$3 was a subsidy.

So, when that is the case, that means there is no transparency. Indeed, it means Congress and the American people have been cut out of the conversation. So transparency is partly about websites and being able to track exactly who got what dollars, and that is an incredibly important part of it.

The transparency is about articulating up front what you are trying to accomplish, why you chose one path instead of another, why one group of people are asked to bear enormous pain and why others are not. That is the heart, that is the start, of this entire process. Until we clearly have Treasury’s attention—we have them focused on these questions for purposes of a public conversation—I am afraid we will not go forward.

The CHAIRMAN. Senator Schumer?

Senator LINCOLN. Thank you, Mr. Chairman. Thank you.

The CHAIRMAN. Thank you.

Senator SCHUMER. Thank you, Mr. Chairman. And just let me add my congratulations to your 30 years as chairman.

The CHAIRMAN. Not quite.

Senator SCHUMER. Not quite as chairman. That is coming. [Laughter.] But as a member of this committee. When you became a member of the Finance Committee I was probably, within a month or two, within the Speaker of the New York State Assembly’s Office, asking him if he could please put me on the New York State Assembly Ways and Means Committee. So, I very much appreciate what you have accomplished.

My first question is for Mr. Barofsky, but I did want to welcome Ms. Warren here because of the great work she has done. I have used your studies on the fact that median income in America has declined from 2001 to 2007—that is before the recession—but the average family was hurting even before the recession. I think if you add in buying power, you told me, it would go down to \$43,000.

We have never had a period of so-called prosperity where median incomes declined. If you do average incomes, of course, it raises it way up because, if someone goes from \$30 million to \$50 million, that raises the average up, but it does not raise the median up a jot. I think your study is groundbreaking, and I hope you will continue to look at that.

Mr. Barofsky, welcome. Thank you for the job you are doing. I am concerned with the estimate of the money that remains in the TARP. Secretary Geithner has said that is \$135 billion. I notice you have a slightly lower figure of \$109 billion. There are outside experts who believe it is considerably lower than that. Some have said it is 3 times lower than the \$30 billion amount. How do you account for the differences? Which number should we believe? Can you give us some feel for this, because obviously it is a very important number.

Mr. BAROFSKY. Sure. The primary difference between our number and Treasury’s number is that they calculate an anticipated return of \$25 billion of money that has already been out, that has been invested, that they expect banks to return.

Senator SCHUMER. Because they want to be out of the TARP.

Mr. BAROFSKY. Because they want to get out of the program.

Senator SCHUMER. And is this a lot of banks returning a little, a few banks returning a lot? Do you know?

Mr. BAROFSKY. Treasury has not given us the back-up for this estimate. This is something that we just learned about over the weekend. Certainly a number of banks have publicly stated that they intend to give the money back but, when the rubber hits the road, they have to get regulatory approval before doing so to make sure that they will still be well-capitalized.

Senator SCHUMER. Yes.

Mr. BAROFSKY. But a large number of banks have said it.

Senator SCHUMER. All right.

Mr. BAROFSKY. So I think that is the difference between us and Treasury.

As to the other number you mentioned, as little as a third, our number too before this weekend was significantly lower than the \$109 billion. Treasury has changed some of its estimates. They originally had \$250 billion for the Capital Purchase Program. That has come down to \$218 billion. There are some other areas where the originally announced numbers have been scaled back a bit, which is why that bottom number on the chart, which is what is left over, \$109.5 billion, is where it is.

Senator SCHUMER. Yes. Just explain that, the scaling back of the Capital Purchase Program.

Mr. BAROFSKY. Sure. I think they initially estimated that there would be \$250 billion that would go out the door on that program.

Senator SCHUMER. Yes.

Mr. BAROFSKY. They have now said, based on the number of applications they have received and the timing, they are now estimating it is only \$218 billion.

Senator SCHUMER. Just, Professor Warren, in your oversight function, do you agree that this is about the right number?

Ms. WARREN. We think it is about the right number, yes.

Senator SCHUMER. Do you agree with that, Mr. Dodaro?

Mr. DODARO. Well, I think at the current moment it is. But one of the things that we want to look at, or some of these new programs that have not started, is to the assumptions—for example, in the Making Home Affordable Program there are some assumptions underlying how many people will participate and at what levels. I think we are going to take a closer look at some of those assumptions. So I would expect that the figures are going to change a bit given the evolving nature of some of these programs.

Our main point has been that Treasury needs good internal controls to track all this. There are also dividend payments that are being made. Now, those do not go back into the program as if principal does get repaid, but all these things need to be tracked, and they need to have good assumptions.

Senator SCHUMER. Great.

Finally, last question. I do not have much time. Conflicts of interest in the public/private partnership. Have you been focusing on that, Mr. Barofsky? Are there guidelines? Are they adequate? How do we deal with that issue, which is a very significant issue?

Mr. BAROFSKY. There are no guidelines yet. I think it is going to be an incredibly significant issue. There are three different public/private programs, and it would take me a while to go through all three of them, but I think one thing that they have is, in many of them you have those who are setting the price who could benefit in other areas of their business by that price increasing. This creates a very, very significant conflict of interest. We have raised this issue already with the Treasury. I am meeting tomorrow with the Federal Reserve to discuss this issue.

Senator SCHUMER. And they are taking it seriously?

Mr. BAROFSKY. So far, they are taking it seriously. But it is of significant concern.

Senator SCHUMER. Any comment on that, Ms. Warren? Then my time is up.

Ms. WARREN. We are also looking at the structural conflict of interest, that is, the way these are set up in order to potentially reward the same person on both sides of the transaction.

Senator SCHUMER. Great. All right.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Senator SCHUMER. Congratulations, again.

The CHAIRMAN. Thank you.

Senator Carper, you are next.

Senator CARPER. First, a question for our acting head of the GAO. A lot of people have testified over the years—in fact, we all have—and it is rare that anyone ever testifies without notes. I have seen you testify any number of times, and you have never used notes. How do you do it? [Laughter.]

Mr. DODARO. I study all the reports, and I listen to my staff. [Laughter.]

Senator CARPER. Is there a member of your staff sitting behind whose lips move when you speak? [Laughter.]

Mr. DODARO. No. No, no.

Senator CARPER. Is that what is going on?

Mr. DODARO. No. I stay close to the work, and that enables me to do it.

Senator CARPER. I have kidded him about this before. He is pretty amazing. All right.

Again, our thanks to each of you for being here today and for your stewardship.

Mr. Barofsky, I understand from your testimony that you sent out some 364 letters to each TARP recipient asking how they utilized the fund to date, and your response rate has been about 100 percent. That is not bad. I appreciate your testimony as well as to the substance of the responses that your staff have analyzed to date.

There is some concern, and I do not know if others on the committee have heard it, from one of the banking folks in the banking community that those participants in the Capital Purchase Program not be lumped together with those who have needed TARP funding because they were too big to fail. Many of those in the Capital Purchase Program are just satisfied, though the government, they think, has been moving the goalposts on them and changing the rules of the game.

In some cases—I will give you an example. Some of these folks did not want to take TARP money, they did not want to take Capital Purchase Program money, and we said we need for you to, and we need for you to take it not because you think you are going down, but because we want to take the stigma away so that others who really need the money will be inclined to accept it.

But let me just ask you if you could give us some sense as to whether you are hearing this concern, some of the concerns, in the responses you have received from recipients of the TARP money and the CPP money. Are the responses from the recipients of the CPP overwhelmingly positive or overwhelmingly negative? Are they somewhere in between?

Mr. BAROFSKY. We have heard those concerns in our correspondence. Part of our survey is not just for use of funds, but also how financial institutions are dealing with, and preparing to comply with, executive compensation restrictions. I have seen, in a number of those letters, frustration from these banks from what they perceive to be a changing of the rules and an indication that they are looking to pay back the money because executive compensation rules have become more strict. So I think that is something we have seen in the correspondence.

Senator CARPER. If you were sitting in our shoes and people were saying, look, we took this money under duress, we really did not want to, and now that we have done it at your encouragement to take away the stigma, now you are changing the rules on us. That troubles my sense of equity. Does it yours?

Mr. BAROFSKY. Well, I would say that, when the rules became more strict in the Recovery Act, Congress also put in the carve-out that made it much easier for banks to repay the money. Before, they would have had to have matching private equity equal to the amount of the stake of the TARP investment in order to get out. Now, if they want to pay back the money, they can pay back the money as long as their capital is adequate according to the regulator. So, I think that concern has been lessened by the Recovery Act.

Senator CARPER. All right.

One last question. It was reported a couple of weeks ago, I think March 20, that at least 13 companies receiving billions of dollars in bail-out money owe a total of more than \$220 million in unpaid Federal taxes. As I understand it, banks and other companies receiving Federal monies were required to sign contracts stating that they have no unpaid Federal taxes, but were not required to produce their tax records. Do you know if this error has been corrected? Do you know where this investigation stands?

Mr. BAROFSKY. My Investigations Division is coordinating with Department of Justice, and it is under review.

Senator CARPER. All right. Thanks very much.

Again, we appreciate your being here and your good work.

Mr. BAROFSKY. Thank you.

The CHAIRMAN. Senator Menendez?

Senator MENENDEZ. Mr. Chairman, let me take a moment of my time, since I was both in the Banking and Energy mark-up, to congratulate you on 3 decades of service to not only your great State, but to the country, and particularly in your leadership of this com-

mittee. You have steered through some of the most challenging and difficult issues that the Nation has faced, and you have done it with extraordinary intellect and ability.

As we look at some of the major challenges we are facing now, I cannot think of a better person at the helm, particularly as we try to tackle health care reform. So, I want to salute you as well.

The CHAIRMAN. Thank you. Thank you, Senator.

Senator MENENDEZ. Mr. Barofsky, when you came before the Banking Committee for your nomination, I asked you a bunch of questions, and I want to follow up on them now. One of the things is, you have the power to pursue waste, fraud, and abuse in the system as you review this. I am wondering whether anything that you have done to date has given you cause to pursue any of those elements as you are reviewing the documentation from the survey and other information flows that you have.

Mr. BAROFSKY. I think that in particular, with respect to fraud, we are very concerned by the design of some of these programs, and in particular the ones that have recently been announced. I think that any time you push out trillions of dollars—even millions of dollars, but certainly trillions of dollars—in a very short period of time, you run the risk and almost a certainty of a large percentage of fraud.

The FBI estimate that I have seen is that 10 percent of any government program is going to be vulnerable to fraud. That would be \$300 billion. So, that is a keen issue for us and one that we are trying to be proactive about. We need something that I think has not been done before with a government program, which is setting up a task force of different experts in the law enforcement community and training them now so that they will be ready if and when the fraud hits.

This says two things. One, because the programs are so complicated, law enforcement is not necessarily comfortable with a lot of the concepts, with a lot of the mechanisms of the program, so it sensitizes law enforcement people to react quickly and rapidly to any fraud.

But second, and I think even more importantly, we are going to have a forum of ideas to make recommendations. S. 383, which was supported by this committee and which passed both houses unanimously, strengthens our already-good strong power of making recommendations.

Senator MENENDEZ. If I may, so you have the wherewithal, you have some concerns, but at this point you have not had any reason to pursue any of the waste, fraud, and abuse because it has not come to your attention?

Mr. BAROFSKY. Oh, no.

Senator MENENDEZ. You are?

Mr. BAROFSKY. We actually have probably more than a dozen ongoing criminal investigations based on fraud related to the TARP.

Senator MENENDEZ. That is what I wanted to know.

Mr. BAROFSKY. Unfortunately—

Senator MENENDEZ. I do not expect you to talk about those.

Mr. BAROFSKY. Yes.

Senator MENENDEZ. I just want to know that you are pursuing them.

Mr. BAROFSKY. Oh, no. Absolutely, Senator. That is one of our primary mandates.

Senator MENENDEZ. All right.

Second, and this may be a hybrid question for both you and Professor Warren, when we also had your nomination we talked about what the purpose of the act was. I read specifically from the act, which talked about restoring liquidity and stability to ensure that such authority is used in a manner that protects home values, college funds, retirement accounts, life savings, preserves home ownership and promotes jobs and economic growth, maximizes overall returns to the taxpayers of the United States, and provides public accountability for the exercise of such authority.

The question in my mind is, have we met those goals as we can envision what has happened today? I am concerned, Professor Warren, when I read from your testimony, both this time and in the past. I am one of those who was a big believer in conditionality up front so that we could have benchmarks and more easily ascertainable ways in which we could determine whether we are achieving success.

On page 4 of your testimony where you said, "The most important lesson we draw from our analysis is that, without a clearer explanation from Treasury about its overall plan for each capital infusion and without more transparency and accountability for how that plan was carried out, it is not possible to exercise meaningful oversight over Treasury's actions."

Could you talk about that? And Mr. Barofsky, could you respond to that as well?

Ms. WARREN. Thank you, Senator. I would make two points here. The first one is the good news point. I want to say there is a little bit of water in the glass. The little bit of water in the glass is we are not going to let these goals be forgotten. This is not going to be a statute that, you put a lot of good language into it and then everyone went off and just spent the money and forgot what it was there for.

So I see our job as to come back to you, to go back to Treasury, to go to the public and keep reminding them of these goals, and reminding Treasury why it is they need to articulate what the plan is, why they have made the choices they have. That said, it is only a small amount of water in the glass, because at this point we clearly are not there.

Frankly, I think the American people understand that we are not there, that we have not yet had a statement of what we are trying to accomplish, why it is that some have to take losses and others do not, why there are no metrics put in place in advance for us to condition how the money is spent and to test whether or not it is achieving any goals on the other end. So we are not there. We are just simply not there. It is not yet happening with Treasury.

Senator MENENDEZ. Mr. Chairman, if I may.

The CHAIRMAN. Go ahead.

Senator MENENDEZ. Would you care to comment on that?

Mr. BAROFSKY. Yes. I think, Senator, you hit the nail right on the head, and that is putting the right conditions on up front. The initial TARP programs were rolled out before we got there. Since then, one of the things that we have been doing with every pro-

gram and every contract is making the recommendations, just like the type that you mentioned, requiring internal controls and the reporting of conditions, getting that up front so we can keep close track of what is happening. I think that is vital to what we do.

Senator MENENDEZ. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Again, how well is Treasury complying with those up-front conditions before sending the money out—that is, setting them?

Mr. BAROFSKY. Well, for this administration we are really going to find out in the very near future. With the mortgage modification program and the recent programs we have had, we will continue to make recommendations on a rolling basis. Now with S. 383 having passed both Houses, the Secretary will be required—assuming the President signs it into law—to either adopt our recommendations or explain to you, to Congress, why he has not. So I think we will have a very good mechanism of being able to keep track.

The CHAIRMAN. All right.

Earlier I said I was going to ask each of you what additional powers you think you should appropriately have. Let us go down the table, go down the list. I will start with you, Mr. Barofsky. What additional powers do you think you should appropriately have in order to protect taxpayers' interests? Go ahead.

Mr. BAROFSKY. Sorry. I think to the extent there was any ambiguity in our powers, they were clarified by S. 383, so for now I do not see any issues. We will certainly, as I promised during my confirmation hearing before you, let you know if we see any other additional need. But for now, I think we are good.

The CHAIRMAN. Feel free to come back.

Ms. Warren?

Ms. WARREN. Senator, I would describe it this way. We need to find a way to make these policy issues and the articulation of these plans higher on Treasury's priority list. I am not here to ask for more power from Congress; I am here to say that is ultimately what we need. We will use whatever you give us.

The CHAIRMAN. I appreciate that. But you are a United States citizen, you are a red-blooded American. What additional powers do you think someone in your position should have to protect the American taxpayers?

Ms. WARREN. Well, Senator, the question that would be appropriate for Congress is whether or not Congress wants to move to the next step, which would be having Treasury required to consult with us on these issues and make public statements. I am just trying to find ways to step in that you can respond to. What we are asking for is not rocket science here. We are not asking for something extraordinary.

Mr. Barofsky, who actually really has to get down to the papers, he has a badge for a reason. We are asking for the much broader articulation of what the plan is, transparency in the goals, transparency in the execution, in the strategy. What we need is, we need Treasury's commitment. If that commitment is better done by statute, then that would be Congress's decision.

The CHAIRMAN. Well, can you get the answer to that question, Mr. Barofsky, by the questions you ask of Treasury when you are

talking about conditions? That is going to give you some clue as to what the goals are.

Mr. BAROFSKY. Absolutely, Senator. Part of our reporting requirement is to set that information out. We asked Treasury, with each of our data calls on a quarterly basis, to give an explanation for each of the programs. In our last report they just referred us to the website, but we are always hopeful that they will provide more detailed information this time.

The CHAIRMAN. Yes. I will not go there.

Mr. Dodaro, what more powers should GAO have to do the job?

Mr. DODARO. I need two bits of help: number one, passage of S. 340 would be an important safeguard for us going forward. I again appreciate your and Senator Grassley's sponsorship of that legislation. That would be a big help. But even beyond that is the Federal Reserve issue. Based on your chart here, most of the money in the \$2.9 trillion is being spent under the tutelage of the Federal Reserve activities, and that is an area where we are statutorily prohibited. As long as they are operating under monetary policy and the discount window operations and an open market committee, we just cannot—

The CHAIRMAN. You make a good point. The role of the Fed has changed dramatically, so the usual defense that we should not intrude on the integrity and the independence of the Fed, I think, no longer applies. We are talking about a role, an involvement which is beyond just regulating the money supply.

Mr. DODARO. Yes.

The CHAIRMAN. There is an honest, direct involvement, trillions of dollars which have very significant effects on inflation, or potential inflationary effects, real management effects related to what the Treasury does or does not do. I mean, clearly the Fed is working in concert with the Treasury. They are hand in hand here.

So I think it is only appropriate that we find some way to find out how the Fed is operating, how it spends its money, and how recipients are using that money, too. You also said we should address this in a constructive way, and I agree with you. But clearly the role of the Fed has changed, and therefore I think we have to look more closely and encourage the Fed to act much more transparently than it has.

Mr. DODARO. Yes. And I think in the short term, Mr. Chairman, there could be some carefully crafted legislation to give us authority, either piggy-backing off of when they use their emergency authority or not. But I would make this point, also. We have said that there is a need to modernize the financial regulatory system, more broadly speaking, that the current system is outdated, fragmented.

The CHAIRMAN. Yes, it is.

Mr. DODARO. This whole issue, as that system is modernized, the question of proper oversight, proper accountability, and proper transparency will need to be revisited in that broader—

The CHAIRMAN. What about resources? Mr. Barofsky, do you have the adequate resources to do your job? Because you have a lot of responsibility here.

Mr. BAROFSKY. We do, Senator. Part of S. 383 released the full \$50 million that you had fought for us to receive under the Stabilization Act, and that will certainly take care of us for the time

being. We will be coming back for more when the time is right to seek more financial resources.

The CHAIRMAN. Well, I thank you all for the job you are doing. Clearly, this hearing indicates the immense uncertainty as to how the money is being spent. I think you are all doing a very good job in trying to answer that question.

But I also think that you need a little help from this committee and from the Congress. You mentioned legislation, which is helpful. But we encourage you to keep up, keep the job up, do what you are doing. Be very aggressive. Be very aggressive. If you run into any problems at all, you let us know, because we want to work with you and help you do your job. You are in a much better position to ask these questions than we are, but we want to give you the full authority to go ahead and proceed. This is very worrisome.

The potential exposure, as I mentioned in my opening statement, is close to \$6 or \$7 trillion. We spent \$2.9 trillion, on the chart there. As I said in my statement, that is the size of the whole U.S. Government last year. We have two governments here, one is a second government just bailing out financial institutions. There is a lot of transparency and accountability in the first government. This next one is the issue here that we are trying to grapple with. Thanks for what you are doing.

Senator Grassley? I have to leave, so you can finish up.

Senator GRASSLEY. All right. Thank you.

I only have a couple of questions, so obviously I will not keep you long. So the chairman can hear this, Ms. Warren, maybe if you are having trouble getting Treasury to give you information, if they would like to sit down and have some Senators sit down with you when you are asking Treasury those questions, I would like to hear them say why we are not entitled to this information.

The same people who are telling you no come before this committee and tell us they will answer our questions, and they do not do it. So I do not think they are lying, but there is a culture—not just in Treasury—in too much of the bureaucracy that, we are going to drag our feet as long as we can get away with it.

Senator Lincoln touched on this a little bit, but to you, Ms. Warren, about small business. Your panel has a different job than the IG's or the GAO when it comes to oversight. Your panel is focused on policy. I would like to know how you think that the TARP is helping small business.

I consider them the engines of growth and job creation, et cetera—I think 70, 80 percent of the new jobs. The overwhelming majority of TARP money has, however, gone to large national, and even multinational, institutions. Yet these institutions are the ones that seem to be doing less lending after getting the TARP money, which means less money for small businesses. Thank God our community banks have stepped in and kept up their responsibilities.

Two questions. One is a short one, and one is a long one. I want to ask them both at the same time. Do you have any suggestions on how to hold these large banks accountable? Number two, also, since the Federal Government, through SBA, already guarantees small business loans, can you tell me how Treasury's purchase of these loans through the Term Asset Loan Facility—TALF, I sup-

pose is the acronym—will improve small business owners' access to credit?

Ms. WARREN. Yes, Senator. I share your view that small businesses are probably our best engine for being able to get this economy back on track in job creation and in every other kind of innovative economic activity. But I am going to go back to where I started this about laying out what your plan is and what you are trying to accomplish.

If the plan had been announced from the beginning that what we want to do is make sure that small businesses have enough money to continue to operate, then I do not think we would have designed the initial infusion of capital into the financial institutions in the same way. It would have gone to financial institutions that did small business lending as a substantial part of their operations, and then it would have gone on terms that said, show us what you have done in the past and show us what you are doing after you receive the money.

So this program is not designed, from the beginning, in my view, to focus efforts on small business lending. We raised this question in our December report, and we came back to it again in our January report. Now the place we are in, we are now going forward, this will be a significant focus not on the report that will be out in a few days, our April report, but our May report. We are deep into investigations about small business lending.

I would say for your question about the TALF, Senator, I am deeply puzzled about the underlying theory that, when a portion of the loans that are already 100-percent guaranteed cannot be sold in the marketplace and somehow we need to pay hedge funds in order to get involved in the sale of those loans, I am struggling to understand the premise behind this portion of the program and therefore struggling to understand how it is that it will increase small business lending.

This is something I hope I will have a better answer for in another month. We are working and we are investigating this right now. We are looking for more answers on it. But I can only say at this point, this is a top priority for the Congressional Oversight Panel and an area where we are deeply troubled by the direction the Treasury has gone.

Senator GRASSLEY. Yes. So I think what you are saying is, we were not explicit enough when we wrote the legislation. I do not know. Maybe this is too transparent on my part. But I think maybe Congress was awed by a person who comes off of Wall Street, making tens and tens of millions of dollars' salary before he comes into the Cabinet, awed that you think he has all the answers. Then you find out when it is all said and done, he does not know a whole lot more about it than we in Congress do who are very generalist. I think that is why this legislation was so poorly written in the first place, at least based upon what you just told me; if we wanted to do small business, we should have said so more.

