CONGRESSIONAL OVERSIGHT PANEL

DECEMBER OVERSIGHT REPORT *

TAKING STOCK: WHAT HAS THE TROUBLED ASSET RELIEF PROGRAM ACHIEVED?

DECEMBER 9, 2009.—Ordered to be printed

* Submitted under Section 125(b)(1) of Title 1 of the Emergency Economic Stabilization Act of 2008, Pub. L. No. 110–343

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Glossary of Terms

ABS	Asset-backed securities
AIFP	Automotive Industry Financing Program
AIG	American International Group, Inc.
AGP	Asset Guarantee Program
ASSP	Auto Supplier Support Program
CBO	Congressional Budget Office
CDS	Credit default swap
CIT	CIT Group, Inc.
CMBS	Commercial mortgage-backed securities
CPP	Capital Purchase Program
CRE	Commercial real estate
EESA	Emergency Economic Stabilization Act of 2008
FDIC	Federal Deposit Insurance Corporation
FRBNY	Federal Reserve Bank of New York
GSE	Government-sponsored enterprise
HAMP	Home Affordable Modification Program
HARP	Home Affordable Refinancing Program
IMF	International Monetary Fund
IRR	Internal rate of return
LIBOR	London Interbank Offered Rate
LTV	Loan-to-value ratio
MHA	Making Home Affordable
OIS	Overnight Indexed Swaps
OMB	Office of Management and Budget
PPIP	Public-Private Investment Program
SBA	Small Business Administration
SEC	U.S. Securities and Exchange Commission
SIGTARP	Office of the Special Inspector General for the Troubled Asset Relief Program
SPA	Securities purchase agreement
S–PPIP	Legacy Securities PPIP
SSFI	Systemically Significant Failing Institution Program
TALF	Term Asset-Backed Securities Loan Facility
TARP	Troubled Asset Relief Program
TIP	Targeted Investment Program
TLGP	Temporary Liquidity Guarantee Program

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EXECUTIVE SUMMARY *

The financial crisis that gripped the United States last fall was unprecedented in type and magnitude. It began with an asset bubble in housing, expanded into the subprime mortgage crisis, escalated into a severe freeze-up of the interbank lending market, and culminated in intervention by the United States and other industrialized countries to rescue their banking systems.

The centerpiece of the federal government's response to the financial crisis was the Emergency Economic Stabilization Act of 2008 (EESA), which authorized the Treasury Secretary to establish the $700 billion Troubled Asset Relief Program (TARP) and created the Congressional Oversight Panel to oversee the TARP. Now, at the end of the first full year of TARP's existence, the Panel is taking stock of the TARP's progress: reviewing what the TARP has accomplished to date, and exploring where it has fallen short.

Although the TARP was a key element of the federal government's response to the financial crisis, it was only one part of a multi-pronged approach. The FDIC and the Federal Reserve undertook major initiatives that are also aimed at bolstering financial stability. In addition, Congress enacted a fiscal stimulus measure that was larger than the TARP. Foreign governments also acted to rescue their banking systems, with consequences that echoed through the U.S. system as well.

Because so many different forces and programs have influenced financial markets over the last year, TARP's effects are impossible to isolate. Even so, there is broad consensus that the TARP was an important part of a broader government strategy that stabilized the U.S. financial system by renewing the flow of credit and averting a more acute crisis. Although the government's response to the crisis was at first haphazard and uncertain, it eventually proved decisive enough to stop the panic and restore market confidence. De-

* The Panel adopted this report with a 4–1 vote on December 8, 2009. Rep. Jeb Hensarling voted against the report. Additional views are available in Section Two of this report.

spite significant improvement in the financial markets, however, the broader economy is only beginning to recover from a deep recession, and the TARP's impact on the underlying weaknesses in the financial system that led to last fall's crisis is less clear.

Congress established broad goals for the Emergency Economic Stabilization Act. It is apparent that, after 14 months, many of the ongoing problems remain in the financial markets and the broader economy:

- **The availability of credit, the lifeblood of the economy, remains low.** Banks remain reluctant to lend, and many small businesses and consumers are reluctant to borrow. Even as new capital and earnings flow into banks, questions remain about whether this money is being used to repair damaged balance sheets rather than putting the money into lending.
- **Bank failures continue at a nearly unprecedented rate.** There have been 149 bank failures between January 1, 2008 and November 30, 2009. The FDIC, facing red ink for the first time in 17 years, must step in to repay depositors at a growing number of failed banks. This problem may worsen, as deep-seated problems in the commercial real estate sector are poised to inflict further damage on small and mid-sized banks.
- **Toxic assets remain on the balance sheets of many large banks.** Some major financial institutions continue to hold the toxic mortgage-related securities that contributed to the crisis, waiting for a rebound in asset values that may be years away. These banks may be considered "too big to fail," but at the same time, they may be too weak to play a meaningful role in keeping credit flowing throughout the economy.
- **The foreclosure crisis continues to grow.** More than two million families have lost their homes to foreclosure since the start of this crisis, and countless more have lost their homes in short-sales or have turned their keys over to the lender. Foreclosure starts over the next five years are projected to range from 8 to 13 million, but more than a year after the TARP was passed, it appears that the TARP's foreclosure mitigation programs have not yet achieved the scope, scale, and permanence necessary to address the crisis.
- **Job losses continue to escalate.** The unprecedented government actions taken since last September to bolster the faltering economy have not been enough to stem the rise of unemployment, which in October was at its highest level since June 1983.
- **Markets remain dependent on government support.** The market stability that has emerged since last fall's crisis has been in part the result of an extraordinary mix of government actions, some of which will likely be scaled back relatively soon, and few of which are likely to continue indefinitely. It is unclear whether the market can yet withstand the removal of this support.
- **Government intervention signaled an implicit government guarantee of major financial institutions, and unwinding this guarantee poses a difficult long-term challenge.** As yet, there is no consensus among experts or policymakers as to how to prevent financial institutions from taking risks that are so large as to threaten the functioning of the nation's economy.

While the TARP, along with other strong government action, can be credited with stopping an economic panic, the program's progress toward the other goals set by Congress—goals that are necessary for reestablishing stability in the financial system and providing the tools for rebuilding the American economy—is less clear.

Since its inception, the TARP has gone through several different incarnations. It began as a program designed to purchase toxic assets from troubled banks, but it quickly morphed into a means of bolstering bank capital levels. It was later put to use as a source of funds to restart the securitization markets, rescue domestic automakers, and modify home mortgages. The evolving nature of the TARP, as well as Treasury's failure to articulate clear goals or to provide specific measures of success for the program, make it hard to reach an overall evaluation. In its report of December 2008, the Panel called on Treasury to make both its decision-making and its actions more transparent. The Panel renews that call, as it has done with every monthly report since then.

Despite the difficult circumstances under which many decisions have been made, those decisions must be clearly explained to the American people, and the officials who make them must be held accountable for their actions. Transparency and accountability may be painful in the short run, but in the long run they will help restore market functions and earn the confidence of the American people.

SECTION ONE

A. Overview

Congress created the Congressional Oversight Panel to oversee the Executive Branch's broad authority to use the $700 billion Troubled Asset Relief Program (TARP). In carrying out its responsibilities under the Emergency Economic Stabilization Act of 2008 (EESA), the Panel has published 12 monthly reports and two special reports on a wide range of the TARP and related financial stabilization initiatives.

This month the Panel assesses what the TARP has accomplished and where it has fallen short from various perspectives in the 14 months since its inception. The report describes the major elements of the TARP—capital assistance for financial institutions, small business and consumer lending initiatives, mortgage foreclosure programs and assistance to two U.S. automakers—and their status, including updates on particular issues since the Panel's earlier reports on these same subjects. It looks at key economic indicators and their behavior over the course of the crisis and what they appear to be telling us now. The report also summarizes the views of academic and other experts whose analysis the Panel requested, as well as the Panel's recent hearing with five prominent economists and experts on the subject of financial sector crises.