My last question. This is to Mr. Barofsky. I have reviewed AIG's retention bonus plans. What bothers me is that the so-called retention bonuses were really performance bonuses based on 2007 performance. From the design of the plan, it looks like people who put it together knew that the 2008 performance was going to be bad,

so, because AIG knew it was not going to be paying performance bonuses in 2008, in a wink and a nod AIG simply paid its employees their 2007 performance bonuses a second time, and they will do it again in 2009, regardless of the company's performance. However, AIG's disclosure of the plan to investors in its May 2008 filing with SEC did not make that clear. It just describes a retention plan in vague terms without mentioning that it was calculated on 2007 performance.

I have three questions, and I will ask you to answer them separately. Is it possible to find out whether people at AIG wrote the bonus plan based on the 2007 performance because they knew AIG was facing massive losses in 2008?

Mr. BAROFSKY. Yes. That will be part of an ongoing audit that we have and will capture that information.

Senator GRASSLEY. All right.

If it is true that management rigged the bonus plan for that reason and failed to properly disclose that to investors, would that be a potential violation of securities law?

Mr. BAROFSKY. An intentional misrepresentation of a material fact, if it met that criteria, would certainly potentially be a violation of the criminal law.

Senator GRASSLEY. Do you happen to know whether SEC is examining whether the disclosure of the bonus plan was adequate?

Mr. BAROFSKY. We coordinate with the SEC on a regular basis, but I would be reluctant to comment on any pending or existing matter.

Senator GRASSLEY. All right. You cannot comment on it, but do you think you know?

Mr. BAROFSKY. Senator, I am sorry. I do not mean to be overly cautious here, but we generally do not comment on other agencies' activities unless they are public.

Senator GRASSLEY. All right. Well, I should not push you to do something you cannot do, unless you are trying to get around me, and I do not think you are.

Mr. BAROFSKY. Never, Senator. Never. I know better. [Laughter.]

Senator GRASSLEY. All right.

Since AIG is a major recipient of TARP funds, are you able to investigate whether disclosure of the bonus plan was adequate?

Mr. BAROFSKY. We can, and we will.

Senator GRASSLEY. All right.

Now, for the chairman and all the other members, thank you for this fine testimony. We are obviously going to have to be in touch with you on a regular basis. I hope the chairman will call you back frequently.

Thank you very much.

The hearing is adjourned.

[Whereupon, at 12:19 p.m., the hearing was concluded.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD



FOR OFFICIAL USE ONLY UNTIL RELEASED BY THE
SENATE FINANCE COMMITTEE

STATEMENT OF NEIL BAROFSKY
SPECIAL INSPECTOR GENERAL
TROUBLED ASSET RELIEF PROGRAM

BEFORE THE
UNITED STATES SENATE
FINANCE COMMITTEE

March 31, 2009

Chairman Baucus, Ranking Member Grassley, and Members of the Committee, I am honored to appear before you today.

The Office of the Special Inspector General for the Troubled Asset Relief Program (“SIGTARP”) was created under the Emergency Economic Stabilization Act of 2008 (“EESA”) to conduct, supervise, and coordinate audits and investigations of the purchase, management, guarantee, and sale of assets under the TARP. More than \$300 billion has already been expended, and Secretary Geithner has recently provided more details about Treasury’s plans for how Treasury will spend - and leverage - the bulk of the full \$700 billion approved by Congress under EESA.

In our second report to Congress due on April 20, 2009, SIGTARP will discuss several of the new programs recently announced by Treasury and our work concerning the original programs. Some of these new programs include efforts to deal with rampant foreclosures, to provide additional capital to struggling banks, to facilitate lending to small businesses, and to address the toxic assets that remain on many financial institutions’ books. As announced, the total amount of money under our oversight, including those aspects of the programs that are funded in part by the Federal Reserve and FDIC, is as much as \$2.97676 trillion. I have included as an attachment to my testimony a chart that lists the different amounts that Treasury has stated it will dedicate to each program, and the amounts that Treasury has indicated will come from the TARP to support these programs. These figures do not reflect additional funding that may be related to the revised auto program announced yesterday, nor does it include the \$750 billion that the Administration put aside in its budget request that it has noted it may seek later this year, any leverage it may apply to those additional funds, or the leverage that it may seek to apply to the remaining TARP funds (or those that may be returned by recipients).

To accomplish SIGTARP’s mission to oversee this vast amount of money for the American taxpayer, I have focused on three areas: transparency, coordinated oversight and robust criminal and civil law enforcement.

Transparency has been an area of focus for SIGTARP from day one. In late December, within days of taking Office, I formally recommended that Treasury post all TARP agreements, whether with recipients of TARP funds or with its vendors, on the Treasury website. That

recommendation has been adopted, and Treasury is in the process of posting all agreements to its website. Similarly, I pushed for, and obtained, oversight language in the Citigroup and Bank of America agreements that require those banks to account for and report on their use of the TARP funds. We continue to press for increased transparency as Treasury rolls out the new TARP programs.

SIGTARP is also using its audit function to bring increased transparency to the TARP. Our first two audit efforts were launched with a survey of TARP recipients on their use of TARP funds and their compliance with TARP executive compensation requirements. These audits were related to two of the most frequently asked questions by the Congress and the public regarding the TARP program. As a part of the audit, SIGTARP issued a survey of recipients of TARP funds, which asked: (1) what had recipients done with the money they had received from Treasury, and (2) whether they were complying with executive compensation requirements imposed as a condition of receiving the funds. Beginning on February 5, 2009, SIGTARP sent letters to the 364 TARP recipients who had received assistance through January 2009. Most of the recipients were financial institutions receiving assistance under the TARP Capital Purchase Program. Recipients were asked to provide their responses within 30 days of the date of the request, and to include copies of pertinent documentation to support their responses. Attached to my testimony is a copy of the letter that we sent out.

As indicated in Table 1 below, the firms surveyed varied in the amount of funding received, but the majority of funding went to a small number of recipients, with 26 firms receiving approximately 93 percent of the funding through January 30, 2009.

Table 1: Number of TARP Recipients Surveyed by Funding Received

Funding category	Number of firms	Funding received (in billions)	Percentage of funding
\$10 billion or more	8	\$219.3	73.4
\$1 billion to \$9.9 billion	18	58.3	19.5
\$100 million to \$999.9 million	54	14.6	4.9

Less than \$100 million	284	6.6	2.2
Total	364	\$298.8	100

Source: SIGTARP analysis of Treasury data.

Note: The total funding associated with the survey recipients included \$190.5 billion under the Capital Purchase Program, \$40 billion under the Targeted Investment Program, \$40 billion under the Systemically Significantly Failed Institutions Program, \$23.3 billion under the Automotive Industry Financing Program, and \$5 billion under the Asset Guarantee Program.

As of March 23, 2009, SIGTARP had received responses from all 364 TARP recipients—a remarkable 100 percent response rate—with additional supporting information arriving beyond that date. Analysis of that information is ongoing and any conclusions are tentative; however, SIGTARP’s initial look at some of the responses indicates that those responding to the request for information provided a broad range of answers to the two sets of questions. One thing, however, was apparent from the responses – complaints that it was impractical or impossible for banks to detail how they used TARP funds were unfounded. While some banks indicated that they had procedures for monitoring their use of TARP money, others did not but were still able to give information on their use of funds. I believe this makes an even stronger case for a recommendation we made back in December and which up until now has not been adopted – Treasury should require TARP recipients to monitor their use of funds and be required to provide certified reports to Treasury on how they are using taxpayer money.

While some banks may have provided general responses, others identified detailed and specific uses of the funds, in some cases with granular detail. For example, some banks provided information about specific loans that they could not have made absent TARP funds, others specifically detailed debt that were able to pay down, and some gave the precise amount of investments that they made with TARP funds. Respondents also provided varying degrees of documentation to augment and support their narrative responses, with some noting that additional documentation had been segregated at their office and were available for review as needed.

As indicated, while time will be required to fully and thoroughly assess the responses received, SIGTARP can report that, based on an initial review of the responses that we received:

1. Respondents provided diverse answers to how funds received have been used such as to strengthen the capital base of individual banks providing a foundation for lending activities; retiring debt, purchasing mortgage backed securities, increasing credit lines, making loans, etc.
2. Some respondents spoke to new lending activities in relationship to actual TARP funds received, whereas others spoke of leveraging the funds to achieve greater lending than that related to the face value of TARP funds received. Some, however, noted that while they were committed to making prudent commercial and consumer loans, growth of new loans had slowed as a result of the economy and the decrease in demand.
3. Some respondents indicated that the Treasury's equity investment was separately recorded as a discrete component of the bank's capital, but the actual funds associated with the investment were not physically segregated from other cash funds; others cited efforts to physically segregate the funds or to manage them separately, at least for a time, such as the funds being held at the holding company level, later to be "down-streamed" to individual banks.
4. Responses to questions regarding compliance with executive compensation restrictions varied from simple statements of compliance based on the size of their banks and compensation, to detailed answers regarding extensive efforts to assess compensation practices relative to restrictions associated with their funding agreements, including having retained expert consultants to help with the assessments.
5. Some responses related to executive compensation took note of the changing guidance and legislation related to executive compensation requirements which limited their ability to give a complete answer at this time; nonetheless, others noted actions they were taking at this time based on their known requirements, recognizing that final guidelines have not yet been issued.

Given the diversity of the responses and the fact SIGTARP asked for and received the information from the banks in narrative form, it will require some time to (1) fully sort through the data, (2) identify areas where follow-up contact with respondents is needed, and (3) identify the degree of commonality of responses in selected areas that may be aggregated for reporting purposes.

To further assess and complete its analysis of the responses during a period when it is still in the process of staffing its audit division, SIGTARP has awarded a contract to Concentrance Consulting Group, a Section 8(a) women-owned small business to help analyze the data. Importantly, it is a firm with proven experience with organizations dealing with business sensitive data such as kind included in our responses. The contract with Concentrance calls for completion of their analysis of the survey responses by June 2009. SIGTARP expects to issue a

report on the survey results as quickly as possible, subject to completion of any needed follow-up work, but hopefully within a few months.

Finally, there have been some complaints to the media that SIGTARP's oversight efforts might dissuade participation in TARP programs. Some might take this as a criticism; we do not. If a bank or financial institution does not want to participate in a TARP program because it is unwilling to disclose what it is doing with taxpayer dollars, or because it is afraid of SIGTARP's vigorous fraud detection programs, keeping those participants out of the TARP will only benefit the American taxpayer.

We have initiated three other audits that will also bring increased transparency to the TARP. First, we are looking into efforts to guard against any inappropriate external influences over the TARP application process, and we will report back to Congress on our findings. We will make such recommendations as needed based on our findings. Second, we have begun an audit into the process under which Bank of America received \$45 billion in capital investment and is to receive a guarantee relating to approximately \$100 billion of toxic assets involving multiple TARP programs. Third, we have begun an audit into federal oversight of executive compensation requirements including bonus payments to American International Group (AIG). Finally, in response to a letter that I received last week from 27 members of Congress, we are in the process of preparing an audit into AIG's payments to counterparties and other related issues raised in that letter.

As to coordinated oversight, it has been and will continue to be a privilege and a pleasure to work closely with my co-panelists, Gene Dodaro, Acting Comptroller General at GAO, and Professor Elizabeth Warren, Chair of the Congressional Oversight Panel (COP). Over the past three plus months, GAO and SIGTARP have worked effectively to coordinate audit efforts to provide maximum oversight coverage while avoiding unnecessary or duplicative burdens on those charged with managing TARP. We also have periodic meetings with the COP to discuss areas of interest, coordinate oversight and suggest areas to pursue in future reports. I have also founded and chair the TARP-IG Council, which has, as its members, GAO and the Inspectors General of the other agencies involved in aspects of the administration of TARP programs: the

Inspectors General of the FDIC, SEC, FHFA, Federal Reserve, HUD, Tax Administration, Treasury, and our newest member, SBA. Through this and other efforts we are actively coordinating our efforts and sharing ideas for comprehensive audits and investigations.

In conducting oversight, one focus of SIGTARP has been to attempt to have a positive impact on TARP programs to increase oversight effectiveness and fraud protections as the programs are developed – in other words, *before* the money goes out the door. Because I did not take office until mid-December, I was not able to offer advice with respect to the early TARP transactions, including the design of the Capital Purchase Program and the agreement with AIG. However, we have been active in providing recommendations concerning the programs and contracts that followed. Pursuant to our recommendations, the Auto Industry, Targeted Invested Program and Asset Guarantee Program agreements all contain explicit acknowledgement of SIGTARP and GAO's authority to oversee the contracts. Moreover, at my Office's recommendation, for many of the significant conditions imposed by the agreements, the recipients are required to establish internal controls to ensure that they comply with those conditions; and to report on their compliance, certifying, under criminal penalty, that their report is accurate. Collectively, these 3 programs and associated agreements – representing approximately \$484 billion in funds¹ subject to SIGTARP oversight – are a significant step forward from an oversight perspective as compared to earlier agreements and programs. In our April report, we will detail additional recommendations to Treasury to avoid waste, fraud and abuse in the recently announced TARP programs, and provide Congress with a status report on the extent that Treasury has implemented our previous recommendations.

The scope and variety of the announced TARP programs, now involving eleven different programs and up to \$2.976 trillion, in funds subject to some degree of SIGTARP oversight, leads to our third area of focus, criminal and civil law enforcement. Of the four primary oversight bodies referenced in EESA, SIGTARP stands as the sole TARP oversight body charged with criminal law enforcement authority: as the cop on the beat. This is one of our most important functions, and we are meeting this unprecedented challenge head on.

¹ This includes \$25 billion under the Auto Program, \$40 billion under the Targeted Investment Program, \$419 and billion under the Asset Guarantee Program.

We are exploring task force and similar regional relationships throughout the country to deter criminal activity before it occurs, and to investigate and prosecute any and all who attempt to profit criminally from this National crisis. On that front, I am pleased to announce that we have established a multi-agency task force focused on the TALF program, a New York Federal Reserve/Treasury program that has been announced as up to a trillion dollar program and will now serve two tasks: to reinvigorate the “shadow” financial system by returning liquidity to the securitization market, and to help move toxic assets off of financial institutions books. The TALF Task Force includes many major law enforcement entities each bringing a unique level of expertise and capability to assist the greater effort. The TALF Task Force will work collectively to identify fraud vulnerabilities in the TALF program and proactively and aggressively investigate any indications of wrongdoing. We believe that this Task Force has already served as a powerful deterrent, and when we detect fraud, rest assured we will promptly investigate the matter and refer it to the relevant and appropriate state or federal prosecutor for quick and effective prosecution. The TALF Task Force had its first formal meeting last week, and we intend for it to redefine the policing of federal government programs: proactively setting up a law enforcement response through training and the leveraging of resources *before* fraud occurs. This structure recognizes the inevitability of fraud in large government programs and will give us the ability to make better recommendations so that the emerging programs will be better designed to avoid fraud; to identify possible fraud related activities and appropriately share them among participating agencies to augment limited resources and improve fraud detection; to educate and sensitize law enforcement so that we may quickly detect fraud and any emerging criminal patterns; and to establish a framework in place to receive and investigate criminal referrals relating to these extremely complex programs. We believe that the TALF Task Force will serve as a model for other multi-agency approaches to TARP programs, and we are considering expansion of the TALF Task Force to include investigations relating to the recently announced Public Private Investment Program. We are also planning a coordinated response to potential fraud in other parts of the TARP, including the recently announced mortgage modification initiative.

I am also very pleased to announce that SIGTARP has developed a partnership with the talented law enforcement analysts working with the New York High Intensity Financial Crime Area (NY HIFCA) program. SIGTARP investigators will work hand-in-hand with HIFCA analysts to

identify indicators of fraud associated with TARP prospectively through comprehensive data research and analysis, and HIFCA analysts will provide analytical support with respect to SIGTARP's ongoing investigations.

Additionally, we have begun our outreach to potential whistleblowers and those who may have tips about ongoing waste, fraud and abuse in TARP programs. The SIGTARP Hotline is operational and can be accessed through the SIGTARP website at www.SIGTARP.gov, and by telephone at 1 (877) SIG-2009. The Hotline has been contacted approximately 180 times during its short existence and has already yielded results, and we have already opened investigations based on whistleblower complaints. Plans are being formulated to develop a fraud awareness program with the objective of informing potential whistleblowers of the many ways available to them to provide key information to SIGTARP on fraud, waste and abuse involving TARP operations and funds, and explaining how they will be protected. Training programs are being developed to instruct law enforcement at a variety of agencies to assist in the oversight of the TARP, particularly with respect to the recently announced programs. In this regard, existing capabilities at several other agencies that routinely receive fraud complaints, have been sensitized to the SIGTARP mission and the various TARP programs, and mechanisms have been established to share TARP related complaints as they are received.

We stand on the precipice of the largest infusion of Government funds over the shortest period of time in our Nation's history. History teaches us that an outlay of so much money in such a short period of time will inevitably attract those seeking to profit criminally. If, by percentage terms, some of the estimates of fraud in recent government programs apply to the TARP programs, we are looking at the potential exposure of hundreds of billions of dollars in taxpayer money lost to fraud. The TARP program is too important, and taxpayer funds are too dear, to allow that to happen.

I would like to take this opportunity to express my gratitude to both houses of Congress for their bipartisan support in unanimously passing S.383, and to the several members of this Committee who cosponsored it. This bill will provide some additional flexibility to hire the kind of experienced staff required to oversee the massive infusion of government funds into the private market.

Finally, I would like to make a couple of comments about the controversy surrounding the bonus payments that AIG has recently made to its executives. First, both in my role as the Special Inspector General, and as an individual taxpayer concerned with stabilizing the financial system in a manner that does not reward those who caused the crisis in the first instance, I too am frustrated with these very substantial bonuses given at a time when AIG would have by now been in bankruptcy proceedings but for huge, repeated infusions of government money.

In this regard, we have been coordinating with the Department of Justice and its examination of the options available to recover tax payer money. As already noted, we have an audit underway examining Federal monitoring and enforcement of executive compensation restrictions imposed as a condition of Federal financial assistance to organizations such as AIG. As part of this audit, we will be looking closely to ensure that the bonuses to AIG employees are not inconsistent with AIG's legal or contractual obligations, to report to Congress the sequence of events which led to the approval of these payments by government officials (including the general approval of retention payments in AIG's agreement with Treasury in November 2008), and to the extent that we find that there were miscommunications among AIG, Treasury and Federal Reserve officials regarding these payments, we will make recommendations to ensure that all parties involved in TARP related programs effectively communicate with one another.

Chairman Baucus, Ranking Member Grassley, and Members of the Committee, I commend you for your efforts to ensure that the trillions of dollars being expended under TARP-related programs receive close oversight scrutiny. This concludes my statement and I would be happy to answer any questions you may have.

SIGTARP Hotline

If you are aware of fraud, waste, abuse, mismanagement or misrepresentations affiliated with the Troubled Asset Relief Program, please contact the SIGTARP Hotline.

By Online Form: www.SIGTARP.gov

By Phone: Call toll free: (877) SIG-2009

By Fax: (202) 622-4559

By Mail:

**Hotline: Office of the Special Inspector General
For The Troubled Asset Relief Program**
1500 Pennsylvania Ave., NW, Suite 1064
Washington, D.C. 20220

Press Inquiries

Please contact our Press Office if you have any inquiries:

Kris Belisle,
Director of Communications
Kris.Belisle@do.treas.gov
202-927-8940

Legislative Affairs

Please contact our Legislative Affairs Office for Hill inquiries: Lori Hayman

Legislative Affairs
Lori.Hayman@do.treas.gov
202-927-8941

Obtaining Copies of Testimony and Reports

To obtain copies of testimony and reports please log on to our website at www.sig tarp.gov




SIGTARP
**OFFICE OF THE SPECIAL INSPECTOR GENERAL
FOR THE TROUBLED ASSET RELIEF PROGRAM**

ADVANCING ECONOMIC STABILITY THROUGH TRANSPARENCY, COORDINATED OVERSIGHT AND ROBUST ENFORCEMENT

TOTAL FUNDS SUBJECT TO SIGTARP OVERSIGHT

Program	Brief Description or Participant	Total Funds Subject To SIGTARP Oversight (\$)	Projected TARP Funding (\$)
Capital Purchase Program ("CPP")	Investments in 518 banks to date, top 9 institutions over \$125 billion	\$218 billion	\$218 billion
Automotive Industry Financing Program ("AIFP")	GM, Chrysler, GMAC, Chrysler Financial Services LLC	\$25 billion	\$25 billion ¹
Auto Suppliers Support Program ("SSP")	Government-backed protection for auto parts suppliers	\$5 billion	\$5 billion
Unlocking Credit for Small Businesses ("UCSB")	Purchase of securities backed by SBA loans	\$15 billion ^a	\$15 billion
Systemically Significant Failing Institutions ("SSFI")	AIG Investment	\$70 billion	\$70 billion ^b
Targeted Investment Program ("TIP")	Citigroup, Bank of America Investments	\$40 billion	\$40 billion
Asset Guarantee Program ("AGP")	Citigroup, Bank of America, Ring Fence Asset Guarantee	\$419 billion ^a	\$12.5 billion ^d
Term Asset-Backed Securities Facility ("TALF")	FRBNY non-recourse loans for purchase of asset-backed securities	Up to \$1 trillion	\$80 billion
Making Home Affordable Program ("MHA")	Modification of mortgage loans	\$75 billion ^e	\$50 billion
Public-Private Investment Program ("PPIP")	Disposition of legacy assets, Legacy Loans Program, Legacy Securities Program (Expansion of TALF)	\$500 billion - \$1 trillion	\$75 billion
Capital Assistance Program ("CAP")	Capital to qualified financial institutions; includes stress test	TBD	TBD
New Programs, or Remaining Funds For Existing Programs	Not yet announced	\$109.5 billion	\$109.5 billion
Total		\$2.476 - \$2.976 trillion	\$700 billion

¹ Excludes any additional funding based on program changes announced on March 30, 2009.

Notes:

- ^a Actual amount of funding has not been announced as of 3/17/2009. The funding will be based on the number and the size of small business loans eligible under SBA program guidelines.
- ^b A new equity capital facility will be created by Treasury allowing AIG to draw down up to \$30 billion as needed.
- ^c Bank of America's pool of assets has not been finalized.
- ^d Bank of America's \$7.5 billion of projected TARP funds is preliminary based on the 1/15/2009 Treasury announcement and pending the finalized agreement.
- ^e \$75 billion is for mortgage modification.

Sources:

CPP, TALF and PPIP. Treasury, Office of Financial Stability, Chief of Compliance and CFO. SIGTARP interview, 3/30/2009. AIFP: From US Department of the Treasury FIRB Tranche Report to Congress, February 6, 2009 pg. 2 states that Treasury will fund an additional \$4Bn on February 17, 2009. SSP: Treasury, "Auto Supplier Support Program: Stabilizing the Auto Industry in a Time of Crisis," 3/19/2009, http://www.treas.gov/press/releases/docs/supplier_support_program_3_18.pdf, accessed 3/19/2009. UCSB: Treasury, "Unlocking Credit for Small Businesses. FAQ on Implementation," 3/17/2009, www.treas.gov, accessed 3/18/2009. SBA, "American Recovery and Reinvestment Act of 2009" webpage, no date, <http://www.sba.gov/recovery/index.html>, accessed 3/25/2009. SSFI: Treasury, "U.S. Treasury and Federal Reserve Board Announce Participation in AIG Restructuring Plan," 3/2/2009, www.treas.gov, accessed 3/4/2009; TIP: Treasury, Transactions Report, 3/24/2009, www.treas.gov, accessed 3/30/2009; AGP: Treasury, "Treasury, Federal Reserve, and FDIC Provide Assistance to Bank of America," 1/16/2009, www.treas.gov, accessed 1/16/2009. Treasury, "U.S. Government Finalizes Terms of Citi Guarantee Announced in November," 1/16/2009, www.treas.gov, accessed 3/30/2009. TALF: Treasury, "Financial Stability Plan Fact Sheet," 2/10/2009, www.treas.gov, accessed 3/17/2009. MHA: Treasury, "Making Home Affordable: Updated Detailed Program Description," 3/4/2009, www.treas.gov, accessed 3/4/2009. GAO, "Report to Congressional Committees: Troubled Asset Relief Program - March 2009 Status of Efforts to Address Transparency and Accountability Issues," 3/26/2009. PPIP: Treasury, "Public-Private Investment Program. Fact Sheet," 3/23/2009, www.treas.gov, accessed 3/23/2009.