Congress stated that its purpose in passing EESA was "to immediately provide authority and facilities that the Secretary of the Treasury can use to restore liquidity and stability to the financial system of the United States." After reviewing the performance of the disparate initiatives that Treasury has carried out under the TARP's authorizing legislation and the assessments of outside experts concerning that performance, this report concludes with a look at how well the TARP has done as measured against the stated objectives of the Act and the espoused goals of Treasury leadership across two administrations.

This report includes some discussion of financial stability efforts of both the Federal Reserve Board and the Federal Deposit Insurance Corporation (FDIC), but only inasmuch as those efforts augment or supplement Treasury's actions under the TARP. The report does not include any detailed discussion of other government responses to the financial crisis, such as the Housing and Economic Recovery Act of 2008 and the American Recovery and Reinvestment Act of 2009, although the Panel is mindful of the difficulties in separating the impact of the various government responses on the overall U.S. economy. The report also does not attempt to bring to light new information about the factors that may have contributed to the decision-making by government officials at the height of the financial crisis, although such accounts by journalists and other oversight bodies have informed the Panel's framework for assessing the TARP.

In reviewing the performance of the TARP after a little over one year, the Panel has benefitted from similar one-year assessments from others. Treasury published a summary of the Administration's financial stabilization efforts in September, and it expects to release its formal accounting statements for the TARP for Federal fiscal year 2009 (running from October 1, 2008 through September

30, 2009) in mid-December. Treasury policy officials have also testified and given public presentations in recent months providing their own review of the performance of the TARP. Assistant Secretary of the Treasury for Financial Stability Secretary Herb Allison testified before the Panel on October 22, 2009 and made several observations on the TARP and its impact after one year. Other oversight groups such as the Government Accountability Office have recently looked at the performance of the TARP.

The TARP is currently scheduled to expire on December 31, 2009. The Secretary of the Treasury is authorized under EESA to extend the program through October 3, 2010, upon notification of Congress. The Panel takes no position on the desirability of such an extension.

B. Background on the Origins and Evolution of the TARP

1. Chronology of the Financial Crisis

The global financial crisis that culminated in intervention by the United States and other industrialized countries to rescue their banking systems was largely the result of an asset bubble in housing, driven in part by the relatively low cost of credit. U.S. housing prices reached their high point in mid-2006. At the market's peak, the average cost of a home was more than twice what it had been just six and a half years earlier, a remarkable annual growth rate of nearly 12 percent.[1] Housing construction had likewise surged to an unsustainable annual rate of 2.15 million new privately owned units, and by 2006 unsold inventory began to pile up.[2] Then house prices began to ebb. The decline was initially not dramatic—prices fell by less than 3 percent over the next 12 months.[3] But it was enough to undermine a key assumption behind the financial instruments that provided much of the support for the U.S. housing bubble—that housing prices never go down, at least not on a sustained nationwide basis.[4]

The impact of falling home prices was felt early on in the subprime mortgage market, where borrowers began defaulting on mortgages that proved unaffordable as soon as prices stopped climbing. Many of the mortgages that helped fuel the boom had been premised on the assumption that borrowers would be able to refinance before their mortgages reset to higher, unaffordable interest rates. But as soon as home prices stopped rising, it became impossible for such borrowers, who had little or no equity in their

[1] *See* Standard & Poor's, *S&P/Case-Shiller Home Price Indices—Instrument: Seasonally Adjusted Composite 20 Index* (online at www2.standardandpoors.com/spf/pdf/index/SA__CSHomePrice__History__092955.xls) (hereinafter "S&P/Case-Shiller Home Price Indices") (accessed Dec. 7, 2009) (relating how the index rose from 100.59 in January 2000 to 206.15 in May 2006, a rise of 11.99 percent, on average, per year).

[2] *See generally* United States Census Bureau, *New Privately Owned Housing Units Started in the United States by Purpose and Design* (online at www.census.gov/const/www/quarterly__starts__completions.pdf) (accessed Dec. 7, 2009).

[3] *See* S&P/Case-Shiller Home Price Indices, *supra* note 1.

[4] *See* Bank of America, *Remarks by Chairman and Chief Executive Officer Kenneth D. Lewis at Los Angeles Town Hall: Mending our Mortgage Markets* (July 9, 2008) (online at newsroom.bankofamerica.com/index.php?s=63&item=205) ("Before this decade, we had a long history of relatively stable appreciation in home values, averaging about 3–4% a year for more than a century. But during that time, the conventional wisdom built that housing prices never go down, except for brief corrections in the march upward").

homes, to refinance.[5] In June 2007 two Bear Stearns-sponsored hedge funds that were heavily invested in subprime mortgages collapsed; Bear Stearns intervened with a private bailout.[6] But the market was becoming more volatile, as credit-rating agencies were issuing more and more downgrades of bonds composed of souring subprime mortgages. By the end of June, the three biggest rating agencies had downgraded their ratings on 2,012 tranches, or slices, of residential mortgage-backed securities. Just 16 days later, that number had climbed to 3,079.[7] Initially the downgrades were largely confined to the bonds' lower-rated tranches.[8] But investors feared the losses would spread,[9] and they did. Soon even the safest pieces of these mortgage-backed bonds, those rated triple-A, were being downgraded.[10]

The first major casualty was Bear Stearns. In addition to its exposure to risky mortgages, the 85-year-old investment bank had come to rely heavily on short-term loans.[11] These factors made Bear Stearns especially vulnerable to a run, which came in March 2008. As the firm lost assets, its ability to borrow deteriorated. On March 14, the Federal Reserve agreed to lend $29 billion as part of a deal that allowed JPMorgan Chase to buy Bear Stearns.[12] JPMorgan Chase ended up paying approximately $10 for each share of Bear Stearns stock, or about six percent of its peak share price.[13] The government's rescue of Bear Stearns established a new

[5] *See, e.g.,* Kristopher Gerardi, Adam Hale Shapiro, and Paul S. Willen, *Subprime Outcomes: Risky Mortgages, Homeownership Experiences, and Foreclosures,* Federal Reserve Bank of Boston, Working Paper No. 07–15 (May 4, 2008) (online at www.bos.frb.org/economic/wp/wp2007/wp0715.pdf) ("[H]ouse price depreciation plays an important role in generating foreclosures. In fact, we attribute much of the dramatic rise in Massachusetts foreclosures during 2006 and 2007 to the decline in house prices that began in the summer of 2005").

[6] *See* Forest Asset Management, *Hedge Funds: Don't Bank On It,* at 1–2 (Aug. 2008) (online at forestmgmt.lightport.com/727830.pdf); *see also* The Bear Stearns Companies Inc., *Presentation, Merrill Lynch Banking & Financial Services Investor Conference,* at 3 (Nov. 14, 2007) (online at www.bearstearns.com/includes/pdfs/investor__relations/presentations/merrill__lynch.pdf).

[7] Standard & Poor's had 767 downgrades through June 2007 and 1,346 through July 16, 2007. For Moody's, it was 479 through June and 933 through July 16. Fitch went from 766 downgrades to 800. *See* Fitch Ratings, *U.S. Subprime Rating Surveillance Update*, at 23–24 (July 2007) (online at www.fitchratings.com/web__content/sectors/subprime/Subprime__Presentation__07__2007.pdf).

[8] *Id.* at 30.

[9] *See* Markus K. Brunnermeir, *Deciphering the 2007–08 Liquidity and Credit Crunch*, 23 Journal of Economic Perspectives, no. 1, at 82–87 (Winter 2009) (online at www.princeton.edu/markus/research/papers/liquidity__credit__crunch.pdf) (describing the "unnerve[ing]" effect of mortgage-backed securities (MBS) downgrades on the broader ABS market).