OFFICE OF THE SPECIAL INSPECTOR GENERAL
TROUBLED ASSET RELIEF PROGRAM
1500 Pennsylvania Ave., N.W., Suite 1064
Washington, D.C. 20220

February 5, 2009

(Addressee)

The Emergency Economic Stabilization Act of 2008 (“EESA”) that established the Troubled Asset Relief Program (TARP) also created the Office of the Special Inspector General Troubled Asset Relief Program (SIGTARP). SIGTARP is responsible for coordinating and conducting audits and investigations of any program established by the Secretary of the Treasury under the act. As part of an audit into TARP recipients’ use of funds and their compliance with EESA’s executive compensation requirements,

I am requesting that you provide my office, within 30 days of this request, the following information:

- (1) A narrative response specifically outlining (a) your anticipated use of TARP funds; (b) whether the TARP funds were segregated from other institutional funds; (c) your actual use of TARP funds to date; and (d) your expected use of unspent TARP funds. In your response, please take into consideration your anticipated use of TARP funds at the time that you applied for such funds, or any actions that you have taken that you would not have been able to take absent the infusion of TARP funds.
- (2) Your specific plans, and the status of implementation of those plans, for addressing executive compensation requirements associated with the funding. Information provided regarding executive compensation should also include any assessments made of loan risks and their relationship to executive compensation; how limitations on executive compensation will be implemented in line with Department of Treasury guidelines; and whether any such limitations may be offset by other changes to other, longer-term or deferred forms of executive compensation.

In connection with this request:

- (1) We anticipate that responses might well be quantitative as well as qualitative in nature regarding the impact of having the funds, and we encourage you to make reference to such sources as statements to the media, shareholders, or others concerning your intended or actual use of TARP funds, as well as any internal email, budgets, or memoranda describing your anticipated use of funds. We ask that you segregate and preserve all documents referencing your use or anticipated use of TARP funds such as any internal email, budgets, or memoranda regarding your anticipated or actual use of TARP funds.
- (2) Your response should include copies of pertinent supporting documentation (financial or otherwise) to support your response.
- (3) Further, I request that, your response be signed by a duly authorized senior executive officer of your company, including a statement certifying the accuracy of all statements, representations, and supporting information provided, subject to the requirements and penalties set forth in Title 18, United States Code, Section 1001.
- (4) Responses should be provided electronically within 30 days to SIGTARP at SIGTARP.response@do.treas.gov with an original signed certification and any other supporting documentation mailed to: Special Inspector General – TARP; 1500 Pennsylvania Avenue, NW; Suite 1064; Washington, D.C. 20220.

We think this initiative is vital to providing transparency of the TARP program, and to the ability of SIGTARP and others to assess the effectiveness of TARP programs over time. If you have any questions regarding this initiative, please feel free to contact Mr. Barry W. Holman, my Deputy Inspector General for Audit at (202) 927-9936.

Very truly yours,



Neil M. Barofsky
Special Inspector General

OMB Control No. 1505-0212
(Expires August 2009)

An agency is not authorized to conduct, and persons are not required to respond to, an information collection request unless it displays a valid control number. Response is mandatory for all selected participants in the TARP program.

Senate Finance Committee
TARP Oversight: A Six-Month Update
March 31, 2009

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

Questions from Senator Baucus

1. **There seems to be some confusion about what happens to dividends paid by banks back to TARP. Second, I would like to know what happens if banks repay TARP funds. What is the status of those funds – can they be used again for TARP, are they used to reduce the deficit, do they go into another separate account?**

Under the Emergency Economic Stabilization Act of 2008 (“EESA”), dividends are treated differently from repayment of principal. Dividends, which are “[r]evenues of” troubled assets, must be used to pay down the debt and cannot be reused by Treasury, pursuant to EESA Section 106(d). According to Treasury, however, the principal of any TARP funds that are repaid can be reused for other TARP initiatives, at least as long as Treasury’s authority to use TARP funds still exists, currently until December 31, 2009. While SIGTARP has not done an in-depth legal analysis on this issue, Treasury’s view does appear to be consistent with EESA, which, in Section 115, gives authority to the Secretary of the Treasury to have up to \$700 billion “outstanding at any one time.”

2. **President Obama has included in his budget \$750 billion in additional funds through TARP. Much of Congress’ determination on whether these funds should be provided will depend on the progress of the existing programs established within TARP. Do you believe Treasury has in place the proper mechanisms to track such progress? To the extent possible, can you please provide what you believe to be a best measurement of progress or success for each of the 12 programs?**

Measuring progress in the various programs depends not only on what program is being measured, but also on how one defines success in the first instance. Moreover, one’s conclusions on these issues often are informed as much by policy viewpoints as by quantitative measures.

As to the programs that involve direct capital infusions into (or asset guarantees relating to) financial institutions, such as the CPP, SSFI, TIP, CAP, and AGP, determining success or failure depends in large part on how one measures success. One’s view might vary considerably if the focus is on whether avoiding the failure of the banks receiving funds is a key goal (an area that has seen success at least thus far) or whether increased lending is the aim (which has generally not yet occurred). As described in SIGTARP’s Quarterly Report, beginning at page 49, Treasury is now tracking lending on a monthly and quarterly basis. For its part, SIGTARP believes that this tracking of TARP’s *effect*, while a step in the right direction, is not sufficient and that

Treasury should (as SIGTARP has repeatedly recommended) require recipients to account for their actual use of TARP funds. Because Treasury has thus far refused to adopt this recommendation, SIGTARP has surveyed 364 TARP recipients that had received TARP funds through January 31, 2009, and has asked them to describe their use or planned use of TARP funds. We anticipate that the preliminary results of that project will be released in June.

Success or failure in the other programs is even more complicated. Whether the TARP funds expended in the various TARP programs designed to bolster the automobile industry during Chrysler and GM's reorganization have been well spent, for example, is almost entirely a policy decision and depends in large part on what one thinks would have happened had those firms been forced into bankruptcy late last year.

On the other programs, it is just too early to tell whether they have been or will be successful. Success or failure in the mortgage modification initiative will depend on how many mortgage modifications are successfully modified in the first instance and how many of those modifications are successful in avoiding foreclosure. That program is just beginning. The Term Asset Backed Securities Loan Facility ("TALF") has only been in existence for two subscription cycles thus far, and TALF has not yet been expanded to additional asset classes. And the Public-Private Investment Program has not yet begun.

As set forth in more detail in the attached excerpt from SIGTARP's Quarterly report, SIGTARP made to has already provided Treasury with significant recommendations concerning these new programs and will be monitoring their progress closely.

Questions from Senator Grassley

- 1. I am and continue to be very concerned about the amount of fraud involved in the mortgage market. I have expressed to among others the Chair of the FDIC that I am concerned and am seeking assurances that loan modification programs do not provide subsidies to borrowers who provided false or misleading information in order to receive a larger mortgage than they could afford. I have suggested some simple changes to the program to combat fraud, such as (1) requiring borrowers to sign a sworn statement that they did not obtain the original loan through fraud, (2) comparing income information from tax returns to the original loan documents, and (3) confirming owner occupancy with copies of utility bills. What are your views on the extent of borrower fraud, its role in causing the mortgage crisis, and what safeguards a mortgage modification plan needs to have to prevent rewarding existing fraud as well as encouraging additional fraud?**

I couldn't agree more that there should be concern about fraud in the mortgage market. I headed the Mortgage Fraud Group as a federal prosecutor in the United States Attorney's Office for the Southern District of New York. This group investigated and prosecuted all aspects of mortgage fraud, from retail mortgage fraud cases to investigations involving potential securities fraud with respect to collateralized debt obligations. One of the matters that I supervised was the broad investigation into the \$55 trillion credit default swap market, which was conducted in partnership with the New York State Attorney General's Office. In light of my background in mortgage fraud law enforcement, and in consultation with mortgage fraud experts at the FBI, SIGTARP

made a series of specific recommendations to Treasury that speak to the potential for fraud in the mortgage modification program. My recommendations dovetail closely with your recommendations, including concerns about the need for sworn statements and income verification. For your reference, I have attached an excerpt from SIGTARP's Quarterly Report that sets forth in detail SIGTARP's recommendations and Treasury's response to those recommendations to date.

2. **During the hearing, you indicated that you had an audit pending that would examine the adequacy of AIG's disclosures of its employee retention bonus plan. Please describe the scope of that audit. Will it inquire into whether the authors of the plan knew that AIG performance in 2008 was likely to be poor, and thus bonuses were based on 2007 performance? Will it be designed to determine whether AIG's SEC filings contained the omission of any material facts related to the bonus plan? Wouldn't an investigative inquiry be more appropriate to make those determinations than an audit?**

SIGTARP, as part of its audit function, has initiated an examination of the federal oversight of executive compensation requirements, focusing specifically on recent payouts of large bonus payments to American International Group, Inc. ("AIG") employees. A copy of the audit's engagement letter is attached. These payments have raised questions regarding AIG's compliance with executive compensation requirements imposed as a condition of financial assistance under TARP and the extent of coordination between Treasury and the Federal Reserve. Accordingly, SIGTARP has undertaken an audit to determine: (i) the extent to which the recent bonus payments were made in accordance with conditions imposed in return for TARP assistance; and (ii) the extent of Treasury's monitoring of AIG's executive compensation agreements, and, specifically, to what extent it was aware of the full range of executive compensation, bonus, and retention payments throughout AIG's corporate structure. The audit will generally inquire into how and when the retention plans were entered into. My office has been coordinating with the Securities and Exchange Commission on issues concerning the AIG bonus structure. We cannot comment on whether these inquiries could be the subject of ongoing criminal investigation, and, of course, decisions concerning whether to undertake audits and investigations are not mutually exclusive.

Questions from Senator Hatch

1. **In your testimony, you stated that you have recommended that Treasury require TARP recipients to monitor their use of funds and be required to provide certified reports to Treasury on how they are using taxpayer money. Why do you think Treasury has not implemented this recommendation?**

This question, of course, would best be answered by Treasury; however, we have been told that Treasury does not see the efficiency of this effort. The argument, as best we understand it, is that due to the inherent fungibility of money asking banks to account for TARP funds would be impossible or not meaningful. While we certainly understand that money is fungible, we simply do not agree that this exercise is impossible or meaningless. One of our first audits involves a survey of TARP recipients asking what recipients had done with the TARP money. While time will be required to fully assess the responses received, SIGTARP's initial review of the

responses indicates that certain banks were able to identify detailed and specific uses of the funds whereas others provided more general responses. For example, some banks provided information about specific loans that they could not have made absent TARP funds, others specifically detailed debt that were able to pay down, and some gave the precise amount of investments that they made with TARP funds. Respondents also provided varying degrees of documentation to augment and support their narrative responses, with some noting that additional documentation had been segregated at their office and were available for review as needed.

- 2. In the table that you provided titled “Total Funds Subject to SIGTARP Oversight” you have an area listed called “New Programs, or Remaining Funds for Existing Programs, which is expected to cost an additional \$109 billion. Can you explain this category and why it will cost that much?”**

The \$109 billion is essentially how much money is left after funding has been allocated to the announced programs, or, in other words, this last category indicates how much has not yet been committed to a specific program. Treasury has not yet indicated how these additional funds will be committed.

- 3. Have you found any misuse of Treasury funding received by TARP participants?**

As the Senator is aware, Treasury has, for most of the TARP programs, imposed only limited restrictions on the use of TARP funds, thereby allowing the recipients great latitude in deciding what to do with TARP funds. SIGTARP has several ongoing audits examining issues that should shed some light on TARP recipients’ use of funds. We also have a number of ongoing investigations that may touch on these issues, but we are, of course, not at liberty to discuss any ongoing investigations.

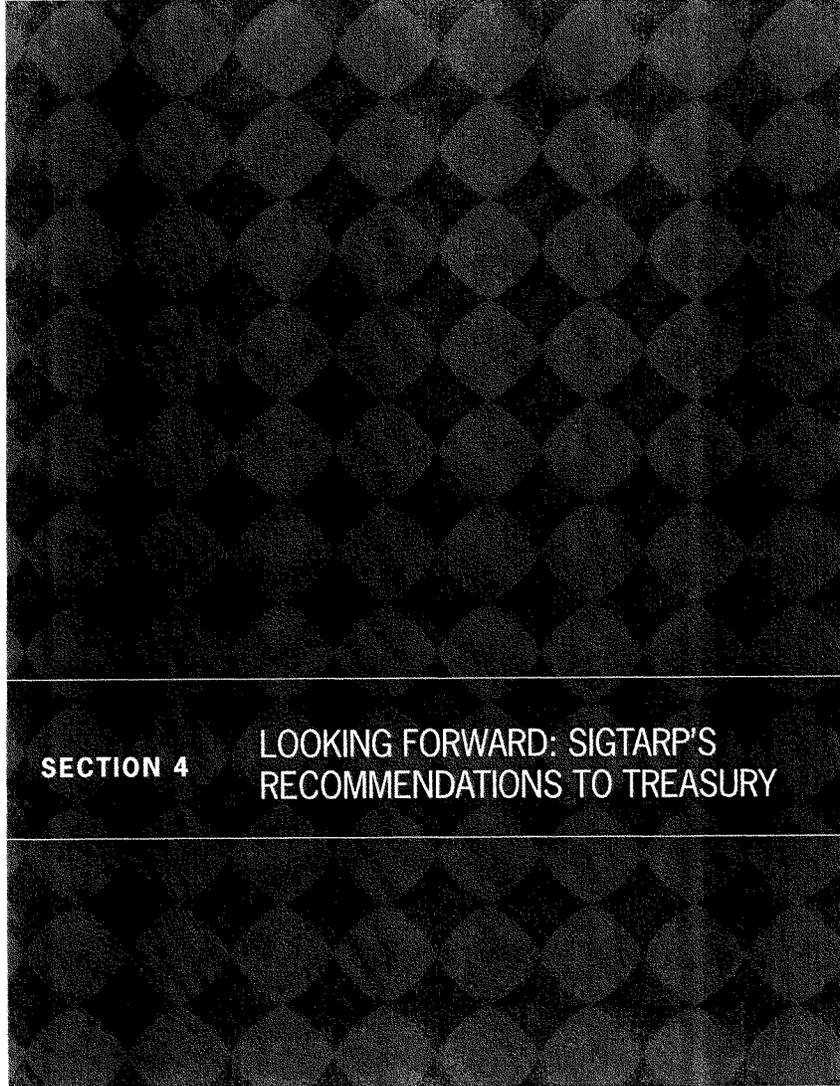
- 4. You have all expressed a common concern with the implementation of TARP. And that is that you all believe TARP can do a much better job with communication. From how money is spent to how much Treasury is receiving from its return on investment to the description of TARP, Treasury has not done a good job getting the word out about TARP. I bring this up because not only is it creating an obstacle for you all to do your job, but I feel that this is what is frustrating my constituents and many Americans. They have their heads spinning on each program that is announced by Treasury under TARP, which seems to occur on a weekly basis. What can Treasury do to strengthen communication to the public about TARP?**

One of the first recommendations that I made after coming on board in December was that all Treasury agreements with TARP recipients be posted on the Treasury website. Secretary Geithner adopted this recommendation when he took office, and Treasury recently introduced a new website to allow for more accessibility of information about TARP programs. While the new website is a significant step in the right direction, SIGTARP has identified several areas where Treasury needs to improve. As set forth in the attached excerpt from SIGTARP’s Quarterly report, we have recommended that:

- Treasury should require all TARP recipients to report on their use of TARP funds. This change alone would, in our view, substantially increase the transparency and credibility of the TARP.

- Treasury should engage asset managers who can value and manage the huge portfolio that Treasury now manages on behalf of the American taxpayer, a recommendation that Treasury has now adopted.

Furthermore, in our reports to Congress, SIGTARP has attempted to provide taxpayers with detailed explanations of the TARP programs in “Main Street” terms. Until Treasury does a better job at communicating with the public, we will continue to fulfill that role through our own reporting.



SECTION 4

**LOOKING FORWARD: SIGTARP'S
RECOMMENDATIONS TO TREASURY**

One of SIGTARP's responsibilities is to provide recommendations to the Department of Treasury ("Treasury") so that Troubled Asset Relief Program ("TARP") programs can be designed or modified to facilitate transparency and effective oversight and prevent fraud, waste, and abuse. SIGTARP's Initial Report to Congress, dated February 6, 2009 (the "Initial Report"), set forth a series of recommendations, some of which were adopted by Treasury and some of which were not. Appendix J: "Treasury Response to SIGTARP Recommendations" contains Treasury's detailed statement as to what it believes it has done to address those recommendations, and, for some of the recommendations that it has not implemented, why it has not done so. Set forth below are SIGTARP's recommendations, first with respect to implemented TARP programs and then for newly announced programs.

RECOMMENDATIONS FOR EXISTING PROGRAMS

Oversight Language in TARP Agreements and Requiring Recipients to Account for Use of TARP Funds

In its Initial Report, SIGTARP recommended that Treasury include language in each of its new TARP-related agreements to facilitate compliance and oversight. Although Treasury has not executed any agreements as part of a new program since the Initial Report, it has indicated that it will include some of the recommended oversight language in the finalized new agreement with American International Group, Inc. ("AIG") and in the Capital Assistance Program ("CAP") documents.

Treasury has indicated, however, that it will not adopt SIGTARP's recommendation that all TARP recipients be required to do the following:

- account for the use of TARP funds
- set up internal controls to comply with such accounting
- report periodically to Treasury on the results, with appropriate sworn certifications

In light of the fact that the American taxpayer has been asked to fund this extraordinary effort to stabilize the financial system, it is not unreasonable that the public be told how those funds have been used by TARP recipients. Treasury is now conducting regular surveys of the banks' lending activities; however, with the exception of Citigroup and Bank of America, Treasury has refused to seek further details on TARP recipients' use of funds.

As a result, in late January, SIGTARP decided to undertake, itself, a use of funds project by conducting a survey of 364 TARP recipients that had received funds as of January 31, 2009. Included in that survey was a request for a description of what the recipients actually did or plan to do with the TARP funds.

Although the results of the survey still need to be analyzed, one thing is clear: Treasury's arguments that such an accounting was impractical, impossible, or a waste of time because of the inherent fungibility of money were unfounded. Banks generally provided a reasonable level of detail regarding their use of TARP funds, and, while the response quality was not uniform, some banks were able to provide detailed, at times even granular, descriptions of how they used taxpayer money.

Continuing Recommendation

SIGTARP continues to recommend that Treasury require all TARP recipients to report on the actual use of TARP funds in the manner previously suggested. This recommendation is particularly important with respect to the potential expansion of the Capital Purchase Program ("CPP") to include large insurance companies. The American people have a right to know how their tax dollars are being used, particularly as billions of dollars are going to institutions for which banking is certainly not part of the institution's core business and may be little more than a way to gain access to the low-cost capital provided under TARP. Similarly, in light of the controversy surrounding AIG's use of Government assistance, both through the paying of bonuses and in its dealings with counterparties, failure to impose this requirement with respect to the injection of yet another \$30 billion into AIG would not only be a failure of oversight, but could call into further question the credibility of the Government's efforts with respect to the assistance provided to AIG. This recommendation applies not only to capital investment and lending programs involving banks and other financial institutions, but also to programs in which TARP funds are used to purchase troubled assets, including details of each transaction in the Public-Private Investment Program ("PPIP") as well as all transactions concerning the surrender of collateral (including the identity of the surrendering borrowers) in the Term Asset-Backed Securities Loan Facility ("TALF").

Asset Management and Valuation Issues

In its Initial Report, SIGTARP noted that "[t]o date, Treasury has not fully developed significant policies or controls with respect to asset management issues," and recommended that "Treasury needs, in the near term, to begin developing a more complete strategy on what to do with the substantial portfolio that it now manages on behalf of the American people."

As of the drafting of this report, however, no asset manager had been hired to manage the existing asset portfolio, and no investment strategy has been developed. Although Treasury did hire EARNEST Partners to manage the securities purchased under the Unlocking Credit for Small Businesses program, their role is limited to the program and, as of March 31, 2009, Treasury had not yet purchased securities under this particular program. Treasury has indicated that, while it has hired some individuals to develop internal models of valuation and believes that it "has

developed a robust, defined valuation method for preferred stock and warrants received under the Capital Purchase Program," no such valuation, as of the drafting of this report, had occurred.¹⁸⁸ Even if Treasury intends to hold these assets for the foreseeable future, its delay in placing a value on these assets (and thus provide the American people with some indication of the performance of their investments), among other things, is detrimental to program transparency. Although other bodies have provided some valuation analysis (the Congressional Oversight Panel has estimated that Treasury overpaid by \$68 billion in its acquisitions of assets and the Congressional Budget Office estimated that taxpayer loss in TARP will ultimately be as high as \$356 billion), SIGTARP believes that Treasury should provide its own estimates on the value of the preferred shares, warrants of common stock, notes, and other instruments that it now holds as a result of TARP. Finally, as TARP recipients pay back their TARP funds, Treasury must liquidate the warrants, either by selling them back to the CPP recipient at a market price or by selling them in the open market. While Treasury, in discussing these recommendations with SIGTARP, has indicated that it has recently made asset management more of a priority and expects to retain asset managers soon, it must act quickly. The failure to have an asset manager, an investment plan, or an accurate valuation of the securities and warrants it holds will soon be a significant deficiency in the program if not promptly addressed.

Continuing Recommendations

As SIGTARP noted in the Initial Report, there are three particular aspects of asset management that Treasury needs to address:

- Treasury should formalize its going-forward valuation methodology and begin providing values of the TARP investments to the public.
- Treasury should develop an overall investment strategy to address the vast portfolio of securities that it holds.
- Treasury should decide whether it has any intention of exercising warrants in order to hold the common stock. SIGTARP asked Treasury what its intentions are on this point in January 2009, and it has not yet indicated its strategy on this issue.

Potential Fraud Vulnerabilities Associated with TALF

In SIGTARP's Initial Report, SIGTARP made a series of recommendations with respect to the design and implementation of TALF. This section will discuss the status of the implementation of those recommendations and then describe new and ongoing recommendations for the design and operation of the program.

SIGTARP previously recommended in its Initial Report that:

- Treasury should require that certain minimum underwriting standards and/or other fraud prevention mechanisms are in place with respect to the assets underlying the asset-backed securities ("ABS") used for collateral.

Since the Initial Report, and after additional consultations with SIGTARP, the Federal Reserve Bank of New York ("FRBNY") and Treasury have taken some important steps with respect to adopting fraud prevention mechanisms far beyond what was initially contemplated for TALF. As set forth in greater detail in the TALF discussion in Section 2 of this report, FRBNY now requires, among other things, certifications from the sponsor, third-party attestations from accounting firms regarding the pledged collateral, and due diligence procedures at the primary dealer level. The TALF haircut methodology, which imposes different haircut percentages over different asset classes and maturities, has been designed, according to Treasury and FRBNY, to be risk-sensitive and therefore incentivizes TALF borrowers to conduct due diligence about the quality of the underlying securities. FRBNY has also imposed some oversight-enabling provisions for itself, including inspection rights and the ability to see through any special purpose vehicles ("SPVs") that borrowers may use to shield themselves from scrutiny. Although Treasury did not require minimum underwriting standards for the ABS acting as collateral for the TALF loans, it believes that the steps taken by FRBNY were sufficient, at least with respect to the originally announced consumer-lending-oriented asset classes. SIGTARP will continue to monitor this aspect of the program.

In its Initial Report, SIGTARP also recommended that:

- Treasury should consider requiring that beneficiaries (*i.e.*, the TALF borrowers, the originators/sponsors, and the primary dealers) sign an agreement that includes oversight-enabling provisions.
- Treasury should establish a compliance protocol with the Federal Reserve before TALF is put into effect.

In SIGTARP's view, Treasury did not receive sufficient oversight-enabling provisions in the agreements, nor has it established a sufficient compliance protocol with the Federal Reserve. Although Treasury did obtain certain inspection rights for the disposition SPV that it is funding, it has no oversight or access rights over any of the borrowers, including the borrowers who default on their loans and surrender the ABS collateral to the SPV. Indeed, Treasury does not even have the right to learn the identity of such borrowers. In other words, under its current agreement, Treasury does not have access to the identity, or any oversight authority over, the borrowers from whom, in effect, it will be buying surrendered ABS. Although

FRBNY officials have assured SIGTARP that it will provide this information in the context of any audit or investigation that SIGTARP conducts, Treasury and Office of Financial Stability ("OFS")-Compliance did not obtain such access, for itself or for SIGTARP, in its agreements with FRBNY. This failure also calls into question SIGTARP's ability to fulfill its statutorily mandated reporting requirement of including in its quarterly reports a listing of all institutions from which TARP buys troubled assets, which arguably would include the identity of the party that surrenders TALE collateral. Furthermore, Treasury has only obtained limited access for itself and SIGTARP with respect to the issuers of the ABS, who only have to grant access if it is later determined that they pledged ineligible assets to the program. This, of course, presents a significant chicken-and-egg problem, as Treasury (and SIGTARP) will be far less likely to detect any eligibility problems if they cannot inspect and test the assets in the first instance. Finally, as a result of its limited access, SIGTARP does not believe that Treasury has adopted SIGTARP's recommendation of establishing a sufficient compliance protocol concerning TALE.

In addressing the potential fraud vulnerabilities of TALE in the Initial Report, SIGTARP further recommended that:

- Treasury should exercise extreme caution and give careful consideration before agreeing to the expansion of TALE to include mortgage-backed securities ("MBS") without further review and without considering certain minimum fraud protections.
- Treasury should oppose any expansion of TALE to legacy MBS without significant modifications to the program to ensure a full assessment of risks associated with such an expansion.

Treasury and the Federal Reserve have signaled their intention to expand TALE to allow the posting of both new and legacy MBS — both commercial MBS ("CMBS") and residential MBS ("RMBS") — as collateral. As the terms of these expansions have neither been formalized nor given final approval by the Federal Reserve or Treasury, it remains to be seen if Treasury has exercised "extreme caution" in expanding TALE to newly issued MBS or whether it will require "significant modifications" before permitting legacy MBS to be included as well.

Accepting legacy MBS as collateral, in particular legacy RMBS, poses substantial issues from a credit loss and fraud loss perspective that are not readily addressed by the current TALE design. Credit ratings, cited as one of the primary credit protections in TALE as currently configured, have been proven to be of questionable value in the general market for MBS, and for legacy RMBS they have proven to be unreliable and largely irrelevant to the actual value and performance of the security. Arguably, the wholesale failure of the credit rating agencies to rate adequately such securities is at the heart of the securitization market collapse, if not the primary cause of the current credit crisis. Furthermore, the underwriting

standards (that is, the diligence the lender does before granting a loan, such as verifying a borrower's income or reported assets) for RMBS in particular, have proven to be woefully lax, potentially putting taxpayer money backing TALF in significant jeopardy. Finally, legacy MBS, particularly RMBS, pose substantial valuation challenges given how long the MBS market has been frozen, which gives rise to the same conflict of interest and collusion vulnerabilities discussed in the "Public-Private Investment Program ("PPIP")" discussion below.

As in the Initial Report, SIGTARP continues to recommend that Treasury not participate in a TALF program expanded to newly issued MBS without exercising an appropriate measure of caution, and, with respect to legacy assets, without significant modifications to the program. On that front, SIGTARP has had initial discussions with the Federal Reserve to discuss its plans for how the program will be modified to accommodate the use of MBS as posted collateral. SIGTARP has been informed by the Federal Reserve that it is considering, but has not yet adopted, the following modifications with respect to legacy RMBS, at least, in order to address the credit risks for such securities:

- acceptance of legacy RMBS as collateral based upon an examination of the composition and performance of the loan portfolio underlying the RMBS, not rating agency determinations
- a more granular determination of "haircut" percentages for RMBS, including a close examination of the underwriting standards associated with the loans that back the RMBS
- significantly higher haircuts relative to the haircuts imposed on asset classes currently useable as collateral

As of the drafting of this report, FRBNY had not indicated what additional anti-fraud measures it will impose when TALF is expanded to MBS. This is of particular importance because some of the anti-fraud provisions that FRBNY and Treasury have cited as being significant (*e.g.*, third-party attestation of assets, credit ratings, *etc.*) for the original TALF program may not be relevant or useful for the expanded TALF. SIGTARP encourages the Federal Reserve to continue this process and will continue working with the Federal Reserve, FRBNY, and Treasury to recommend protections in the program to avoid as much fraud and abuse as possible.

Recommendations

In light of the previous discussion, SIGTARP thus recommends that:

- Treasury and the Federal Reserve should provide to SIGTARP, for public disclosure in SIGTARP's quarterly reports, the identity of the borrowers who surrender collateral in TALF.

- Treasury should dispense with rating agency determinations and require a security-by-security screening for each legacy RMBS. Treasury should refuse to participate if the program is not designed so that RMBS, whether new or legacy, will be rejected as collateral if the loans backing particular RMBS do not meet certain baseline underwriting criteria or are in categories that have been proven to be riddled with fraud, including certain undocumented subprime residential mortgages (i.e., "liar loans").
- Treasury should require significantly higher haircuts for all MBS, with particularly high haircuts for legacy RMBS, or other equally effective mitigation efforts.
- Treasury should require additional anti-fraud and credit protection provisions, specific to all MBS, before participating in an expanded TALF, including minimum underwriting standards and other fraud prevention measures.
- Treasury should design a robust compliance protocol, with complete access rights for itself, SIGTARP, and other relevant oversight bodies, to all TALF transaction participants.

Treasury officials, in discussing these recommendations with SIGTARP, stated that the potential expansion of the TALE program to include legacy MBS remains in the design phase and will include more stringent standards, including "CUSIP by CUSIP evaluation of underlying collateral, conducting due diligence with respect to the underlying collateral and applying appropriate haircuts."¹⁰⁹ They have also indicated that they will adopt SIGTARP's recommendation, at least with respect to newly issued RMBS, by reviewing certain minimum underwriting standards, including high credit scores and fully documented loans. These officials also stated they are in the process of hiring a fraud specialist to assist them in developing risk mitigation efforts for all TARP programs — an action that SIGTARP previously recommended and which could greatly assist in the design of TARP programs to account properly for the dangers of fraud.

Another new development with respect to TALE is that Treasury has announced, as part of PPIF, that Public-Private Investment Funds ("PPIFs") operated under the Legacy Securities Program will be able to use PPIF funds and Treasury leverage in TALE transactions. That issue, and SIGTARP's recommendation regarding the danger of such a practice, are discussed in the upcoming "Recommendations for Newly Announced Programs" portion of this section.

Executive Compensation

It has been more than two months since the American Recovery and Reinvestment Act imposed new executive compensation requirements on TARP recipients. As of the drafting of this report, Treasury has not issued regulations imposing these new requirements or the executive compensation restrictions that the Administration announced in early February. SIGTARP's initial review of responses to its survey

of 364 TARP recipients demonstrates that the absence of clear guidance on this important issue has caused uncertainty among TARP recipients who have struggled to understand and implement the requirements. This lack of clarity in executive compensation limitations may also impede participation in other TARP programs.

Recommendation

Accordingly, SIGTARP recommends that:

- Treasury should address the confusion and uncertainty on executive compensation by immediately issuing the required regulations.

Treasury officials, in discussing this recommendation with SIGTARP, stated that internal vetting on updated guidance is nearing completion and is expected to be provided to the Office of Management and Budget for final clearance shortly. They also indicated that the outcome of this effort is expected to be a "comprehensive rule" with applicability beyond CPP.

Lack of Resources within OFS-Compliance

The Compliance department within OFS has primary responsibility over a vast and complex array of compliance and risk management functions. This responsibility includes ensuring that appropriate internal controls are in place over OFS management of TARP programs, providing primary oversight of vendors that are providing services to OFS, and monitoring TARP recipients' compliance with their contractual and legal obligations. More than 500 financial institutions are already participating in various TARP programs; additional announced programs will expand OFS-Compliance's responsibilities to a mortgage modification program involving millions of mortgages and to public-private partnerships that will involve not only many new participants but also a whole new set of compliance challenges and types of risk.

To carry out all of these responsibilities, now six months into TARP operations, OFS-Compliance currently has a staff of approximately 10 employees. Although SIGTARP has plans for a future audit to assess the integration and effectiveness of OFS's risk assessment and compliance efforts, SIGTARP makes a preliminary observation that the current resource commitment for this vitally important function appears plainly inadequate. OFS has built substantially in the past six months, but its compliance office has not grown in proportion to its historic task.

Recommendation

Accordingly, SIGTARP recommends as follows:

- Treasury should significantly increase the staffing levels of OFS-Compliance

and ensure the timely development and implementation of an integrated risk management and compliance program.

Treasury officials, in discussing this recommendation with SIGTARP, acknowledged that their compliance and risk management efforts have been understaffed but indicated they were in the process of making job offers to fill immediately five compliance positions dealing primarily with executive compensation. They also cited the use of Freddie Mac to facilitate compliance efforts in the area of home loan modifications and a vendor who is providing general fraud prevention advice. More broadly, they indicated that decisions are yet to be made concerning the ultimate size of their compliance efforts and the extent to which the functions would be performed in-house or under contract.

SIGTARP is encouraged by Treasury's efforts toward an increased emphasis on compliance, but believes additional near-term attention needs to be devoted to implement a comprehensive and integrated risk based compliance program.

RECOMMENDATIONS FOR NEWLY ANNOUNCED PROGRAMS

Capital Assistance Program

The CAP, as described in Section 2, contemplates additional capital infusions into financial institutions and/or the conversion of the preferred shares that Treasury obtained under the CPP into convertible preferred shares. Treasury announced that it would require CAP applicants to set forth how they *intend* to use CAP funding. Notwithstanding this requirement, Treasury adamantly continues to refuse to adopt SIGTARP's recommendation that it require CAP recipients (and indeed all TARP recipients) to report on how they *actually* used TARP funds. Putting aside the value of this recommendation in other TARP programs, SIGTARP submits that it is largely meaningless to require an applicant to report on its intended use of funds without setting up a mechanism to monitor its actual use of funds.

Recommendations

SIGTARP therefore recommends that:

- Treasury should require CAP participants to (i) establish an internal control to monitor their actual use of TARP funds, (ii) provide periodic reporting on their actual use of TARP funds, and (iii) certify to OFS-Compliance, under the penalty of criminal sanction, that the report is accurate; the same criteria of internal controls and regular certified reports should be applied to all conditions imposed on CAP participants.

- Treasury should require CAP participants to acknowledge explicitly the jurisdiction and authority of SIGTARP and other oversight bodies, as appropriate, to oversee conditions contained in the agreement.

Operation of the Public-Private Investment Program

As discussed more fully in Section 2, PPIF is a program in which Government funds will be invested side-by-side with private investors to purchase legacy assets, including the "toxic" mortgages and legacy MBS widely believed to be one of the root causes of the current financial crisis. As announced, PPIF consists of separate subprograms.

- Under the Legacy Loans Program, newly formed PPIFs will bid on pools of legacy mortgages and other assets held on participating banks' balance sheets. The private equity in the PPIFs will be matched, dollar-for-dollar with TARP funds, and the PPIF will be able to obtain financing guaranteed by the Federal Deposit Insurance Corporation ("FDIC") up to a 6-to-1 debt-to-equity ratio. The pools of legacy loans will be assembled with the approval of FDIC, and the auction process will be managed by FDIC. By way of example, a group of pre-qualified private investors invests \$50 million in a PPIF, which is then matched by \$50 million in TARP funds. The PPIF obtains financing guaranteed by FDIC of up to \$600 million (a 6-to-1 ratio of the total \$100 million of equity) and uses the combined \$700 million to purchase a pool of legacy mortgages. Any profits on these transactions are shared equally between the private investors and TARP; the private investors' total potential loss, however, is limited to their investment, \$50 million, whereas Government interests could lose up to the remaining \$650 million.
- Under the Legacy Securities Program, Treasury, through an application process, will pre-qualify fund managers to manage PPIFs. The fund managers will raise private capital for equity participation in the PPIF that will be matched, again, dollar-for-dollar, with TARP funds. The PPIF will then be able to obtain additional financing in TARP funds, depending upon the circumstances, of up to 100% of the amount of total equity. The fund manager, who earns a fee both from Treasury and from the private investors, will then use the money to purchase legacy MBS. For example, a fund manager selected by Treasury raises \$500 million from private investors as equity in the PPIF. That \$500 million is matched by \$500 million in TARP funds, making the total equity in the PPIF \$1 billion. The PPIF can then obtain up to an additional \$1 billion loan (100% of the equity) in TARP funds and use the whole \$2 billion to purchase MBS. In this example, profits again are shared 50%/50% between the private equity investor and TARP. Losses are also suffered equally, but only up to the private investors' equity. If the PPIF failed completely, TARP would thus suffer 75% of the loss.

- Finally, as a further extension of PPIP, TALF will be expanded to permit lending based on the posting of legacy MBS as collateral.

Areas of Vulnerability within PPIP

Many aspects of PPIP could make it inherently vulnerable to fraud, waste, and abuse. First, PPIP deals with assets that have recently been illiquid, making valuation difficult, therefore raising the danger that the Government will overpay for the assets. Second, many of the participants in these markets, such as hedge funds, are substantially unregulated and the internal oversight and compliance capability at those institutions vary widely. Next, the interrelationships between the market participants can be extremely complex and difficult to anticipate: the same entity might buy and sell toxic assets for its own benefit and manage portfolios of toxic assets for others, all while holding or managing equity or debt securities of the banks and other institutions that have large positions in the same toxic assets. Finally, the sheer size of the program — up to a trillion dollars for the PPIFs and up to another trillion dollars for the expansion of TALF — is so large and the leverage being provided to the private equity participants so beneficial, that the taxpayer risk is many times that of the private parties, thereby potentially skewing the economic incentives.

After receiving initial briefings from Treasury on PPIP and discussing the issue with law enforcement partners, SIGTARP has identified three of the most significant areas of potential vulnerability to fraud and abuse applicable across the program. Because SIGTARP has not been provided with many of the specific details of the mechanics of the various programs, SIGTARP's observations and recommendations are necessarily at a high level.

Conflicts of Interest

The first area of vulnerability is that the private parties managing the PPIFs might have a powerful incentive to make investment decisions that benefit themselves at the expense of the taxpayer. By their nature and design, including the availability of significant leverage, the PPIP transactions in these frozen markets will have a significant impact on how any particular asset is priced in the market. As a result, the increase in the price of such an asset will greatly benefit anyone who owns or manages the same asset, including the PPIP manager who is making the investment decisions.

As an extremely simplified example from the Legacy Securities Program, assume that the fund manager of the PPIF owns 1 million bonds of MBS X in its own account. MBS X is currently valued on the fund manager's books at 20% of its original value, or \$20 per bond, for a total of \$20 million. The fund manager does an estimate and believes that, in a fully functioning market, MBS X is actually worth 30% of face value, or \$30 per bond. In the absence of a conflict of interest, the fund manager, using PPIP funds, might be willing to pay up to \$30 per bond

in the market. However, the fund manager realizes that it can make more money for itself if it drives the price even higher. It thus uses the funds it controls in the PPIF to buy 1 million MBS X bonds from someone else at \$40 per bond, or \$40 million. This transaction has the potential, in the current illiquid market, of setting the market price for that MBS X at \$40, even though that price is far above what the MBS is actually worth. As a result, the fund manager could sell the MBS on its own books and recognize a profit of \$20 million. Over time, however, the price of MBS X declines to its actual value, \$30 per bond, and results in a \$10 million loss to the PPIF fund. This loss has no negative impact to the fund manager, however, because it did not have any of its own money invested in the fund. Indeed, the fund manager has made money on the PPIF, because it has received fees from both Treasury and the private investors based only on the total size of the PPIF. In other words, the conflict results in an enormous profit for the fund manager at the expense of the taxpayer.

The same incentives to overpay could exist in the Legacy Loans Program and in numerous other factual circumstances. The incentives exist, for example, even if the fund manager does not own MBS X but is merely managing other funds that hold MBS X, as the manager earns fees based on the value of that fund, a value that would, in this example, be significantly overstated (temporarily) as it can increase the value of that fund based on valuing, or "marking" the MBS X at the inflated "market" price that it set. The conflict can even exist if the manager holds or manages equity tied to the value of the banks from which the MBS are being purchased; here, using PPIF funds to overpay for bank assets may increase the bank's stock price, thus giving a greater profit to the fund manager.

Collusion

A closely related vulnerability is that PPIF managers might be persuaded, through kickbacks, *quid pro quo* transactions, or other collusive arrangements, to manage the PPIF's not for the benefit of the PPIF (and taxpayers), but rather for the benefit of themselves and their collusive partners. In both the Legacy Loans Program and the Legacy Securities Program, the significant Government-financed leverage presents a great incentive for collusion between the buyer and seller of the asset, or the buyer and other buyers, whereby, once again, the taxpayer takes a significant loss while others profit.

This time, consider an example from the Legacy Loans Program. Imagine that a bank owns a pool of mortgage loans that both it and the private equity firm investing in a PPIF values at \$600 million. The private equity firm invests \$60 million into the PPIF, which is matched by \$60 million of TARP funds, and which is leveraged by a loan of \$720 million guaranteed by FDIC (the 6-to-1 debt-to-equity ratio). The PPIF private equity firm surreptitiously agrees with the bank to overpay for the pool of loans and causes the PPIF to bid \$840 million at auction

for that pool. After the auction, the bank secretly pays the PPIF private equity firm a kickback of \$120 million, or half the difference between the auction price (\$840 million) and the true value (\$600 million). Although the PPIF will eventually perform poorly as a result of the overpayment, the private equity firm's loss is relatively small. Even if the PPIF was completely wiped out, the most the PPIF private equity firm could lose is \$60 million, which would still give it a guaranteed profit of at least \$60 million as a result of the kickback, a 100% return. Meanwhile, the bank would have gained an illegal benefit of \$120 million, all at the expense of the taxpayer and FDIC. Of course, in practice, the collusive scheme would be far more complex and would likely involve a series of affiliates and offsetting transactions, but the principle would be the same.

The same collusion could occur in the Legacy Securities Program between buyer and seller. Similarly, collusion could occur among other buyers. For example, using the example described above involving MBS X, the fund manager could convince another PPIF fund manager to overpay for MBS X, yielding the same profits for the fund manager as if he himself directed the overpayment. In return, the original fund manager could overpay for a different MBS that is on the other PPIF fund manager's books. As a result, both fund managers could potentially reap significant illegal (and difficult to detect) profits, all at the expense of the taxpayer.

Money Laundering

National and international criminal organizations — from organized crime, to narcotics traffickers, to large-scale fraud operations — are continually looking for opportunities to make their illicit proceeds appear to be legitimate, thereby “laundering” those proceeds. It is estimated that the amount of funds laundered each year is in the hundreds of billions of dollars worldwide. Money-laundering organizations are highly sophisticated, utilizing the full arsenal of corporate, trust, and offshore financial structures, and vast sums of illicit proceeds can and do make it into the U.S. financial system each year.

Because of the significant leveraging available and the inherent imprimatur of legitimacy associated with PPIP and TALE, these programs present an ideal opportunity to money-laundering organizations. If a criminal organization can successfully invest \$10 million of illicit proceeds into a PPIF, not only does the organization enjoy the possibility of profiting through the Government-backed leverage, but any eventual distributions from the PPIF are successfully laundered because they appear to be PPIF investment gains rather than drug, prostitution, or illegal gambling proceeds. It would of course be unacceptable if TARP funds, FRBNY loans, or FDIC guarantees were used to leverage the profits of drug cartels or organized crime groups. This vulnerability is particularly problematic in light of the contemplation of the use of SPVs — legal entities created for the purpose of holding PPIF assets — which can be, depending upon how they are designed, difficult to look

behind to discern the true participants. Although the term sheets for PPIF place requirements on the individual PPIF managers to conduct some screening of the individual investors, it is not clear what ability Treasury will have to “look through” to each of the individual investors to identify them and assure their legitimacy, or have access to the individual investors’ books and records.

Recommendations

To address these vulnerabilities, SIGTARP makes the following recommendations with respect to the design and implementation of PPIF.

- Treasury should impose strict conflict-of-interest rules upon PPIF managers across all programs that specifically address whether and to what extent the managers can (i) invest PPIF funds in legacy assets that they hold or manage on behalf of themselves or their clients or (ii) conduct PPIF transactions with entities in which they have invested on behalf of themselves or others. SIGTARP recognizes that there is a trade-off between hiring managers with significant experience in the marketplace (who have the expertise to make them effective asset managers but who have complex conflict-of-interest issues as a result) and hiring managers who are not in the market at all (who have less expertise but also no conflicts); however, Treasury should at least consider whether its fund manager requirements address the serious conflict issues. It may very well be that some of the conflicts cannot be mitigated under the current structure of the programs unless the fund managers have no interests (and have no clients who have interests) in the kinds of legacy assets that the PPIFs are purchasing. This may, in turn, significantly limit what entities should be making PPIF investment decisions.
- Treasury should mandate transparency with respect to the participation and management of PPIFs. This should include disclosure of the beneficial owners of all of the private equity stakes in the PPIFs and of all transactions undertaken in them. In addition to the reporting requirements contained in the PPIF term sheets, Treasury should obtain and publicly disclose certified reports from all PPIFs across all programs that include all transactions and the current valuation of all assets. This transparency is necessary in light of the taxpayers’ reasonable expectation of knowing how their money is being used, as a way to track and/or deter the types of conflicts of interest and collusion abuses previously described, and as a way to deter criminal organizations from trying to use PPIF to launder illicit proceeds. To the extent that PPIF managers are permitted to hold or engage in transactions in the same securities that they are buying and selling in the PPIF’s, Treasury should require PPIF managers to report to Treasury on any and all holdings and transactions in the same types of legacy assets on their own behalf or on behalf of their clients. Such a disclosure would help identify

conflicts of interest. Moreover, in addition to the requirement that SIGTARP will have access to all of the PPIF's books and records, as set forth in the term sheets, Treasury should impose a requirement that PPIF managers retain all books and records pertaining in any way to the PPIF (including all e-mails, instant messages, and all other documents), and permit SIGTARP and other oversight entities access to the fund manager's books and records and employees, upon request. In this manner, Treasury, SIGTARP, and other oversight bodies might be able to detect and address the potential conflicts and any indication of collusion. Treasury should also require access to the private investors' books and records, at least to the extent that they relate to the PPIF investment.