[10] *See* Office of the Comptroller of the Currency, *Remarks of Comptroller John C. Dugan before the Global Association of Risk Professionals* (Feb. 27, 2008) (online at www.occ.treas.gov/ftp/release/2008-22a.pdf) ("These better-than-triple A tranches were supposed to be the least risky parts of the subprime securities pyramid. Instead they have generated the clear majority of reported subprime writedowns in capital markets, which in turn have been at the core of several of the worst episodes of the market's disruptions: the seizing up of the asset-backed commercial paper market because of conduit and SIV investments in these instruments; the huge, surprising, and concentrated losses in commercial and investment banks that packaged and sold subprime ABS CDOs; the large losses in regulated firms that thought they had conservatively purchased 'safe' securities, including regional banks from as far away as Germany; and most recently in the news, the large losses projected for monoline insurance companies that sold credit protection on these super-senior tranches").

[11] *See* U.S. Securities and Exchange Commission, Office of Inspector General, *SEC's Oversight of Bear Stearns and Related Entities: The Consolidated Supervised Entity Program,* at v (Sept. 25, 2008) (online at www.sec-oig.gov/Reports/AuditsInspections/2008/446-b.pdf).

[12] Federal Reserve Bank of New York, *Summary of Terms and Conditions Regarding the JPMorgan Chase Facility* (Mar. 24, 2008) (online at www.newyorkfed.org/newsevents/news/markets/2008/rp080324b.html) (hereinafter "Summary of Terms and Conditions Regarding the JPMorgan Chase Facility").

[13] JPMorgan Chase, *JPMorgan Chase and Bear Stearns Announce Amended Agreement* (March 24, 2008) (online at www.jpmorgan.com/cm/cs?pagename=JPM__redesign/JPM__Content__C/Generic__Detail__Page__Template&

precedent. Previously, the government had allowed faltering investment banks, which are not insured by the federal government or regulated like commercial banks, to go bankrupt, as Drexel Burnham Lambert did in 1990.[14]

As 2008 wore on, conditions in the financial markets continued to deteriorate. U.S. securitization markets, which had provided the funding that fueled the housing boom, were severely contracting. The number of privately securitized mortgages plunged from 1.75 million in 2006 to a mere 27,296 in 2008.[15] In the first two quarters of that year, U.S. issuance of asset-backed securities, which include car loans, student loans, credit card lending, as well as home equity loans, averaged about $58 billion, down from an average of $175 billion per quarter between 2005 and the first half of 2007.[16] In addition, the effects of the weak financial sector were now being felt in the real economy, where unemployment had risen from a low of 4.4 percent in March 2007 to 6.2 percent by August 2008.[17] Foreclosure filings had more than doubled in just 16 months, from 147,708 in April 2007 to 303,879 in August 2008.[18]

Fear in the financial markets, which had been building, evolved into a full-blown panic in September 2008. During a remarkable 19-day stretch, the federal government took over the two largest players in the mortgage market, allowed a large investment bank to go bankrupt, bailed out one of the world's largest insurance companies, and steered a major financial institution through the largest bank failure in U.S. history. Treasury took Fannie Mae and Freddie Mac into conservatorship on September 7.[19] Lehman Brothers failed on September 14.[20] The next day, Bank of America announced it was buying Merrill Lynch.[21] The day after that, the

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cid=1159339104093&c=JPM__Content__C); Ciovacco Capital Management, *Forget the Spin, Bear Stearns Was Given Away To Calm Markets* (Mar. 17, 2008) (online at ciovaccocapital.com/Article%20January%20Lows.pdf).

[14] *See* Kenneth Ayotte and David A. Skeel, Jr., *Bankruptcy or Bailouts?,* Northwestern University School of Law Research Paper No. 09–05 (July 23, 2009) (online at papers.ssrn.com/sol3/papers.cfm?abstract__id=1362639##).

[15] Federal Financial Institutions Examination Council, *Home Mortgage Disclosure Act National Aggregate Report—Instrument: Loans Sold by Tract in 2006, 2008* (online at www.ffiec.gov/hmdaadwebreport/NatAggWelcome.aspx) (accessed Dec. 4, 2009).

[16] Securities Industry and Financial Markets Association, *US ABS Issuance* (online at www.sifma.org/uploadedFiles/Research/Statistics/SIFMA__USABSIssuance.pdf) (hereinafter "US ABS Issuance") (accessed Dec. 4, 2009).