- Treasury should require PPIF managers to provide PPIF equity stakeholders (including TARP) "most-favored nations clauses," requiring that the fund managers treat the PPIFs (and the taxpayers backing the PPIFs) on at least as favorable terms as given to all other parties with whom they deal. In that same vein, PPIF managers should be required to acknowledge that they owe the PPIF investors – both the private investors and TARP – a fiduciary duty with respect to the management of the PPIFs. Treasury should also require that each PPIF fund manager have a robust ethics policy in place and a compliance apparatus to ensure adherence to such code.
- In order to prevent money laundering and the participation of actors prone to abusing the system, Treasury should require that all PPIF fund managers have stringent investor-screening procedures, including comprehensive "Know Your Customer" requirements at least as rigorous as that of a commercial bank or retail brokerage operation. Additionally, fund managers should be required to provide Treasury with the identities of all of the beneficial owners of the private interests in the fund so that Treasury can do appropriate diligence to ensure that investors in the funds are legitimate.

Interactions between PPIF and TALF

In announcing the details of PPIF, Treasury has indicated that PPIFs under the Legacy Securities Program could, in turn, use the leveraged PPIF funds (two-thirds of which will likely be taxpayer money) to purchase legacy MBS through TALF, greatly increasing taxpayer exposure to losses with no corresponding increase of potential profits. By way of example, a PPIF manager could raise \$500 million of private equity, which would be matched with \$500 million of TARP funds, and a loan of an additional \$500 million from TARP funds (according to the term sheet, loans will only be given up to 50% of the total equity if investments will be made through TALF rather than 100% otherwise). The PPIF could then take the total \$1.5 billion, bring it to the TALF window, and effectively use that money as the "haircut" amount in a TALF financing to purchase legacy RMBS. Assuming that the haircut will be 20% (larger than any existing haircut), the PPIF will be able to receive a non-recourse loan from FRBNY for an additional \$6 billion, enabling the PPIF to purchase \$7.5 billion in legacy RMBS. The private investors would thus enjoy 50% of the profits from this enhanced buying power, but only be exposed to less than 7% of the total losses if the fund were wiped out.

Aside from potential unfairness to the taxpayer, this leverage upon leverage on legacy RMBS raises other significant issues. First, it only magnifies the dangerous incentives discussed above (the conflicts of interest and collusion issues), because the fund manager now has up to five times the buying power than it would if it participated in the Legacy Securities PPIF alone. Moreover, it severely undermines the validity of the methodology that the Federal Reserve has used to build the haircut percentages in TALF thus far. The Federal Reserve has told SIGTARP that it has determined its haircut percentage based at least in part on the fact that the haircut represents a TALF borrower's "skin in the game" — someone's own capital at risk — that incentivizes appropriate due diligence on the borrower's part. If leveraged PPIFs are permitted to participate in TALF, that effectively lowers the private equity's skin in the game by at least the amount of money borrowed from TARP, materially diminishing the incentive to do due diligence. Put in simpler terms, an investor who is funding 100% of the haircut amount with his own money (as is typical in TALF) can logically be expected to be far more careful than one only putting up 33% (as would occur under this example).

Recommendations

Accordingly, SIGTARP recommends that:

- Treasury should not allow Legacy Securities PPIFs to invest in TALF, unless significant mitigating measures are included to address these dangers. These might include prohibiting the use of TARP leverage if the PPIF invests through TALF, or proportionately increasing haircuts for PPIFs that do so.

Failure to adopt this recommendation may well protect the Federal Reserve's own balance sheet, but it would do so at the expense of putting at risk Treasury assets, hardly a victory from the taxpayers' perspective. SIGTARP thus further recommends:

- All TALF modeling and decisions, whether on haircuts or any other credit or fraud loss mechanisms, should account for potential losses to Government interests broadly, including TARP funds, and not just potential losses to the Federal Reserve.

Treasury officials, in discussing these recommendations with SIGTARP, recognize the increased risks associated with this area of the program but suggested that flexibility would be needed to consider alternate ways of mitigating the risks to the extent possible.

SIGTARP will continue to monitor the development of the PPIP requirements and procedures and will make future recommendations concerning standards and mechanisms that will help protect against fraud, waste, and abuse in the program, as appropriate.

Design of the Mortgage Modification Program

Shortly after the February announcement of the Administration's intent to launch a mortgage modification plan, SIGTARP provided a series of high-level recommendations to address potential fraud in the program, first by providing OFS officials an outline of potential fraud issues and then in a series of discussions with OFS and other Treasury officials.

SIGTARP's recommendations were made in the context of the Special Inspector General's prior experience as the founder of the Mortgage Fraud Group in the United States Attorney's Office for the Southern District of New York and after consultation with and advice from mortgage fraud experts at the Federal Bureau of Investigation. The recommendations address some of the patterns of the rampant mortgage fraud that contributed to the current financial crisis, including corruption of many of the potential gatekeepers who were supposed to limit such fraud: attorneys, appraisers, notaries, mortgage brokers, title insurance agents, and insiders at banks and mortgage originators. Recognizing that many of the most prevalent frauds had common characteristics, SIGTARP's recommendations reflected an attempt to shield the program from such schemes before they could be adapted to the mortgage modification plan.

In general, mortgage fraud schemes are viewed by law enforcement in two categories: (i) fraud for home, where a homeowner lies in order to get a mortgage for which he or she would otherwise not qualify; and (ii) fraud for profit, which involves rings of individuals whose goal is to defraud banks and individual

homeowners for the purpose of profit. Recognizing that the greatest economic damage is done by those who commit mortgage fraud for profit, SIGTARP's recommendations primarily address this type of fraud.

In this section, SIGTARP's mortgage modification recommendations, followed by Treasury's response, are each discussed in detail.

Verification of Residence Recommendation

One of the most common characteristics of fraud-for-profit schemes is that the individual holding the mortgage, often a "straw purchaser," does not actually live in the home for which he or she is obtaining a mortgage. Recognizing this indicator, SIGTARP strongly recommended that Treasury include provisions to ensure that the individual applying for the mortgage modification actually lives in the home, including (i) a signed certification from the applicant, and (ii) third-party verification that the home is the applicant's primary residence. Indeed, to guard against servicer failings (such as not doing the verification but then claiming that it had) or complicity (such as purposefully misrepresenting the residence of the applicant in furtherance of a fraud-for-profit scheme), SIGTARP recommended that Treasury require submission of third-party verification to Treasury or its agent prior to its funding a modification.

Status of Recommendation

Treasury has partially implemented this recommendation. It has taken some important steps, including requiring a signed certification from the applicant that he or she lives in the home and requiring the servicer to acquire from the applicant some proof of residence. Treasury has not required, however, that the servicer obtain third-party verification of the applicant's residence before submitting and implementing the mortgage modification. This is critical, as most fraud-for-profit schemes have ready access to forged documents (e.g., false utility bills, pay stubs, bank account statements). As a result, the current system will not capture a fraud scheme that involves doctored documents or one involving the complicity or the negligence of the servicer, because the servicer is not required to submit proof of its verification of residence before receiving Government funding. Accordingly, SIGTARP continues to recommend that:

- Before funding a mortgage modification, Treasury should require the servicer to submit third-party verified evidence that the applicant is residing in the subject property.

Treasury, in discussions with SIGTARP about this recommendation, indicated that servicers will be able to obtain (i) the borrowers' tax return information from the IRS and (ii) credit reports. If Treasury requires servicers to provide such

third-party verified information regarding residence to Treasury or its agent before funding a modification, it would represent a significant improvement in the program.

Closing Procedures Recommendation

Many fraud-for-profit schemes involved fraudulent closings, at which signatures were forged or where the homeowners and/or purchasers signed documents they did not understand and thus could be charged exorbitant fees without their knowledge. As a result, several states have tightened the requirements of the typical mortgage closing procedure with measures that increase deterrence and which greatly assist law enforcement in its investigation of mortgage fraud-for-profit schemes. Adopting some of the characteristics of these reforms, SIGTARP recommended that a closing-like procedure be conducted that would include:

- a closing warning sheet that would warn the applicant of the consequences of fraud
- the notarized signature and thumbprint of each participant
- mandatory collection, copying, and retention of copies of identification documents of all participants in the transaction
- verbal and written warnings regarding hidden fees and payments so that applicants are made fully aware of:
 - the benefits to which they are entitled under the program (to prevent a corrupt servicer from collecting payments from the Government and not passing the full amount of the subsidies to the homeowners)
- the fact that no fee should be charged for the modification

Status of Recommendation

Treasury has decided against using a closing procedure, stating that mortgage modifications typically take place over the telephone and through the mail. Treasury has, however, attempted to address several of the concerns raised in this recommendation by: (i) including a fraud warning sheet with every mortgage modification solicitation that includes SIGTARP's hotline to report fraud; and (ii) beginning outreach efforts, along with other agencies, to warn homeowners that they should not pay fees as part of the program, as discussed more fully in the following paragraphs. SIGTARP remains concerned that Treasury has not taken sufficient action related to its previous recommendation. Accordingly, SIGTARP continues to recommend that:

- Additional anti-fraud protections should be adopted to verify the identity of the participants in the transaction and to address the potential for servicers to steal from individuals by receiving Government subsidies without applying them for the benefit of the homeowner.

Treasury officials, in discussing this recommendation with SIGTARP, noted that they have a financial agent agreement with Freddie Mac to provide a range of compliance and anti-fraud efforts for the loan modification program and are consulting with an anti-fraud expert. They also indicated that these efforts would align with many of the issues and recommendations identified by SIGTARP pertaining to loan modifications and will include provisions that address potentially corrupt loan servicers.

Income Verification Recommendation

One of the most common features of traditional mortgage fraud is that applicants falsely inflate their income and support those lies with fraudulent documentation and employment verification. In the mortgage modification program, due to the increased subsidy for homeowners whose income is lower, there exists an incentive for applicants to understate their income intentionally. To address this potential fraud, SIGTARP recommended that Treasury require servicers to: (i) compare the income reported on their initial mortgage application with the income reported on the modification application, and, if they differ significantly, require an explanation and verifiable documentation of the change in income; and (ii) require third-party verification of employment.

Status of Recommendation

Treasury has not adopted this recommendation, but has taken some steps to verify income, including requiring the homeowner to sign a waiver so that the servicer can obtain tax return information for the applicant and requiring the applicant to provide documentation to verify income. Although this is helpful, SIGTARP believes that further action is still needed as it does not appear that Treasury is requiring the servicer actually to obtain and verify the income tax information before approving the modification. Tax return information, for example, even if obtained, may be of limited value given the time lag between the last income tax return and the date of the application. Further, as noted earlier in the discussion, relying on documentation provided by the borrower is unreliable given the prevalence and ease with which false pay stubs, W-2s, and 1099s can be generated. Accordingly, SIGTARP continues to recommend that:

- Treasury require that verifiable, third-party information be obtained to confirm an applicant's income before any modification payments are made.

Timing of Incentive Payments Recommendation

Generally speaking, one of the fraud dangers to the mortgage modification program is the activity of "modification mills," corrupt servicers that will churn out unverified or unlikely-to-perform mortgage modifications in order to collect the \$1,000

up-front incentive payment. Because the servicer is not currently required to provide verified information prior to commencing a modification (and receiving the \$1,000 up-front payment), there is a fraud incentive for servicers to push through modifications that do not necessarily meet the criteria and/or make modifications that they know will never be successful. Indeed, it is unfortunately foreseeable that a servicer could take a mortgage that is in default, submit fraudulent paperwork, and collect the \$1,000 fee, without any intent on the part of the homeowner to make any further payments on the mortgage modification. SIGTARP thus recommended that Treasury delay the up-front payment by 90 days to ensure that the homeowner has made several payments as part of the mortgage modification program before awarding the servicer the \$1,000 incentive payment.

Status of Recommendation

Treasury has implemented a procedure under which it will not pay the \$1,000 incentive payment until after the homeowner has made three payments to the servicer; however, these payments occur prior to the Government's modification of the mortgage and require no independent verification. Although Treasury's insistence of a servicer-run trial period is certainly an improvement over a system of immediate incentive payments, it does not necessarily protect Treasury from a corrupt servicer who could fraudulently claim that an applicant has successfully completed a trial period even if not true. Accordingly, to protect against such fraud, SIGTARP continues to recommend that:

- Treasury should defer payment of the \$1,000 incentive to the servicer until after the homeowner has verifiably made a minimum number of payments under the mortgage modification program.

Treasury officials, in discussing this recommendation with SIGTARP, have indicated that they will work with their agents "to verify that the borrower makes the required number of payments under the trial modification."¹⁴⁰

Education and Outreach Recommendation

One of the most insidious forms of mortgage fraud are "foreclosure rescue scams," in which fraudsters trick struggling homeowners into paying up-front fees by promising them assistance in navigating the foreclosure process. Sadly, most of the companies promising these services do nothing for the homeowner other than give them false hope while taking an exorbitant fee. SIGTARP therefore recommended that Treasury proactively educate homeowners about the nature of the program, warn them about these predators, and publicize that no fee is necessary to participate in the program.

Status of Recommendation

Treasury is doing an excellent job in implementing this recommendation. The Making Home Affordable website prominently features fraud warnings, and, in an April 6, 2009, press conference, the Treasury Secretary, along with the Attorney General, the Secretary of the Department of Housing and Urban Development, the head of the Federal Trade Commission, and the Attorney General for the State of Illinois, announced a coordinated and detailed outreach effort to educate homeowners about the dangers of such fraud, as well as efforts to detect and prosecute such scams. SIGTARP's Investigations Division will continue to work with its partners to bring the perpetrators of such fraud to justice.

Mandated Data Collection Recommendation

Mortgage fraud is often perpetrated by repeat offenders, and one of law enforcement's most powerful tools to detect this abuse is the capability to mine data to identify those individuals and entities (such as appraisers, mortgage brokers, straw purchasers, or attorneys) who repeatedly appear in connection with suspicious foreclosures. SIGTARP recommended that Treasury require its agents to keep track of the names and identifying information for each participant in each mortgage modification transaction and to maintain a database of such information. Not only would such a database assist law enforcement in the detection and apprehension of fraudsters, but it could also assist in fraud prevention. For example, a centralized database could identify if a potential homeowner applicant had already applied for or received a mortgage modification on a different property, a strong indicator of fraud (because an applicant can only live in one home, an application for an additional modification would strongly suggest that the homeowner had lied about his or her primary residence).

Status of Recommendation

Treasury officials, in discussing this recommendation with SIGTARP, recognized the importance of data mining to fraud prevention efforts and stated that they are working with Freddie Mac, their compliance agent, to determine the feasibility of this recommendation.

Auto Supplier Support Program

SIGTARP was briefed on the Auto Supplier Support Program shortly before it was announced. At the time of the briefing, SIGTARP raised concerns regarding two potential fraud vulnerabilities. First, SIGTARP inquired as to what protections would be in place to prevent "phantom receivables" — auto parts that are subject to TARP funding but never make it to the automobile manufacturers. Second, SIGTARP warned of the dangers of commercial bribery, a vulnerability borne from the structure of the program, which empowered the automobile manufacturers

with unfettered discretion to choose which suppliers and at what amounts the suppliers can participate in the program — effectively picking winners and losers with no clear restrictions.

In discussions concerning this recommendation, Treasury has indicated that certain financial aspects of the program would act as a disincentive to these vulnerabilities. SIGTARP awaits further briefing on the program.



**Hearing Statement of Senator Max Baucus (D-Mont.)
Regarding TARP Oversight -- A Six Month Update**

In a 1989 interview, our former Colleague, Congressman Jim Leach, said: "The banks use rather surreal accounting practices."

Since then, the world of banking and financial oversight has become, if anything, yet more surreal.

One of our witnesses today, the Special Inspector General for the Troubled Assets Relief Program, has calculated that, in the TARP and associated programs, taxpayers are potentially at risk for about \$2.9 trillion.

\$2.9 trillion is just short of what the entire Federal Government spent in fiscal year 2008. It's like having a second United States Government budget, dedicated solely to saving the financial system. And that is truly surreal.

The chart behind me outlines what makes up the \$2.9 trillion.

And that \$2.9 trillion does not include the \$400 billion that the Treasury Department has pledged in support of Fannie Mae and Freddie Mac. That \$2.9 trillion does not include the resources that the Federal Reserve is dedicating to shoring up the financial system, which amount to about \$3 trillion. And that \$2.9 trillion does not include the second TARP request for \$750 billion in the President's budget.

This is a huge, unprecedented financial commitment. It strains the comprehension of taxpayers and policy-makers alike.

It has been nearly six months since Congress created the TARP program. Almost all of its \$700 billion have been committed. So it's time for the Finance Committee to survey the many oversight issues related to this new Treasury Department program.

I worked hard to create the office of the Special Inspector General for the TARP. And so I am very pleased to welcome Mr. Barofsky to the Committee today. So far, the Special I.G. has done a good job.

The latest controversy involving the TARP program centers on the A.I.G. bonuses paid from taxpayer money. Senator Grassley and I introduced legislation to reclaim those bonuses for the taxpayers. And we are looking forward to bringing that legislation to the Senate floor. I am pleased that the Special I.G. is conducting his own full investigation of how those bonuses got out the door.

But the A.I.G. fiasco is just the tip of the iceberg. There are many, many tough oversight issues connected with this new program.

Today, we will look at 12 major areas of TARP involvement. I hope to get an update on each area from our oversight teams.

The 12 areas are: the capital investment program for large banks, the capital investment program for small banks, Citigroup, Bank of America, A.I.G., the Term Asset-Backed Securities Loan Facility, or TALF, G.M., G.M.A.C., Chrysler, the mortgage relief program, the small business program, and the "bad assets" program announced last week.

I hope that at least one of our witnesses can comment on each of these 12 program areas today.

We will also survey some other key issues on which our oversight experts have been focusing, during the past six months.

For one, I am pleased that improving transparency has been a priority for the Special I.G.

Mr. Barofsky recommended that the TARP post all TARP agreements — whether with recipients or with its vendors — on the Treasury website. And the Treasury Department agreed.

The Special I.G. also successfully pushed for oversight language in the Citigroup and Bank of America agreements that requires those banks to account for, and report on, their use of TARP funds.

And in late January, Mr. Barofsky sent each bank participating in the capital investment program a letter asking how they have used TARP dollars.

This was a much-needed exercise. Americans want to know how their tax dollars are being spent.

I understand that all of the 360 banks involved have responded. That's commendable. And I look forward to hearing the Special I.G.'s preliminary analysis of the banks' reports.

I am also pleased that the Special I.G. has made progress on civil and criminal law enforcement. I am heartened that he has reached out to the F.B.I. and U.S. Attorneys around the country to coordinate fraud investigations related to TARP funds.

As Mr. Barofsky says, of the primary oversight bodies referenced in the TARP bill, the Special I.G. stands as the sole TARP oversight body charged with criminal law enforcement authority. The Special I.G. is the "cop on the beat."

Finally, the new program announced last week by the administration and Fed Chairman Bernanke presents another huge challenge to our oversight teams.

The plan to purchase so-called "bad assets" will involve up to \$100 billion of TARP funds. And it will involve backing from the F.D.I.C. and the Federal Reserve. The total commitment for this new program could reach \$1 trillion.

The new program presents another very tough task for our three oversight teams. They will have to oversee pricing the assets, what entities are managing the assets, and taxpayers' exposure for each group of bad assets.

I want to thank our witnesses and their teams for their hard work. This is an enormously complicated new program. The money involved is mindboggling; indeed, it is surreal. I look forward to our witnesses' efforts to help explain their task in ways that will make it just a little more real.

United States Government Accountability Office

GAO

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

For Release on Delivery
Expected at 10:00 a.m. EDT
Tuesday, March 31, 2009

TROUBLED ASSET RELIEF PROGRAM

Status of Efforts to Address Transparency and Accountability Issues

Statement of Gene L. Dodaro
Acting Comptroller General of the United States



Mr. Chairman, 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), under which the Department of the Treasury (Treasury) has the authority to purchase and insure up to \$700 billion in troubled assets held by financial institutions through its Office of Financial Stability (OFS). As you know, Treasury was granted this authority in response to the financial crisis that has threatened the stability of the U.S. banking system and the solvency of numerous financial institutions. The Emergency Economic Stabilization Act (the act) that authorized TARP on October 3, 2008, requires GAO to report at least every 60 days on the findings resulting from our oversight of the actions taken under the program.¹ We are also responsible for auditing TARP's annual financial statements and for producing special reports on any issues that emerge from our oversight. To carry out these oversight responsibilities, we have assembled interdisciplinary teams with a wide range of technical skills, including financial market and public policy analysts, accountants, lawyers, and economists who represent combined resources from across GAO. In addition, we are building on our in-house technical expertise with targeted new hires and experts. The act also created additional oversight entities—the Congressional Oversight Panel (COP) and the Special Inspector General for TARP (SIGTARP)—that also have reporting responsibilities. We are coordinating our work with COP and SIGTARP and are meeting with officials from both entities to share information and coordinate our oversight efforts. These meetings help to ensure that we are collaborating as appropriate and not duplicating efforts.

My statement today is based primarily on our March 31, 2009 report that we are issuing today—the third under the act's mandate, which covers the actions taken as part of TARP through March 27, 2009, and follows up on

¹Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat. 3765 (2008). 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.

the recommendations we made in our previous reports.² The statement also provides information on our ongoing review of the Auto Industry Financing Program, which we plan to report on separately. Specifically, like the March 2009 report, this statement focuses on (1) the nature and purpose of the activities that had been initiated under TARP through March 27, 2009, unless otherwise noted; (2) Treasury's Office of Financial Stability's (OFS) hiring efforts, use of contractors, and progress in developing a system of internal control; and (3) indicators of TARP's performance.

To do this work, we reviewed documents related to TARP, including contracts, agreements, guidance and rules. We also met with officials from OFS, contractors, and federal agencies. We plan to continue to monitor the issues highlighted in our prior reports, as well as future and ongoing capital purchases, other more recent transactions undertaken as part of TARP, and the status of other aspects of TARP. We conducted this performance audit between February 2009 and March 2009 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

As of March 27, 2009, Treasury had disbursed \$303.4 billion of the \$700 billion in TARP funds. Most of the funds (about \$199 billion) went to purchase preferred shares of 532 financial institutions under the Capital Purchase Program (CPP)—Treasury's primary vehicle under TARP for stabilizing financial markets. Treasury has continued to take significant steps to address all of the recommendations from our December 2008 and January 2009 reports. In particular, Treasury has recently expanded the scope of the monthly CPP surveys of the largest institutions to include all institutions participating in the program, which is intended to provide Treasury with information necessary to begin to track the effectiveness of

²GAO, *Troubled Asset Relief Program: March 2009 Status of Efforts to Address Transparency and Accountability Issues*, GAO-09-504 (Washington, D.C.: Mar. 31, 2009), *Troubled Asset Relief Program: Status of Efforts to Address Transparency and Accountability Issues*, GAO-09-296 (Washington, D.C.: Jan. 30, 2009) and *Troubled Asset Relief Program: Additional Actions Needed to Better Ensure Integrity, Accountability, and Transparency*, GAO-09-161 (Washington, D.C.: Dec. 2, 2008).

the program. Treasury also continued to make progress in several other areas, including requiring firms participating in certain new programs to show how assistance will expand lending. These requirements will better enable Treasury to determine what institutions plan to do with any capital infusions and to track the resulting lending activity of participating institutions on a regular basis. In addition, we specifically found that though Treasury is now receiving dividends from the investments it has made in CPP and certain other programs, it has not publicly reported these receipts, which totaled almost \$2.9 billion through March 20, 2009. We recommended that Treasury could improve transparency pertaining to TARP program activities by reporting publicly the monies, such as dividends, paid to Treasury by TARP participants.