[17] United States Department of Labor, Bureau of Labor Statistics, *Labor Force Statistics from the Current Population Survey* (online at data.bls.gov/PDQ/servlet/SurveyOutputServlet?data__tool=latest__numbers&series__id=LNS14000000) (hereinafter "Labor Force Statistics") (accessed Dec. 7, 2009).

[18] For April 2007 data see Bloomberg, *Mortgage Defaults Rise 62 Percent, RealtyTrac Reports* (May 15, 2007) (online at www.bloomberg.com/apps/news?pid=20601087&sid=a8IPzXdjD06o&refer=home) (quoting the RealtyTrac press release which is no longer available online). For August 2008 data see RealtyTrac, *Foreclosure Activity Increases 12 Percent in August* (Sept. 12, 2008) (online at www.realtytrac.com/contentmanagement/pressrelease.aspx?channelid=9&accnt=0&itemid=5163).

[19] U.S. Department of the Treasury, *Statement by Secretary Henry M. Paulson, Jr. on Treasury and Federal Housing Finance Agency Action to Protect Financial Markets and Taxpayers* (Sept. 7, 2008) (online at www.ustreas.gov/press releases/hp1129.htm) (hereinafter "Secretary Paulson Statements on Action to Protect Financial Markets and Taxpayers").

[20] *See* United States Securities and Exchange Commission, *Statement Regarding Recent Market Events and Lehman Brothers* (Sept. 14, 2008) (online at www.sec.gov/news/press/2008/2008-197.htm).

[21] *See* Bank of America, *Bank of America Buys Merrill Lynch Creating Unique Financial Services Firm* (Sept. 15, 2008) (online at newsroom.bankofamerica.com/index.php?s=43&item=8255).

government announced its bailout of AIG.[22] Also on September 16, the assets of a money-market mutual fund fell below $1 per share, exposing investors to losses, an occurrence known as "breaking the buck" that had not happened in the industry for 14 years.[23] On September 20, the Federal Reserve announced that it was allowing Goldman Sachs and Morgan Stanley, the nation's only two remaining large investment banks, to become bank holding companies, giving them access to a key source of low-cost borrowing from the Federal Reserve.[24] On September 25, the FDIC took Washington Mutual, the nation's largest savings and loan, into receivership and sold many of its assets to JPMorgan Chase.[25]

One particularly stark measure of the panic that had seized the markets was the spread between the three-month London Interbank Offered Rate (LIBOR), which shows quarterly borrowing costs for banks, and the Overnight Indexed Swaps (OIS) rate, which shows the cost of extremely short-term borrowing. The spread between these two rates reflects what the market believes to be the risk in lending money to a bank; it is therefore understood to be a measure of the banking sector's overall health.[26] Prior to the widespread market fears about subprime lending, this spread hovered at or below 10 basis points, or 0.1 percent. In late 2007, it rose as high as 105 basis points, reflecting a significantly heightened perception of risk. At the height of the financial crisis on October 10, 2008, the spread was 364 basis points.[27] In the fall of 2008, many major banks had large amounts of bad loans on their books, leading to fears that they were insolvent.[28] The problem was exacerbated by the big banks' heavy use of leverage, their opaque balance sheets, and the complex structures of many of their holdings.[29] As a result, lenders did not know whom to trust. At the same time, the already impaired securitization markets were now on the verge of shutting down. Issuance in the United States of

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[22] *See* Board of Governors of the Federal Reserve System, *Press Release* (Sept. 16, 2008) (online at www.federalreserve.gov/newsevents/press/other/20080916a.htm) (hereinafter "September 16 Press Release").

[23] *See* The Reserve, *Important Notice Regarding Reserve Primary Fund's Net Asset Value* (Nov. 26, 2008) (online at www.reservefunds.com/pdfs/Press Release Prim NAV 2008 FINAL 112608.pdf); Christopher Condon, Reserve Primary Money Fund Falls Below $1 a Share, Bloomberg (Sept. 16, 2008) (online at www.bloomberg.com/apps/news?pid=20601087&sid=a5O2y1go1GRU).