In February 2009, Treasury announced its broad strategy for using the remaining TARP funds and provided the details for its major components in the following weeks. Specifically, Treasury announced the Financial Stability Plan, which outlined a comprehensive set of measures to help address the financial crisis and restore confidence in our financial markets, and a Homeowner Affordability and Stability Plan to mitigate foreclosures and preserve homeownership. While articulating its plan was an important first step, Treasury continues to struggle with developing an effective overall communication strategy that is integrated into TARP operations. Without such a strategy, Treasury may face challenges, should it need additional funding for the program. Therefore, in our March 2009 report, we have recommended that Treasury develop a communication strategy that includes building an understanding of and support for the various components of the program. Specific actions could include hiring a communications officer, integrating communications into TARP operations, scheduling regular and ongoing contact with congressional committees and members, holding town hall meetings with the public across the country, establishing a counsel of advisors, and leveraging available technology.

Also, while Treasury has announced up to \$70 billion dollars in assistance to AIG—more assistance than has been announced for any other single institution to date—it has yet to disperse the up to \$30 billion of additional assistance or finalize the agreement. Therefore, Treasury has an opportunity to further improve the integrity and accountability associated with this announced additional assistance. In our report, we recommended that Treasury require that AIG seek to renegotiate existing contracts with management, employees, and counterparties, among others, as appropriate, as it finalizes its agreement for the up to \$30 billion in additional assistance announced on March 2, 2009.

Treasury has also made progress in establishing OFS and continued to take steps to address our previous recommendations related to OFS's management infrastructure, including hiring, contract oversight, and internal control. First, it has continued to hire additional permanent staff to address OFS's long-term organizational needs. As of March 20, 2009, OFS had 113 total staff, with the number of permanent staff increasing substantially—from 38 to 77—since our last report. Second, Treasury has enhanced its capacity to manage vendors by using trained oversight personnel and looking for opportunities to use fixed-price arrangements. Further actions are needed to complete its review of existing vendor conflicts of interest mitigation plans and to improve its documentation of decisions related to potential conflicts. Consequently, we made two new recommendations to Treasury—(1) complete its review, and, as necessary, renegotiate, the four existing vendor conflict of interest mitigation plans to enhance specificity and conformity with the new interim conflicts of interest rule, and (2) issue guidance requiring that key communications and decisions concerning potential or actual vendor-related conflicts of interest be documented. Third, OFS continued to refine, develop and document its internal control framework over financial reporting and compliance, including its risk assessment activities. However, we found that OFS documentation of certain internal control procedures and guidance pertaining to determining warrant exercise prices had not been updated to be consistent with actual practice. As such, we recommended that Treasury update OFS documentation in these areas to be consistent with actual practices applied by OFS.

We continue to note the difficulty of measuring the effect of TARP's activities. Developments in the credit markets have generally been mixed since our January 2009 report. Some indicators revealed that the cost of credit has increased in interbank and corporate bond markets and decreased in mortgage markets, while perceptions of risk (as measured by premiums over Treasury securities) have declined in interbank and mortgage markets and risen in corporate debt markets. In addition, although Federal Reserve survey data suggest that lending standards remained tight, the largest CPP recipients extended almost \$245 billion in new loans to consumers and businesses in both December 2008 and January 2009, according to the Treasury's new loan survey. However, attributing any of these changes directly to TARP continues to be problematic because of the range of actions that have been and are being taken to address the current crisis. While these indicators may be suggestive of TARP's ongoing impact, no single indicator or set of indicators can provide a definitive determination of the program's impact.

Finally, I would like to express my thanks to Chairman Baucus and Senator Grassley for introducing S. 340, the Troubled Asset Relief Program Enhancement Act of 2008, and Senator Snowe for co-sponsoring this bill. It would enhance GAO's ability to bring accountability and transparency to the TARP program by providing us with direct access to the companies that receive TARP funds. Another TARP access issue for GAO involves the growing role of the Federal Reserve. On March 3, 2009, Treasury and the Federal Reserve launched TALF—the Term Asset-Backed Securities Loan Facility—which is a lending program to increase the availability of credit for consumers and businesses. More recently, the Federal Reserve and Treasury announced plans to expand the role of TALF as part of a new Public-Private Investment Program. Finally, Treasury and the Federal Reserve have coordinated in the restructuring of federal assistance to AIG. For all of these joint endeavors, GAO has authority to oversee the activities of Treasury, but not the Federal Reserve, because the Banking Agency Audit Act specifically precludes us from auditing the Federal Reserve's monetary policy and discount window operations. We would fully support legislation to provide GAO with audit authority over those activities, together with appropriate access, recognizing the sensitivity of this area and the need for careful drafting.

**Treasury's Strategy
for Deploying TARP
Funds Continues to
Evolve, Though CPP
Remains Key Effort to
Stabilize Financial
Market**

As of March 27, 2009, Treasury had disbursed \$303.4 billion of the \$700 billion in TARP funds (see table). Most of the funds (about \$199 billion) went to purchase preferred shares of 532 financial institutions under the Capital Purchase Program (CPP)—Treasury's primary vehicle under TARP for stabilizing financial markets. Treasury has continued to improve the integrity, accountability and transparency of TARP. For example, it recently expanded monthly surveys of the largest institutions' lending activity to cover all CPP participants, as GAO recommended. These surveys should provide additional important information about how the capital investments are impacting participants' lending activities and capital levels.

Table 1: Status of TARP Funds as of March 27, 2009 (dollars in billions)

Program	Maximum Announced Program Funding Level ^a	Projected Use of Funds	Disbursed
Capital Purchase Program	\$250.0	\$218.0	\$198.8
Systemically Significant Failing Institutions	70.0	70.0	40.0
Targeted Investment Program	40.0	40.0	40.0
Automotive Industry Financing Program	24.9	24.9	24.5
Citigroup Asset Guarantee	5.0	5.0	0.0
Bank of America Asset Guarantee	7.5	7.5	0.0
Homeowner Affordability & Stability Plan	50.0	50.0	0.0
Term Asset-Backed Securities Loan Facility (TALF)	100.0	55.0	0.1
Unlocking Credit for Small Business	15.0	15.0	0.0
Auto Supplier Support Program	5.0	5.0	0.0
Public Private Investment Program	100.0	100.0	0.0
Capital Assistance Program	TBD ^b	TBD	
Total	\$667.4	\$590.4	\$303.4

Source: Treasury OFS, unaudited.

^aSome of Treasury's announced transactions are not yet legal obligations and actual amounts will depend on participation.

^bTreasury has announced the Capital Assistance Program, but has not yet announced the funding level for that program.

During this period, Treasury has also taken some steps to improve its monitoring of compliance with the terms of its existing agreements, but has yet to hire asset managers to manage its growing portfolio of assets. Treasury officials told us that they still plan to hire asset managers, whose primary role will be to provide market advice about the portfolio, but who also will help monitor dividends and stock purchase limitations. They noted that asset managers will have a limited role in the area of executive compensation. In the interim, Treasury has developed a process to ensure that institutions are complying with dividend, stock repurchase, and executive compensation restrictions. Treasury relies on participants' representations and warranties articulated in the agreements, and if Treasury finds reason to believe that these representations cannot be relied upon, it can pursue available remedies for any false representations. At this point, Treasury has not taken steps to verify this information or

require the institutions to provide any additional documentation. As recommended in our December 2008 report, we continue to believe that Treasury should develop a formal system to help ensure compliance with the agreements and leverage the oversight activities of the bank regulators by having them include compliance with the agreements as part of their ongoing examinations. This type of compliance activity is generally consistent with ensuring the safety and soundness of institutions; the regulators previously told us they are taking steps to build such oversight into their examination procedures. Without a consistent oversight approach, Treasury runs the risk of getting inconsistent or incomplete information from the regulators.

OFS had received approximately \$2.9 billion in dividends through March 20, 2009, from its investments in CPP and certain other programs. Approximately 20 percent of possible dividends during the period were not declared and, therefore, not paid. This information about the returns on Treasury's investments has not been shared with Congress and the public. We recommended that, to improve transparency, Treasury should report publicly the monies, such as dividends, paid to it by TARP participants. By not sharing this information, Treasury is missing an opportunity to provide information about the returns it is receiving on its investments.

Treasury has also continued to take steps to articulate a more clearly defined vision for TARP; and, in February 2009, it provided its strategy for using its remaining funds. This strategy identified the existing problems and how the various programs would attempt to address them. Specifically, Treasury announced the Financial Stability Plan, which outlines a set of measures to address the financial crisis and restore confidence in the U.S. financial and housing markets. The plan established six components: Capital Assistance Program; Public-Private Investment Fund; Consumer and Business Lending Initiative; Small Business and Community Lending Initiative; the Affordable Housing Support and Foreclosures Prevention Plan; and Transparency and Accountability Agenda. While the initial plan provided a broad vision and strategy, in the subsequent weeks, Treasury provided additional details for the various components of the program. In particular, it has announced its plans to participate in the purchase of troubled assets through public-private partnerships and launched a homeownership protection program, both activities consistent with the original plans for TARP. Given that only 60 days have passed since our last report, we acknowledge the significance of these accomplishments. Yet, Treasury continues to get questions about TARP and what OFS is doing, which raises questions about the

effectiveness of its existing communication strategy. While Treasury's strategy has largely been one of posting information to its Web site, press releases, speeches, testimonies, and ad hoc outreach to Congress, it continues to face ongoing communication challenges. Given the complexity of the issues involved and the heightened public scrutiny, an effective communication strategy continues to be critical, but Treasury has yet to develop a means of regularly and routinely communicating its activities to relevant congressional committees, members, the public, and other critical stakeholders. An effective communication strategy should, among other things, build understanding and support for the program through regular and routine outreach, including confidential member briefings; integrate communications and operations by making communication integral to the program; and increase the impact of communication tools, such as electronic and print media and video. Given that the President's proposed budget contemplates additional funding, an effective communication strategy is critical for ensuring the support necessary to obtain the funding. Therefore we recommended in our March 2009 report that Treasury develop a communication strategy that includes building understanding and support for the various components of the program and suggested specific actions, such as hiring a communications officer, integrating communications into TARP operations, and scheduling regular and ongoing contact with congressional committees and members, among other actions.

Treasury has taken appropriate actions to bolster the conditions or requirements for assistance that is deemed exceptional, but certain assistance may require that it go farther to help repair damage caused to the program. Controversies about the actions of some TARP participants continue to create issues for the program, in general, and AIG, in particular. While Treasury has announced \$70 billion dollars in assistance to AIG—more assistance than has been provided to any other single institution to date—it has yet to disperse the up to \$30 billion of additional assistance or finalize the terms under which the assistance will be provided. Therefore, Treasury has the ability to further improve the integrity and accountability associated with this additional assistance, announced in March 2009. Based on our previous work on government assistance to the private sector, as well as the Treasury Secretary's position, as articulated in the Financial Stability Plan, that "government support must come with strong conditions," Treasury has an opportunity to take additional steps to strengthen its agreement with AIG by requiring AIG to seek concessions from management, employees, and counterparties before the agreement is finalized. For example, Treasury could require that AIG seek to renegotiate contracts with its employees, as

appropriate, such as those related to the retention bonuses provided to AIG Financial Products and existing counterparties that would face substantial losses were AIG to have its credit downgraded or fail. While we understand that Treasury is making an investment in AIG, Treasury's failure to act in this instance could cause additional harm to the program's reputation and impair its ability to seek additional funding for the program if it were to need it in the future. We recommended in our March 2009 report that Treasury require that AIG seek to renegotiate existing contracts with management, employees, and counterparties, among others, as appropriate, as it finalizes its agreement for the up to \$30 billion in additional assistance, announced on March 2, 2009.

Following the announcement of Treasury's Homeownership Affordability and Stability Plan, in March 2009, Treasury released information on its Making Home Affordable Program. One of its components—the Home Affordable Modification Program (HAMP)—will use \$50 billion in TARP funds to modify mortgages. According to OFS officials, Fannie Mae and Freddie Mac will provide an additional \$25 billion for a total of \$75 billion to assist up to 4 million homeowners in order to avoid potential foreclosure.³ The Making Home Affordable program also includes a non-TARP funded initiative to help up to 4 million to 5 million homeowners refinance loans owned or guaranteed by Freddie Mac and Fannie Mae at current market rates. According to Treasury, this initiative could help homeowners save thousands of dollars in annual mortgage payments. Treasury worked with other agencies to estimate the cost and number of borrowers that would be eligible for loan modifications under HAMP and to design program parameters. On March 19, 2009, in order to reach out to borrowers, Treasury launched a Making Home Affordable Web site, which, among other things, provides program, eligibility, and housing counselor information. While the basic structure of HAMP has been announced, as of March 23, 2009, Treasury had not specified several components of the program, including a system of internal controls over TARP funds used to make loan modifications. According to Treasury, it plans to put in place such a system of internal control by the time the first payments are due to servicers. In addition, as of March 20, 2009, Treasury had not provided specific information on incentive payments, which servicers and mortgage

³According to Treasury officials, TARP funds will be used to modify mortgages that financial institutions own and hold in their portfolios (whole loans) and private-label securitized loans (loans not insured or guaranteed by Fannie Mae, Freddie Mac, HUD's Federal Housing Administration, the Department of Veterans Affairs, and rural housing loans).

holders/investors would be eligible for under HAMP. We will continue to monitor the design and implementation of this program, with a particular focus on the empirical basis for HAMP and the structure and effectiveness of its system of internal control.

Treasury also established the Auto Industry Financing Program (AIFP) in December 2008 to prevent a disruption of the domestic automotive industry that would pose systemic risk to the nation's economy. Under this program, Treasury has lent \$13.4 billion to General Motors (GM) and \$4 billion to Chrysler to allow the automakers to continue operating while working out details of their plans to become solvent, such as achieving concessions from stakeholders. The loans were designed to allow the automakers to operate through the first quarter of 2009 with recognition that, after that point, GM and Chrysler would need additional funds or have to take other steps, such as an orderly bankruptcy.⁴ As required by the terms of their loan agreements, GM and Chrysler submitted restructuring plans to Treasury in February that describe the actions the automakers will take to become financially solvent. Because of the continued sluggish economy and lower than expected revenues, GM and Chrysler are requesting an additional \$16.6 billion and \$5 billion in federal financial assistance, respectively. On March 30, Treasury announced that it had determined the plans GM and Chrysler submitted were not viable and would give GM 60 days and Chrysler 30 days to take additional steps to restructure their companies. Treasury said that it would provide the companies with interim financing during this period. As part of our oversight responsibilities for TARP, we are monitoring Treasury's implementation of AIFP, including the development of the required restructuring plans.

⁴Under AIFP, Treasury also lent \$884 million to GM to enable it to participate in GMAC's—a financing company owned, in part, by GM—new rights offering related to its reorganization as a bank holding company—and bought \$5 billion in preferred stock investment, plus warrants from GMAC. Treasury also agreed to lend \$1.5 billion to a special purpose entity created by Chrysler Financial Services Americas LLC (Chrysler Financial) to finance the extension of new consumer automotive loans, of which \$1.1 billion been disbursed to Chrysler Financial. Additionally, in March 2009, Treasury established the Auto Supplier Support Program under TARP, which will provide up to \$5 billion in financing to guarantee the payments owed to suppliers for the products they ship to automakers.

Treasury Continues to Make Progress in Establishing OFS

Treasury has also made progress in establishing its management infrastructure, which includes five of our nine recommendations from our January 2009 report related to hiring, contracting, and establishing its internal controls. However, in our March 2009 report, we made new recommendations to improve contract oversight and documentation of certain internal control procedures, as well as guidance pertaining to determining warrant exercise prices.

- In the hiring area, Treasury has continued to make progress in establishing its management infrastructure, including hiring more staff. In accordance with our prior recommendation that it expeditiously hire personnel in OFS, Treasury continued to use direct-hire and various other appointments to bring a number of career staff on board quickly. Since our January 2009 report, Treasury increased the total number of OFS staff overall and shifted from mostly detailees to more permanent staff, indicating that the workforce has become more stable over time. Specifically, as of March 20, 2009, OFS has 113 total staff, with the number of permanent staff increasing substantially—from 38 to 77—since our last report and the number of detailees decreasing from 52 to 36. Of the permanent staff currently working in OFS, 50 have come from other parts of Treasury and the federal government and 27 from the private sector. In addition, detailees from several Treasury and non-Treasury offices, bureaus, and agencies currently support OFS. While Treasury expects that permanent staff will be largely tasked with long-term responsibilities, as the TARP strategy evolves, detailees will continue to play a critical role in supporting the flexibility of OFS operations. In our last report, we recognized that the changing nature of OFS had made it difficult for officials to determine its long-term organizational needs, but that such considerations continue to be vital for retaining institutional knowledge within the organization as programs evolve. Treasury has taken further steps to align OFS's human capital program with its current and emerging mission and programmatic goals. For example, as outlined in its draft workforce plan, Treasury has taken steps to identify the critical skills and competencies needed to operate OFS and plans to develop strategies to address gaps in these areas. These actions will be critical to OFS's ability to monitor its progress in building and developing the OFS workforce.
- Treasury has continued to build a network of contractors and financial agents to support TARP administration and operations. Since our January report, Treasury has awarded seven new contracts and two new financial agency agreements as of March 13, 2009, bringing to 25 the total number of TARP financial agency agreements, contracts, and blanket purchase agreements. Four new contracts are for a variety of legal services; others are for management consulting and document production and program

support services; and the two new financial agency agreements are to support the new home loan modification program.⁴ At the same time, Treasury has continued to build its capacity to manage these vendors by putting into place the people and processes necessary to enhance its oversight of contractor and financial agent performance. Given the still-evolving nature of TARP requirements, we recognize that opportunities for using fixed-price arrangements may be limited. Nonetheless, Treasury has a process that should help it determine where those opportunities exist. In developing this process, Treasury has addressed our prior recommendation in this area and we will continue to monitor its continued progress. In addition, Treasury could enhance its efforts to safeguard the TARP program from conflicts-of-interest involving its contractors and financial agents by completing its review of mitigation plans to enhance specificity and conformity with the new conflicts-of-interest rule and by requiring that decisions on potential conflicts be documented, which we recommended in our March 2009 report.

- OFS has begun to build a financial reporting structure, including addressing the key accounting and financial reporting issues necessary to enable it to prepare financial statements and receive an audit opinion on those statements at this fiscal year end. Consistent with our previous recommendations, OFS is continuing to develop a comprehensive system of internal control and has established plans for finalizing formal policies and procedures to govern TARP activities and assess its risks. In the interim, OFS has developed and documented process flows and narratives describing internal control procedures for TARP transactions. While OFS applied adequate control procedures over selected CPP and SSFI transactions we tested, it has not taken steps to provide consistency between the documented control descriptions and the actual control procedures that were applied to the transactions. Inconsistencies in the application of a control procedure complicate review of the transactions and increase the risk that the transactions are not recorded completely, properly, or consistently. Similarly, OFS needs to address inconsistencies in guidance pertaining to determining warrant exercise prices. Inconsistencies in guidance available to the public for these price determinations may create confusion about the actual terms and conditions executed by Treasury for its investments.

⁴Treasury also modified several other existing task orders to obligate more funds and extend the performance periods.

**Indicators Suggest
Mixed Developments
in the Credit Markets,
but Isolating the
Impact of TARP
Continues to Present
Challenges**

Finally, we again note that while isolating the effect of TARP's activities continues to be difficult, conditions appear to have generally improved in various credit markets since the announcement of the first TARP program. However, some indicators demonstrate that, since our January 2009 report, the cost of credit continues to increase in interbank and corporate bond markets and decrease in mortgage markets, while perceptions of risk (as measured by premiums over Treasury securities) have declined in interbank and mortgage markets and risen in corporate debt markets. In addition, although Federal Reserve survey data suggest that lending standards remained tight, the largest CPP recipients extended over \$240 billion in new loans to consumers and business in both December 2008 and January 2009, according to the Treasury's new loan survey. Attributing any of these changes directly to TARP continues to be problematic because of the range of actions that have been and are being taken to address the current crisis. While these indicators may be suggestive of TARP's ongoing impact, no single indicator or set of indicators will provide a definitive determination of the program's impact.

Mr. Chairman, Ranking Member Grassley, and Members of the Committee, I appreciate the opportunity to discuss this critically important issue and would be happy to answer any questions you may have. Thank you.

GAO Contact

For further information on this testimony, please contact Thomas J. McCool at (202) 512-2642 or mccoolt@gao.gov.

GAO Response to Senate Finance Committee
TARP Oversight: A Six Month Update

March 31, 2009

Questions for Acting Comptroller General Dodaro

Questions from Senator Baucus

1. **There seems to be some confusion about what happens to dividends paid by banks back to TARP. Second, I would like to know what happens if banks repay TARP funds. What is the status of those funds—can they be used again for TAR, are they used to reduce the deficit, do they go into another separate account?**

GAO's response: Generally, dividends paid by banks back to TARP are deposited into the general fund of the Treasury and are not available for future TARP-related disbursements. However, dividends paid on the preferred shares received as premiums through the Asset Guarantee Program (i.e., Citigroup) are to be deposited into the Troubled Asset Insurance Financing Fund to be used to fulfill obligations associated with the guarantees.

As of April 30, 2009, 11 CPP participants have repaid TARP funds to Treasury. These payments are deposited in the general fund of the Treasury, which are used (in theory) to repay the debt that was issued to fund Treasury's original purchase. The face value of the redeemed instruments is available to use up to the \$700 billion limit on Treasury's purchase authority. Treasury then may issue new debt to purchase new financial instruments if it so chooses.

2. **President Obama has included in his budget \$750 billion in additional funds through TARP. Much of Congress' determination on whether these funds should be provided will depend on the progress of the existing programs established within TARP. Do you believe Treasury has in place the proper mechanism to track such progress? To the extent possible, can you please provide what you believe to be a best measurement of progress or success for each of the 12 programs?**

GAO's response: Treasury does not yet have in place a systematic method to track the progress of all of its programs. It is looking to a broad set of measures to track the progress of TARP in general; indicators such as interest rates and risk-related spreads; but with a few exceptions it has not developed more specific indicators for particular programs. It has begun to examine lending activity from CPP recipients and will analyze call report data from the fourth quarter of 2008 and the first quarter of 2009 to track any progress from this program. It is also developing indicators for the Home Affordable Mortgage Program (HAMP) but this is still at an early stage.