[24] Goldman Sachs' and Morgan Stanley's ability to borrow from the Federal Reserve dated back to March 2008, when the Primary Dealer Credit Facility was established, but that initiative was meant to be temporary. As bank holding companies, Goldman Sachs and Morgan Stanley would have permanent access to funding from the Federal Reserve. See Board of Governors of the Federal Reserve System, *Press Release* (Sept. 21, 2008) (online at www.federalreserve.gov/newsevents/press/bcreg/20080921a.htm).

[25] *See* Federal Deposit Insurance Corporation, *JPMorgan Chase Acquires Banking Operations of Washington Mutual* (Sept. 25, 2008) (online at www.fdic.gov/news/news/press/2008/pr08085.html).

[26] *See* Federal Reserve Bank of St. Louis, *Economic Synopses: What the Libor-OIS Spread Says* (Number 24) (May 11, 2009) (online at research.stlouisfed.org/publications/es/09/ES0924.pdf).

[27] Bloomberg, *3 Mo LIBOR–OIS Spread* (online at www.bloomberg.com/apps/cbuilder?ticker1=.LOIS3%3AIND) (hereinafter "3 Mo LIBOR–OIS Spread") (accessed Dec. 4, 2009).

[28] For a more detailed view of which loans went bad and when, see Figure 9 in Section 1.C.1.c.i. *See also* Congressional Oversight Panel, Written Testimony of Center for Economic and Policy Research Co-Director Dean Baker, *Taking Stock: Independent Views on TARP's Effectiveness*, at 4 (Nov. 19, 2009) (online at cop.senate.gov/documents/testimony-111909-baker.pdf) (hereinafter "Baker COP Testimony").

[29] *See* Bank of England, *Remarks as Prepared for Delivery by Mervyn King, Governor of the Bank of England, to the Worshipful Company of International Bankers in London: Finance* (Mar. 17, 2009) (online at www.bankofengland.co.uk/publications/speeches/2009/speech381.pdf).

asset-backed securities fell from $63 billion in the second quarter of 2008 to just $3.5 billion in the fourth quarter.[30]

2. The Initial Federal Response to the Crisis

The federal government's initial responses to the financial crisis were often ad hoc, with decisions made on an emergency basis.[31] On March 13, 2008, during the run on Bear Stearns, the Federal Reserve learned that, due to a large and sudden deterioration in liquidity, the firm was one day from filing for bankruptcy. As Chairman of the Board of Governors of the Federal Reserve System Ben S. Bernanke later told Congress, there were numerous systemic factors for the Federal Reserve to consider as it contemplated a possible bailout, including the effects that Bear Stearns' failure would have on the firm's counterparties, the effects it would have on confidence in the financial markets, and the effects that any resulting contraction in available credit would have on the U.S. economy.[32] Within hours, the Federal Reserve decided to facilitate Bear Stearns' acquisition by JPMorgan Chase by extending a $29 billion loan using its authority under Section 13(3) of the Federal Reserve Act,[33] which allows the Federal Reserve to lend to "any individual, partnership, or corporation" under "unusual and exigent circumstances." [34]

In March 2008, at the same time that it was dealing with the Bear Stearns collapse, the Federal Reserve also took further steps to bolster financial markets and the economy with the creation of two special liquidity facilities.[35] These facilities served as backstops in the marketplace by ensuring that firms that held less liquid assets had access to the cash they needed to fund their day-to-day operations. The government's improvisations accelerated at a dizzying rate in September 2008, as market forces repeatedly overwhelmed whichever step the government had most recently taken. The decision by Treasury and the Federal Housing Finance Agency to take control of Fannie Mae and Freddie Mac was driven by the two firms' thin capitalization, as well as the effects of falling home prices, rising delinquency rates, and instability in the financial markets.[36] In addition, the firms' enormous sizes—together they

[30] US ABS Issuance, *supra* note 16.