GAO has stated in each of its reports the difficulty in separating the effects of TARP on the financial system from all of the other rescue efforts that are being undertaken. Nevertheless, we do believe that there are indicators that can in combination give a sense that things are moving in the right direction. From our first report we noted inter-bank interest rates and spreads, corporate bond rates and spreads and mortgage interest rates and spreads as some of the indicators we would track. We have seen definite improvement in the interbank market, some improvement in the mortgage market (although not likely related to TARP at that time) and little improvement in the bond markets as of the end of March. We were also looking to analyze the lending and call report data of recipient banks to determine if the Capital Purchase Program is having any effect.

There is probably not any one best indicator for each of the programs. For those programs focused on individual institutions such as Systemically Significantly Failing Institution Program, Targeted Investment Program and Asset Guarantee Program the best indicators would involve sustaining or unwinding those institutions at minimal government expense. For those programs such as the Term Asset-backed Securities Loan Facility and the Small Business Initiative the best indicators would be revitalization of the relevant secondary markets, including lower interest rates, risk spreads, and increases in new securitizations. Public-Private Investment Program will be a harder program to judge because it will depend on the amount of loan/asset purchase and the appropriateness of pricing. All of these indicators need to take into account the cost to the government of achieving any positive market outcomes.

Questions from Senator Grassley

1. Does GAO have any views on how to reform the current financial regulatory system?

GAO's response: In January 2009, GAO issued a report entitled, *Financial Regulation: A Framework for Crafting and Assessing Proposals to Modernize the Outdated U.S. Financial Regulatory System* (GAO-09-216) that provides a framework for crafting and evaluating regulatory reform proposals; it consists of the following nine characteristics that should be reflected in any new regulatory system.

Clearly defined regulatory goals. A regulatory system should have goals that are clearly articulated and relevant, so that regulators can effectively conduct activities to implement their missions.

Appropriately comprehensive. A regulatory system should ensure that financial institutions and activities are regulated in a way that ensures regulatory goals are fully met. As such, activities that pose risks to consumer protection, financial stability, or other goals should be comprehensively regulated, while recognizing that not all activities will require the same level of regulation.

Systemwide focus. A regulatory system should include a mechanism for identifying, monitoring, and managing risks to the financial system regardless of the source of the risk or the institutions in which it is created.

Flexible and adaptable. A regulatory system should be adaptable and forward-looking such that regulators can readily adapt to market innovations and changes and include a mechanism for evaluating potential new risks to the system.

Efficient and effective. A regulatory system should provide efficient oversight of financial services by eliminating overlapping federal regulatory missions, where appropriate, and minimizing regulatory burden while effectively achieving the goals of regulation.

Consistent consumer and investor protection. A regulatory system should include consumer and investor protection as part of the regulatory mission to ensure that market participants receive consistent, useful information, as well as legal protections for similar financial products and services, including disclosures, sales practice standards, and suitability requirements.

Regulators provided with independence, prominence, authority, and accountability. A regulatory system should ensure that regulators have independence from inappropriate influence; have sufficient resources, clout, and authority to carry out and enforce statutory missions; and are clearly accountable for meeting regulatory goals.

Consistent financial oversight. A regulatory system should ensure that similar institutions, products, risks, and services are subject to consistent regulation, oversight, and transparency, which should help minimize negative competitive outcomes while harmonizing oversight, both within the United States and internationally.

Minimal taxpayer exposure. A regulatory system should have adequate safeguards that allow financial institution failures to occur while limiting taxpayers' exposure to financial risk.

2. **Your testimony indicated that a significant percentage of the dividend payments the government expected to receive from Capital Purchase Program participants were not paid. Please explain why those payments were not made and describe to what extent the failure of AIG to declare and pay an expected dividend contributed to that shortfall.**

GAO's response: TARP received approximately \$2.9 billion in dividend payments through March 20, 2009. However, AIG and eight other institutions under CPP did not declare and therefore did not pay their expected dividends through this period. The dividend payments to Treasury are contingent on each institution declaring dividends. AIG notified Treasury that the board of directors did not declare a dividend of approximately \$733 million for the February 1, 2009, dividend payment. Also Treasury did not receive approximately \$150,000 in possible noncumulative dividends related to eight CPP participants. According to Treasury officials, these

eight banks informed Treasury that they lacked the necessary regulatory or shareholder approvals to declare dividends on their preferred stock. Federal banking laws and regulations include minimum capital requirements and limitations on the use of capital to pay dividends. In addition, some state laws impose similar limitations and require shareholder approval for certain reductions of capital.

3. What additional steps could Treasury take to help protect the government interest concerning AIG?

GAO's response: In our March 2009 TARP report, GAO recommended that Treasury require AIG to negotiate stronger concessions from its counterparties, employees, and creditors, as appropriate. As with all TARP programs, Treasury must ensure that it has proper oversight mechanisms in place to ensure that AIG is complying with the terms of its agreements and program requirements.

4. In its initial decision to provide assistance to the automakers, did Treasury follow GAO's principles on providing federal assistance to large firms?

GAO's response: According to GAO's principles, the federal government should (1) identify and define the problem, (2) determine the national interests and set clear goals and objectives that address the problem, and (3) protect the government's interests.

Regarding the first principle, Treasury identified as a problem of national interest the financial condition of the U.S. automakers and its potential to affect financial market stability and the economy at large. In determining what actions to take to address this problem, Treasury concluded that Chrysler and GM's lack of liquidity needed immediate attention and, in order to prevent a significant disruption of the automotive industry, provided short-term bridge loans to the automakers. To address the industry's structural challenges, which will take more time to resolve, Treasury required Chrysler and GM to prepare restructuring plans that describe the changes the automakers intend to make in order to achieve long-term financial viability.

Regarding the second principle, Treasury established goals and objectives for the federal financial assistance in the loan agreements and other program documentation. For example, the loan agreements state that funding should be used to enable the automakers to develop a viable and competitive business and develop the capacity to produce energy-efficient advanced technology vehicles, among other things. Although Treasury identified goals for the assistance, it will need to determine how to assess goals that rely on concepts that are not clearly defined and to evaluate the relevant trade-offs associated with the goals that appear to conflict. For example, the goals stated in the loan agreements include concepts that were not defined, such as rationalized manufacturing capacity and competitive product mix. In addition to lacking clear definitions, some of Treasury's goals may work at cross purposes, at least in the short-term, and thus will require an assessment of the relevant trade-offs

among the goals. For example, according to members of our panel of individuals with auto industry expertise, producing advanced technology vehicles has the potential to conflict with the goal of developing a viable business in the near term because the costs of designing, developing, and producing these types of vehicles are greater than the revenue generated in the initial years of sales. As we have previously reported, it is important that policymakers choose clearly among potentially conflicting goals of providing federal financial assistance.

Regarding the third principle, in developing the terms and conditions of the loans to Chrysler and GM, Treasury included provisions to manage risk and protect the government's interest. These provisions include requiring concessions from stakeholders, instituting controls over management, and securing collateral for the loans. While the loan agreements include a number of terms and conditions to help protect the government's interests, some potential risks, as described below, remain.

Concessions from stakeholders. The loan agreements called for stakeholder concessions, including agreements from creditors to reduce overall debt, from labor for more competitive wage structures, and from retirees for modifications to voluntary employee benefit association (VEBA) contributions, as well as limits on executive compensation. However, agreements on concessions with all of these stakeholders have not been reached. For example, as of April 30, GM and its bondholders had not reached agreement on how to restructure GM's debt. Similarly, Treasury is waiting for the Office of Management and Budget to approve additional regulations that Treasury has drafted on executive compensation as required by the Recovery Act before establishing a process to monitor compliance with the executive compensation requirements.

Collateral. Treasury's goal in its negotiations with Chrysler and GM prior to signing the loan agreements was to obtain senior liens whenever possible and, for assets already encumbered, to obtain junior liens. For Chrysler, because most assets were already encumbered with senior liens, Treasury was only able to obtain a senior lien on a portion of the company's parts inventory, known as Mopar.¹ For GM, Treasury obtained a senior lien on cash, inventory, real property, equity in domestic and foreign subsidiaries, and intellectual property. Treasury also received junior liens on additional assets from both companies. According to Treasury officials, Treasury cannot put an estimated dollar value on either company's pledged collateral because the value of certain items, such as cash and inventory, is constantly changing. Treasury officials said that the limited amount of assets on which the government has senior liens could become an issue if the companies enter bankruptcy or otherwise liquidate their assets, although the situation differs somewhat for the two companies. According to Treasury, in the case of Chrysler, the sale of the assets would result in cash equal to only a small percentage of the value of the loans. Moreover, because Treasury placed liens on all unencumbered assets to secure the December loans, it will be difficult or impossible for the government to obtain additional collateral for

¹Chrysler reported in its restructuring plan that the Mopar inventory has a recovery value between \$149 million and \$261 million.

any new loans that may be provided. In its restructuring plan, GM proposed that additional federal assistance could be in the form of a preferred equity investment in the company, a revolving loan, and a loan secured by the collateral already used to support the current \$13.4 billion loan. Chrysler did not propose collateral options for any additional federal assistance in its restructuring plan.

4. What is the status of GAO's work on the auto industry, and what are your major findings to date?

GAO's response: We issued a report on April 23 summarizing the government's efforts and the automakers' restructuring to date (See www.gao.gov/new.items/d09553.pdf). We will continue to monitor the government assistance to the auto industry and plan to report periodically on this assistance as part of the requirement that we report on the use of funds under TARP.

The reporting objectives and major findings of the April 23 report include the following.

The nature and purpose of federal assistance to the auto industry: From December 2008 through March 2009, the Treasury Department established a series of programs to help bring relief to the U.S. auto industry and prevent the economic disruptions that a sudden collapse of Chrysler and GM could create. In December 2008, Treasury provided bridge loans of \$4 billion to Chrysler and \$13.4 billion to GM and required both automakers to submit restructuring plans in February 2009. In March, Treasury determined that the automakers' restructuring plans were not sufficient to achieve long-term viability and required that they take more aggressive action as a condition of receiving additional federal assistance. At the same time, Treasury also established programs to ensure payments to suppliers of parts and components needed to manufacture cars and to guarantee warranties of cars Chrysler and GM sell during the restructuring period. In addition to these programs, the President announced a new White House initiative to help communities and workers affected by the downturn in the industry.

How the federal assistance to the auto industry addresses GAO's principles for assistance to large firms: In providing assistance to the auto industry, Treasury identified goals and objectives and took steps to protect the government's interest. Provisions to protect the government's interest include requiring automakers to submit periodic financial reports and to gain concessions from stakeholders such as the UAW, creditors, and bondholders. As of the reporting date, however, Chrysler and GM had not reached agreements with these stakeholders. In addition, Treasury included provisions to secure collateral from the automakers. However, because many of Chrysler's and GM's assets were already encumbered by other creditors, the amount of assets on which Treasury could secure senior liens was limited. An additional area of risk is the financial health of the automakers' pension plans. In the event that Chrysler or GM cannot continue to maintain its pension plans—such as in the case of liquidation—the Pension Benefit Guaranty Corporation, a government

corporation, may be required to take responsibility for paying the benefits for the plans, which are not fully funded.

Important factors for Chrysler and GM to address in achieving long-term viability and the challenges that they face to become viable: GAO's panel of individuals with auto industry expertise identified a number of factors for achieving viability, including reducing the number of brands, reassessing the scope and size of dealership networks, reducing production capacity and costs, and obtaining labor concessions. However, Chrysler's and GM's restructuring plans submitted in February did not fully address these factors, according to GAO's panelists. In its assessment of the plans, Treasury identified concerns similar to those identified by the panelists, and concluded that Chrysler and GM need to establish a new strategy for long-term viability in order to justify a substantial additional investment of federal funds. Achieving viability is made more difficult because of many additional challenges facing the automakers, some of which are outside their control—such as the weak economy and the limited availability of credit. The condition of the U.S. economy will likely continue to affect the financial health of Chrysler and GM, as historically automobile sales almost always decrease during periods of economic recession.

5. How is Treasury providing oversight of the assistance provided to the automakers?

GAO's response: In developing the terms and conditions of the loans to Chrysler and GM, Treasury included provisions to manage risk and protect the government's interest. These provisions are described in the table below. Treasury also established an internal working group—referred to as the auto team—to oversee the assistance to the automakers and provide analysis in support of the Auto Industry Task Force and the Secretary of the Treasury. In addition, Treasury officials are working closely with Chrysler and GM as the companies take steps to restructure their companies.

Loan Terms and Conditions Designed to Manage Risk and Protect the Government's Interest

Concessions from stakeholders

- Executive compensation limitations: Restrictions on compensation for senior executive officers include recovery of any bonus or incentive payments based upon materially inaccurate statements of earnings, limiting tax deductions on executive compensation over \$500,000 per executive and prohibiting golden parachute payments.⁴
- Agreements with debt holders: The automakers must use their "best efforts" to convert at least two-thirds of their unsecured public debt through a bond exchange or other appropriate means.
- Labor concessions: The automakers must use their "best efforts" to reduce the compensation of their workers to be comparable to workers at the transplant companies' U.S. facilities, align their work rules⁵ more closely with those at the transplant companies' U.S. facilities, and close the Jobs Bank programs.⁶
- Retiree concessions: The automakers must use their "best efforts" to reach agreement with the union to provide at least one-half of the automakers' future payments or contributions for retiree health plans (VEBA) in the form of company stock.

Controls over management

-
- Approval of material transactions: Treasury must approve any fundamental changes to the automakers' companies and certain transactions for more than \$100 million in value and outside the ordinary course of business.
 - Restrictions on expenses: The automakers must maintain and implement an expense policy with limitations on, among other things, sponsoring conferences and events, travel costs, office renovations, and entertainment. In addition, the automakers must provide for oversight and mechanisms to ensure compliance with the expense policy.
 - Restructuring plans: The automakers are required to prepare restructuring plans outlining the actions they will take to meet the requirements set forth in the loan agreements, including concessions from various stakeholders. Treasury must approve these plans and the actions the automakers have taken toward implementing the plans before additional assistance is provided.⁷
 - Periodic reporting requirements: The automakers must submit periodic financial reports including weekly rolling cash forecasts⁸ and biweekly liquidity status reports,⁹ as well as monthly certifications of expense policy conformance and quarterly certification of compliance with executive compensation provisions.
-

Collateral

- Liens: In negotiations prior to signing the loan agreements, Treasury attempted to obtain senior liens on all unencumbered assets at both GM and Chrysler.⁸
-

Compensation for risk

- Compensation: The automakers agreed to provide Treasury with compensation in the form of warrants and notes in the case of GM and additional notes in lieu of warrants in the case of Chrysler. Both automakers are required to repay the loans with interest.
-

⁷A golden parachute is defined as any payment in the nature of compensation to a senior executive officer made on account of involuntary termination or in connection with any bankruptcy filing, receivership, or insolvency of the institution to the extent that the present value of the payment equals or exceeds three times the executive's average annual compensation over the preceding 5 years.

⁸Work rules generally refer to those sections of a contract that define issues such as hours to be worked and what work is done by what employees.

⁹Under their Jobs Bank programs, the Detroit 3 continue to provide wages and benefits to workers that have been laid off.

¹⁰Chrysler and GM submitted these plans on February 17, and Treasury announced on March 30 that additional steps must be taken before further assistance is provided.

¹¹This forecast outlines for each of the thirteen weeks both operating and non-operating cash receipts and disbursements which result in a net cash flow for the week that increases or decreases the previous week's ending cash balance and results in the current cash balance.

¹²This report details the company's current liquidity profile; expected liquidity needs; any material changes in the company's business since the date of the last status report; any transfer, sale, pledge or other disposition of any material asset since the date of the last status report; and any changes to the company's capital structure.

¹³A lien is a legal right that a creditor has in another's assets, usually lasting until a debt is repaid. Senior liens have priority over other liens on the same asset.

6. What kind of progress have the automakers made in implementing their restructuring plans?

GAO's response: On March 30, after an assessment of the February restructuring plans by the Treasury Department and the Auto Industry Task Force, the President announced that the steps laid out in these plans did not establish a credible path to viability. The President said that each company must establish a new strategy and outlined a series of actions that each company must undertake to receive additional federal assistance. We plan to review any updates to the restructuring plans that

Chrysler or GM submit and to monitor their progress in achieving the steps laid out by Treasury.

Questions from Senator Hatch

1. **GAO recommends in the March 2009 report that Treasury require that AIG seek to renegotiate existing contracts with management, employees, and counterparties, among others, as appropriate, as it finalizes its agreement for the up to \$30 billion in additional assistance, announced on March 2, 2009. Can you please explain the importance of this renegotiation?**

GAO's response: This negotiation is important because Treasury had not finalized the agreement and therefore, presents an opportunity for Treasury to ensure that it had negotiated strong concessions from AIG before doing so.

2. **According to testimony by GAO, the Office of Financial Stability has received nearly \$2.9 billion in dividends from TARP participants and did not make that public. Why has Treasury not publicly revealed dividends paid to Treasury from TARP participants?**

GAO's response: Treasury officials told us that, per their interpretation, the Economic Emergency Stabilization Act of 2008 does not require Treasury to disclose dividend receipts from TARP participants. However, in response to our recommendation on this matter, Treasury officials told us that starting in May 2009 they will begin to report publicly dividends received on TARP investments.

3. **You mentioned that "conditions" appear to have generally improved in various credit markets since the announcement of the first TARP program. Can you elaborate on these conditions?**

GAO's response: In our report we stated that conditions in the interbank market had improved because rates and spreads had fallen. We also stated that mortgage interest rates and spreads had declined although the timing did not suggest that TARP was the primary reason. Conditions in the corporate bond markets had not improved as of the end of March. According to the Treasury lending survey data lending by the largest TARP recipients had dropped from October to November, increased from November to December and remained relatively flat in January.

4. **At this point, Treasury has not taken steps to verify information or require the institutions participating in TARP to provide any additional documentation in regards to executive compensation? Is this why Treasury did not become aware of the \$165 million in bonuses from AIG to its executives even though AIG promised these bonuses to executives back in 2007 or early 2008?**

GAO's response: The initial assistance provided to AIG was provided by the Federal Reserve Bank of New York (FRBNY) under its emergency powers provided under 13(3) of the Bank Agency Audit Act. According to officials from the Federal Reserve Board, FRBNY, Treasury and AIG, FRBNY has been the primary point of contact and responsible for monitoring the day-to-day operations of AIG since September 2008. According to these officials, Treasury has only recently begun to be more involved in monitoring AIG as its assistance has increased.

5. **The largest Capital Purchase Program recipients extended over \$240 billion in new loans to consumers and business in both December 2008 and January 2009, according to the Treasury's new loan survey. Why are many of my constituents still asking me why they cannot get loans from banks?**

GAO's response: While the largest CPP recipients were still lending they clearly are lending at a slower pace than before the crisis and the recession began. This reflects a number of factors. Underwriting standards have become more stringent over the last year to year and a half making it more difficult for borrowers to qualify. The recent crisis revealed that underwriting standards had become too loose in the mid 2000s and regulators encouraged banks to strengthen them. However, the financial system tends to over correct in a downturn as institutions attempt to shed risk and decrease leverage to get themselves back on a firmer footing. The recession has also clearly lowered the perceived creditworthiness of many borrowers. In addition, the recession has reduced to some extent the demand for credit especially for business expansion, much of which is being postponed until things get better. For these and other reasons it is not surprising that while lending is occurring it is occurring at a reduced level.

6. **\$303 billion of the \$700 billion allocated by Congress under TARP has been disbursed and another \$364 billion has been committed to be spent. My calculations show that \$667 billion of the \$700 approved by Congress has been used, leaving \$33 billion left.**

- a. **Do you expect TARP will need more funding?**

GAO's response: As GAO stated in its testimony, Treasury revised its estimated funding commitments based in March 2009 based on its projected use of funds, which was \$590.4 billion as of March 27, 2009. According to Treasury's estimate, this would leave it almost \$110 billion available for future use. Given the dynamic nature of the financial crisis, GAO has no basis to project whether TARP will need additional funding at this time.

- b. **Can you estimate how much more funding TARP will need?**

GAO's response: As mentioned previously GAO, has no basis to estimate whether TARP will need additional funds in the future, but the President's proposed budget included a "placeholder" for additional TARP funding should additional funding be needed

c. When Treasury receives dividends from TARP participants, do those monies return to TARP or to Treasury?

GAO's response: Generally, dividends paid by recipients back to TARP are deposited into the general fund of the Treasury and are not available for future TARP-related disbursements.

d. So it is very likely, that TARP will need more funding?

GAO's response: Based on Treasury's estimated use of existing funds and what remains, this remains unclear and will be determined by the condition of the financial markets going forward.

7. You have all expressed a common concern with the implementation of TARP. And that is that you all believe TARP can do a much better job with communication. From how money is spent to how much Treasury is receiving from its return on investment to the description of TARP, Treasury has not done a good job getting the word out about TARP. I bring this up because not only is it creating an obstacle for you all to do your job, but I feel that thus is what is frustrating my constituents and many Americans. They have their heads spinning on each program that is announced by Treasury under TARP, which seems to occur on a weekly basis. What can Treasury do to strengthen communication to the public about TARP?

GAO's response: As we noted in our March 2009 report, while Treasury has continued to take steps to articulate a more clearly defined vision for TARP, including providing its strategy for its remaining funds, it continues to be hampered by questions about its overall strategy. An effective communication strategy should, among other things, build understanding and support for the program through regular and routine outreach, including confidential member briefings; integrate communications and operations by making communication integral to the program; and increase the impact of communication tools such as electronic and print media and video. Specifically, GAO recommended that Treasury, develop a communication strategy that includes building an understanding and support for the various components of the program. Specific actions could include hiring a communications officer, integrating communications into TARP operations, scheduling regular and ongoing contact with congressional committees and members, holding town hall meetings with the public across the country, establishing a counsel of advisors, and leveraging available technology.

United States Senate
Committee on Finance



Sen. Chuck Grassley · Iowa
Ranking Member

Hearing Before the Committee on Finance
“TARP Oversight: A Six Month Update”
Statement of Ranking Member Charles Grassley
Tuesday, March 31, 2009

Thank you, Mr. Chairman, for calling this critically important hearing today. It has been a year since the collapse of Bear Stearns, and about six months since the \$700 billion Troubled Asset Relief Program, or “TARP” for short, was created in the Emergency Economic Stabilization Act. According to its purpose clause, the Act was supposed to help Treasury restore liquidity and stability in financial system, and to do it in a manner that protects home values, college funds, retirement accounts, and life savings; preserves homeownership and promotes jobs and economic growth; maximizes returns to taxpayers; and provides public accountability for the exercise of such authority.

I had my doubts about the creation of the TARP and the way it was rushed through Congress. Congressional leaders paired the bill with the hard-fought tax legislation for Midwest flood relief and equity for Midwest flood victims compared to what Washington did for Katrina victims. I voted against the second round of TARP funding because my initial concerns about the rest of the bill were justified, including my concerns that limits on executive compensation were too weak. As soon as Treasury received the funds, it decided to bail out big banks instead of buying up toxic assets, as they told us. Millions continued to lose jobs and homes, which makes me wonder about the program’s effectiveness. But you can’t measure effectiveness when you don’t know what the goals and objectives of a program are, or how the program is being run.

I am disappointed and frustrated that the Administration refused the Committee’s request for Mr. Kashkari to testify here today. It would have been nice to hear how he is gauging the success of the program. Mr. Chairman, I ask unanimous consent to enter in the record my letter to Secretary Pauslon dated November, 12, 2008. During his confirmation process, I asked Secretary Geithner for his commitment to respond to all of my inquiries, including this letter. There are certain answers that only the Administration can provide, and I will continue to push until I get them.

While the operation of TARP is troubling, it is a small relief to know that the program’s watchdogs are doing their jobs. I’m glad to have worked with you, Mr. Chairman, to create the Special Inspector General for the TARP, who will be testifying here today along with the heads of the Government Accountability Office and the Congressional Oversight Panel.

These watchdog agencies are vital to helping Congress and the American people keep track of multiple TARP and TARP-related programs that the Treasury Department is initiating. Treasury has announced several new programs just in the last two weeks, some on its own and some in partnership with the Federal Reserve. With so much happening so fast and so much taxpayer money at stake, the need for quality oversight and transparency has never been greater. Unfortunately, despite saying all the right things about open government, the new administration has not had made any major changes aimed at making TARP more transparent. Moreover, I have heard about potential problems with access to information from all three of these oversight bodies.

The Treasury Department told the Inspector General that it didn't want to ask banks what they did with taxpayer money provided through the Capital Purchase Program. So the Inspector General said he would ask the banks himself through an initial survey. At first, he faced a few bureaucratic hurdles, but he has now received responses from the several hundred financial institutions that received capital injections of taxpayer money. Contrary to the claims by some that it was impossible to know how the money was used, I understand that many of the responses provide a very clear understanding of where our money went. I guess the money was not as fungible as we thought and in fact if we want to know where the money went — with a little ingenuity, you can get a pretty good idea.

The Treasury's recently announced initiatives demonstrate an increasing reliance on partnerships with the Federal Reserve. However, these moves threaten the ability of the Government Accountability Office to monitor the program effectively. That's because the GAO is limited by statute from examining the activities of the Federal Reserve. That limitation is aimed at ensuring the Fed's independence in monetary policy. However, its unprecedented actions in the last year have taken it far beyond traditional monetary policy. Chairman Baucus and I have already introduced legislation to expand GAO's ability to obtain records from TARP recipients because the bill that created the program failed to grant GAO the authority to look into the books and records of TARP recipients.

The Congressional Oversight Panel has also had problems getting answers to some of its questions from the Treasury Department. According to the Panel's most recent monthly report, Secretary Geithner has failed to respond to key questions that have been pending since even before his time at the Treasury Department. Elizabeth Warren, the panel's Chair and one of our witnesses here today, wrote to him again on March 5, 2009, urging him to respond to her inquiries.

If these oversight efforts are to be successful, Congress must be willing to provide the necessary attention and support. Today's hearing is an attempt to do just that. We want to know if there is meaningful cooperation. We want to know what these organizations have recommended to the Treasury. We want to know whether the Treasury is taking those recommendations seriously and making meaningful changes. If not, then we need to help follow-up and make sure that the problems identified through this process are fixed. It's not about assigning blame. It's about making sure that government works. It's about making sure that government is accountable to the taxpayers who are footing the bill. With everything that is at stake, we can't afford to have it any other way, and we will not accept anything less.

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
 KEN SALAZAR, COLORADO

CHUCK GRASSLEY, IOWA
 ORRIN G. HATCH, UTAH
 OLIVIA J. SNOWE, MAINE
 JON KYL, ARIZONA
 GORDON SMITH, OREGON
 JIM BUNNING, KENTUCKY
 MIKE CRAFO, IDAHO
 PAT ROBERTS, KANSAS
 JOHN ENSIGN, NEVADA
 JOHN E. SUNUNU, NEW HAMPSHIRE

RUSSELL SULLIVAN, STAFF DIRECTOR
 KOLAN DAVIS, REPUBLICAN STAFF DIRECTOR AND CHIEF COUNSEL

United States Senate

COMMITTEE ON FINANCE
 WASHINGTON, DC 20510-6200

November 12, 2008

The Honorable Henry M. Paulson, Jr.
 Secretary
 U.S. Department of the Treasury
 1500 Pennsylvania Avenue, NW
 Washington, DC 20220

The Honorable Ben S. Bernanke
 Chairman
 Board of Governors of the Federal Reserve System
 Twentieth and Constitution Avenue, NW
 Washington, DC 20551

Dear Secretary Paulson and Chairman Bernanke:

I am writing to express my concerns and receive answers to questions I have regarding the Treasury Department's implementation of the Emergency Economic Stabilization Act of 2008 (the "Act") which was signed into law on October 3, 2008. As you know, pursuant to the Act and the President's written certification of need dated October 14, 2008, Treasury received the authority to purchase, or commit to purchase, troubled assets up to the limit of \$350 billion outstanding at any one time. Of the first \$350 billion, I understand that Treasury has already sent out \$125 billion to 9 large banks, is in the process of sending out up to \$125 billion to other financial institutions, including smaller banks, and will be sending another \$40 billion to AIG.

Under the Act, the President can submit a request to authorize Treasury to obtain an additional \$350 billion. Secretary Paulson in his statement today indicated that these additional funds should be used to reinvigorate the markets for credit cards, student loans and auto loans. In addition, he stated that the funds would not be used to purchase the "toxic assets" that Treasury intended to purchase when it sought passage of the Act.

In light of the President's imminent request for up to an additional \$350 billion, I ask that you respond to my questions and concerns. I noted that in my statement entered into the Congressional record on October 1, 2008, the day the Senate passed the Act, that Congress would be monitoring Treasury's actions and asking questions about its implementation of the Act. In that speech, I stated that "[t]axpayers are protected because the final bill doesn't provide \$700 billion upfront. The Administration originally

wanted the authority to have it all at once, but this bill provides for the program to be implemented in stages. Only \$250 billion will be provided immediately, and another \$100 billion will be provided upon a written certification of need by the President. Finally, the remaining \$350 billion will be provided unless Congress acts. Let's be clear. Congress can act anytime to revoke the Treasury's authority. They will be watched, and they will be questioned. And, if Congress doesn't like what it sees, we can repeal this economic stabilization plan."

Executive Compensation

The Act only restricts the deductibility of compensation and the payment of golden parachute payments to the top five executives of financial institutions that: (1) sell an equity interest or debt position to Treasury in a "direct purchase" or (2) sell at least \$300 million in troubled assets to Treasury in an "auction sale." The Act does not restrict, for example, the payment of bonuses and other perks paid to executives and top managers outside of the top five executives. The Act also does not restrict the payment of severance benefits to executives who voluntarily terminate from employment. Recent reports indicate that financial institutions that have received taxpayer funds under the Act are using these funds to pay bonuses to executives inside and outside of the top five executives of the institution. Top executives are walking away from their troubled institutions with tens of millions of dollars.

As I stated in my October 10, 2008, letter to you, I am concerned that these provisions are mere window dressing. My concerns have only increased given Secretary Paulson's announcement this morning that Treasury will not be using funds authorized by the Act to purchase "toxic assets." It would appear that no penalties will apply to institutions that receive taxpayer funds and violate the Act's restrictions on executive compensation.

Treasury is not constrained by the Act and should be exercising its broad authority to issue regulations that further limit executive compensation and other expenses paid by institutions that are receiving funds under the Act. Treasury should also take steps to ensure that taxpayer dollars are not being used to pay bonuses or other rewards to those executives responsible for their institutions' poor performance that, in turn, led to an institution's demise and destruction of shareholder value. On November 10, 2008, the same day on which AIG received an additional \$40 billion of federal funds, there were new reports of AIG spending money on another lavish retreat in Arizona. This is unconscionable.

I raised a number of questions in my October 10, 2008, letter to you. To date, I have not received a response. Please provide responses to these questions that I am repeating here.

1. Why would the Troubled Asset Relief Program ("TARP"), Capital Purchase Program, and the program for Systematically Significant Failing Institutions fail if the Act contained tighter provisions for executive compensation?
2. What is being done to monitor the expenses of companies rescued with taxpayer dollars?

3. Given that Treasury has broad authority to write regulations governing executive compensation, why is Treasury not utilizing this authority to restrict compensation and other expenses paid by rescued companies?

Purchase of Mortgage-Backed Securities

When Treasury pitched the need for a financial rescue bill to Congress, Congress was told that \$700 billion was needed to purchase mortgage-backed securities in order to reestablish a market in these securities that had frozen up. Congress was told that this was essential to unfreezing the credit markets, and that if Congress did not act, Americans on Main Street would soon begin to suffer as a result of an inability to get credit to fund small businesses and purchase items such as houses and cars. However, shortly after the Act was signed into law, Treasury announced that it would partially nationalize certain banks. Next, Treasury announced that it was considering guaranteeing up to 3 million mortgages totaling up to \$600 billion in principal amount according to press reports. In addition, on November 10, 2008, the Treasury Department announced that it would be providing an additional \$40 billion to AIG under the Act in exchange for preferred stock and warrants of AIG. When added together with aid provided by Treasury outside of the Act, AIG will have received approximately \$150 billion of taxpayer money. Then, in his news conference today, Secretary Paulson announced that Treasury is no longer considering purchasing mortgage-backed securities and indicated there were other priorities for TARP funds.

In light of the above, I would appreciate detailed responses to the following questions.

1. Why did Treasury decide to use the money to partially nationalize certain banks rather than follow through with the stated purpose of purchasing mortgage-backed securities?
2. Was Treasury considering using the money that it expected to receive under the Act to partially nationalize certain banks and guarantee mortgages prior to October 3, 2008, the date the Act was passed in the House of Representatives and signed into law by the President?
 - a. If yes, did you inform any members of Congress of the fact that Treasury was considering using the money that it expected to receive under the Act for these purposes?
 - b. If yes, which members of Congress did you inform and when?
3. Explain in detail the Department's rationale for providing \$40 billion in additional aid to AIG under the Act and provide all relevant materials to support this decision.
4. Explain in detail the rationale prioritizing the markets for credit cards, student loans and auto loans.

Extension of Credit

According to a number of published reports, the banks that have received large sums of money from the Act are not using the majority of that money to extend credit. Instead, it has been reported that these banks are using the money received under the Act to acquire

other banks, pay large bonuses to their executives, and pay dividends to their shareholders.

Because these reports raise additional concerns, please respond to the following questions.

1. Is Treasury tracking how these banks are using the taxpayers' money? If yes, describe in detail the methodology for tracking these funds, including how Treasury is managing any databases that it may be using.
2. Describe in detail how taxpayer money is being used?

Contracts with Third Parties

Treasury has already executed a number of contracts with companies to assist Treasury in implementing the Act. I am strong believer that sunlight is the best disinfectant and think it is important that the process of implementing the Act be as transparent as possible, especially when taxpayer money is being used. As a result, please provide responses to the following questions.

1. Provide original copies of all contracts.
2. Explain why only redacted copies of these contracts are available on your website and explain the rationale for redactions in each contract.
3. Explain how the Treasury plans to abide by the Act to ensure that there are no conflicts of interest that may arise in connection with the administration and execution of the authorities provided.

Selection of Participants

As you know, on October 24, 2008, Treasury approved \$7.7 billion in aid to PNC Financial Services Group Incorporated, which just hours later announced that it was acquiring National City Corporation for \$5.58 billion. Although Treasury approved aid to PNC, it had denied aid to National City Corporation.

1. Describe in detail, and provide copies, of the standards, policies and procedures the Department is using to decide which banks will receive aid.
2. Who makes the decision as to whether or not a bank will receive aid from Treasury?
3. How did Treasury decide that National City was ineligible to receive funds?

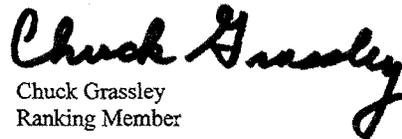
Resolution of Disapproval

Since it appears that Treasury has already identified uses for the additional \$350 billion, it seems very likely that the President will be requesting the use of these funds soon. As you aware, should Congress decide to deny the President's request, Congress would only have 15 days from the transmission of the President's request to pass a resolution of disapproval. I am concerned that the President may transmit this request when Congress is not in session and unable to come back in session within the 15 days in which Congress must act to deny the President's request.

As a result, I would like to know when the President intends to submit to Congress the request for the additional funds.

If you have any questions, please do not hesitate to contact Ellen McCarthy of my staff at (202) 224-4515.

Sincerely,


Chuck Grassley
Ranking Member

**Testimony of Professor Elizabeth Warren
Chair, Congressional Oversight Panel
Submitted to the
Senate Finance Committee
March 31, 2009**

Thank you, Chairman Baucus, Ranking Member Grassley and members of the Committee, for inviting me to testify regarding oversight of the Troubled Asset Relief Program. We share a desire to bring accountability and transparency to the TARP program, and I am pleased to assist your efforts in any way that I can.

From the outset I would like to stress that although I am Chair of the Congressional Oversight Panel, I do not have a pre-approved script. The views I express today are my own and do not necessarily represent those of the entire panel.

The Oversight Panel was created as part of the TARP in last year's Emergency Economic Stabilization Act. The job of the Panel is to "review the current state of the financial markets and the financial regulatory system" and report to Congress every 30 days. The Panel has submitted reports to Congress on December 10, January 9, February 6, and March 6, and it is preparing its fifth TARP oversight report for submission next week. The Panel also submitted a special report on regulatory reform to Congress, as required by the legislation, at the end of January.

The Oversight Panel is one of three organizations to which the TARP legislation gives oversight responsibilities. In my capacity as Panel chair, I have been pleased to work alongside my colleagues Gene Dodaro, the Acting Comptroller General of the United States, and Neil Barofsky, the Special Inspector General for the Troubled Assets Relief Program. Together we are charged with ensuring that the tax dollars of the American people are used prudently and effectively to ameliorate and ultimately reverse the deepening financial crisis in which our country – and much of the world – now finds itself.

The Special Inspector General for the TARP has a broad responsibility, and matching authority, to audit and investigate any part of the Program. GAO is given an even more detailed set of instructions for "ongoing oversight of the activities and performance of the TARP," as well as responsibility for an annual audit of the TARP's financial statements. Between the Oversight Panel's obligation to report to Congress every 30 days, the GAO's obligation to report every 60 days, and the obligation of the Special Inspector General to report every 90 days, Congress will receive an average of two TARP oversight reports every month.

The three oversight organizations are working to complement, not duplicate, one another. We hold regular meetings with the office of the Special Inspector General and with GAO senior staff responsible for TARP oversight. We share information and discuss possible lines of inquiry. We have also shared, where possible, preliminary work product. If GAO or the SIGTARP identify questions for the Oversight Panel, they will pass them to us and give us access to data that we can synthesize to inform our work; similarly, when our analysis or information indicates a significant instance of non-compliance with the terms or spirit of the TARP legislation, we will inform GAO, the SIGTARP, or both. We all want to make the whole of our work greater than the sum of its parts.

The Oversight Panel is the smallest of the three organizations. We see our contribution as fact-based analysis designed to raise issues about the operation and direction of the TARP and about the broader effort to restore stability to the financial system. In the Emergency Economic Stabilization Act, Congress specifically asked that the Oversight Panel conduct oversight on: the use of Treasury authority under the TARP; the Program's effect on the financial markets, financial institutions, and market transparency; the effectiveness of foreclosure mitigation efforts; and the TARP's effectiveness in minimizing long-term costs and maximizing long-term benefits for the nation's taxpayers. Our ultimate question is whether the TARP is operating to benefit the American family and the American economy. If we believe the answer is no, we will ask "why not," and try to suggest alternatives.

The Panel's first report back in December 2008 asked whether the public was receiving a "fair deal" when Treasury used TARP funds to make capital infusions into financial institutions. After that report came out, we worked with recognized independent experts to develop multiple valuation models to determine whether the securities Treasury received had a fair market value equal to the dollar amount of the infusions. With minimal variation, the models all demonstrated that Treasury made its infusions at a substantial discount. Treasury received securities that were worth substantially less than the amounts it had paid in return, given the financial institutions involved. In all, as we documented in our February report, Treasury had overpaid by an estimated \$78 billion. For each \$100 Treasury invested in these financial institutions, it received on average stock and warrants worth only about \$66. We believe this is an important issue.

Our report does not draw a conclusion about whether such discounts may – or may not – have been appropriate as a matter of policy. The Panel continues to examine the matter, and Congress may decide to keep it in mind as well as it responds to new Treasury initiatives. Thus far, Treasury has not given the public an explanation, so that the appropriateness of the overpayment remains, at best, unresolved.

The most important lesson we draw from our analysis is that without a clearer explanation from Treasury about its overall plan for each capital infusion, and without more transparency and accountability for how that plan was carried out, it is not possible to exercise meaningful oversight over Treasury's actions. Congress has given Treasury substantial discretion, as befits this fast-moving crisis. But that discretion carries with it an equivalent obligation to explain, in real time, why the discretion is exercised as it is. Congress and the American people need to understand Treasury's conception of the problems in the financial system, the comprehensive strategy to address those problems, and metrics to measure success toward meeting those goals. Our collective financial security is on the line, and we all have a stake in the outcome.

The Oversight Panel has also focused on mortgage foreclosure mitigation, with particular regard to impediments to mitigation efforts. The March report offers a checklist of items to evaluate the likely effectiveness of any proposal to halt the cascade of mortgage foreclosures.

- Will the plan result in modifications that create affordable monthly payments?
- Does the plan deal with negative equity?
- Does the plan address junior mortgages?
- Does the plan overcome obstacles in existing pooling and servicing agreements that may prevent modifications?

- Does the plan counteract mortgage servicer incentives not to engage in modifications?
- Does the plan provide adequate outreach to homeowners?
- Can the plan be scaled up quickly to deal with millions of mortgages?
- Will the plan have widespread participation by lenders and servicers?

President Obama's announcement of the Administration's Homeowner Affordability and Stability Plan last month addressed many of these issues. The Plan focuses on payment affordability through an expanded refinancing program involving Fannie Mae and Freddie Mac and a modification program targeting a wide range of borrowers at risk. The Plan also includes financial incentives to encourage both lenders and borrowers to strive for sustainable outcomes. It also encourages servicers to modify mortgages for at risk homeowners before they are delinquent. There are additional incentives available to extinguish junior mortgages. The Administration estimates that the Plan's expanded refinancing opportunities could assist four to five million responsible homeowners, some of whom otherwise would likely have ended up in foreclosure.

While these projections are encouraging, the Panel noted areas of serious concern that are not addressed in the plan. In particular, the Plan does not include a safe harbor for servicers operating under pooling and servicing agreements to address the potential litigation risk that may be an impediment to voluntary modifications. It is also important that the Plan more directly address second mortgages, lest they otherwise continue to contribute substantially to the rise in foreclosures. And, while the modification aspects of the Plan will be mandatory for banks receiving TARP funds going forward, Treasury has not made it clear how the federal regulators will enforce these new standards industry-wide to reach the needed level of participation.

The Plan also supports permitting bankruptcy judges to restructure underwater mortgages in certain situations. Such statutory changes would expand the impact of the Plan. Without the bankruptcy piece, however, the Plan does not deal with mortgages that substantially exceed the value of the home. Such a failure could sharply limit the relief it provides, particularly in parts of the country that have experienced the greatest price declines.

It is also critical for the federal government to collect and analyze loan performance and loss mitigation data. Without adequate data, measuring the success or failure of mitigation efforts is, at best, a hit-or-miss proposition. Reliable data will demonstrate whether TARP funds used for foreclosure mitigation efforts are achieving their intended purpose and whether such programs require modification or termination.

Recently, the Oversight Board has also opened an inquiry into the Term Asset-Backed Loan Facility (TALF). Specifically, the Oversight Panel is concerned that the TALF appears to involved substantial downside risk and high costs for the American taxpayer, while offering substantial rewards to a small number of private parties. Equally important, the TALF appears to subsidize the continuation of financial instruments and arrangements whose failure was a primary cause of the current economic crisis. The Panel is further concerned because the documents posted on Treasury's website describing the terms of operation of the TALF and press reports about the content of those terms as they are to be implemented by the Federal Reserve Bank of New York are contradictory, promoting substantial confusion.

To clarify the questions surrounding TALF, the Panel has asked Treasury for more information. Generally, the Panel is seeking information on a number of points to better

understand what Treasury intends to accomplish with TALF and why the TALF structure is the most effective way to accomplish that goal. We have not received answers to this inquiry, but have been told we can expect a response tomorrow. Until we receive detailed and accurate information, the Panel cannot perform its oversight function. Moreover, it is difficult for Congress and the American public to have confidence in an initiative for which so much money is at stake and so little key information is available.

The Oversight Panel has also launched an inquiry into Treasury and Fed actions to provide continued capital infusions and other assistance to the American International Group, Inc. (AIG). The Panel has raised a number of important questions. These include the basis for deciding that AIG posed systemic risk, the economic consequences of the assistance provided to AIG, the ultimate beneficiaries of this assistance, and the manner in which Treasury and the Board have monitored the recipients of taxpayer dollars. The Panel is particularly concerned that the opaque nature of the relationship among AIG, its counterparties, the Treasury, and the Federal Reserve Banks, particularly the Federal Reserve Bank of New York, has substantially hampered oversight of the TARP program by Congress and, equally important, has impaired the understanding of that program by the American people.

The Panel has requested information from Treasury and the Fed on a number of points related to AIG, including how the assistance was requested and need was analyzed, the assessment of risk to the national and international financial system, any conditions placed on the assistance, and information about counterparties and credit default swaps. We await the requested information from Treasury. Again, it is not surprising that Congressional and public outrage have been stoked on issues such as bonuses for AIG executives when there is no information or basic explanation as to why substantial taxpayer-funded assistance is necessary and what that money is accomplishing.

The TARP legislation is now six months old, and according to Secretary Geithner, Treasury has spent or committed \$565 billion. However, when calculating based on the maximum program levels as announced, the amount swells to \$667 billion. The Oversight Panel has repeatedly called on Treasury to articulate a clear strategy for its use of TARP funds; the absence of such a vision hampers effective oversight. In fact, our first report outlined a series of ten basic questions, starting with the question, "What is Treasury's strategy?" Months later, Congress and the American public have no clear answer to that question. The ongoing uncertainty has hindered recovery efforts.

I have sent two letters to Treasury Secretary Geithner asking for clarification on this specific point. I am disappointed to report that the Oversight Panel has not received a substantive response. We have concerns in other areas as well. Although the initiatives announced over recent weeks describe a commitment to transparency and accountability, the general frameworks do not provide an adequate foundation to oversee Treasury's activities or to measure the success of the TARP or the Stability Plan.

As part of its April report, the Oversight Panel will further analyze the evolving strategy of Treasury. The Panel has focused in recent weeks on the lessons from previous financial crises, both foreign and domestic, to help inform our analysis of the current situation. Our report will examine four case studies of particular relevance: the Japanese "Lost Decade" of the 1990s; the Swedish experience with bank nationalization in the 1990s; the establishment of the Resolution Trust Corporation (RTC) in response the American savings and loan

collapse in the late-1980s; and the actions taken to stabilize the financial and housing sectors during the Great Depression. In each case we can learn from the steps taken—or not taken—as policymakers tried to cope with failing financial institutions.

What have we learned thus far? In a crisis, transparency, accountability and a coherent plan with clearly delineated goals are necessary to maintain public confidence and the confidence of the capital markets. Sophisticated metrics to measure the success and failure of program initiatives are also critical. Assuring that the TARP reflects these elements underlies all of our oversight efforts.

Thank you again for the opportunity to explain the work of the Congressional Oversight Panel.