[31] *See* Steven M. Davidoff and David Zaring, *Regulation by Deal: The Government's Response to the Financial Crisis*, 61 ADMIN. L. REV. 463, 467 (2009) (available online at papers.ssrn.com/sol3/papers.cfm?abstract_id=1306342) (characterizing the government's role as "that of an extraordinarily vigorous dealmaker"); Richard A. Posner, *A Failure of Capitalism: The Crisis of '08 and the Descent Into Depression* (2009) (excerpted online at www.finreg21.com/lombard-street/a-failure-capitalism-the-crisis-of-'08-and-the-descent-into-depression) (writing that the government responded to the crisis with "a series of improvisations").

[32] Senate Banking Committee, Written Testimony of Ben S. Bernanke, chairman, Board of Governors of the Federal Reserve System, *Turmoil in U.S. Credit Markets: Examining the Recent Actions of Federal Financial Regulators*, 110th Cong., at 2–3 (Apr. 3, 2008) (online at banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=0a0ec016-ad61-4736-b6e3-7eb61fbc0c69).

[33] Summary of Terms and Conditions Regarding the JPMorgan Chase Facility, *supra* note 12.

[34] 12 U.S.C. § 343.

[35] The new facilities were known as the Term Securities Lending Facility and the Primary Dealer Credit Facility. One additional Federal Reserve special liquidity facility pre-dated the market upheaval around the time of Bear Stearns' collapse, though its size was expanded in March 2008. The Term Auction Facility, which provided short-term liquidity to depository institutions, was created in December 2007.

[36] *See* Secretary Paulson Statements on Action to Protect Financial Markets and Taxpayers, *supra* note 19; see also Federal Housing Finance Agency, *Statement of FHFA Director James B. Lockhart* (Sept. 7, 2008) (online at www.ustreas.gov/press/releases/reports/

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held $5.4 trillion in guaranteed securities and outstanding debt, on par with the federal government's publicly held debt [37]—raised the possibility that their failure would have systemic consequences. Then-Secretary of the Treasury Henry Paulson also cited Fannie Mae's and Freddie Mac's ambiguous relationships with the government as a motivating factor for the backstops. Investors worldwide had purchased Fannie and Freddie debt on the understanding that the U.S. government implicitly stood behind it.[38] Secretary Paulson stated that under these circumstances the United States was obliged to assist the firms.[39]

The reasoning behind the decision not to bail out Lehman Brothers is less clear. Then-Secretary Paulson insisted that he never considered committing taxpayer funds to a Lehman rescue. Secretary Paulson cited "moral hazard," the idea that firms will take greater risks if they believe the government is prepared to bail them out.[40] Government officials including Timothy Geithner, then President of the Federal Reserve Bank of New York (FRBNY), Chairman Bernanke, and Secretary Paulson, ultimately decided against a rescue.[41] Treasury maintains that it doubted its legal authority to intervene in the collapse of Lehman, despite its role in the Bear Stearns rescue.[42]

Subsequent media accounts present a more complicated picture—supporting the view that the key decision-makers hoped to send a message to the market by letting Lehman fail.[43] Additionally, Treasury may have been leery of the popular reaction to a rescue that likely would have benefitted non-U.S. counterparties as much as U.S. interests—a real risk, as evidenced by the impact of the AIG rescue later.[44] In any case, it would appear that the reasons Chairman Bernanke cited for the bailout of Bear Stearns—the effects of a failure on counterparties, the effects on financial markets,

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fhfa_statement_090708hp1128.pdf) (hereinafter "Statement of FHFA Director James B. Lockhart").

[37] Statement of FHFA Director James B. Lockhart, *supra* note 36.

[38] Secretary Paulson Statements on Action to Protect Financial Markets and Taxpayers, *supra* note 19.

[39] Secretary Paulson Statements on Action to Protect Financial Markets and Taxpayers, *supra* note 19.

[40] White House, *Press Briefing by Dana Perino and Secretary of the Treasury Henry Paulson* (Sept. 15, 2008) (online at georgewbush-whitehouse.archives.gov/news/releases/2008/09/20080915-8.html).

[41] Carrick Mollenkamp et al., *Lehman's Demise Triggered Cash Crunch Around Globe*, Wall Street Journal (Sept. 29, 2008) (online at online.wsj.com/article/SB122266132599384845.html).

[42] *See* House Committee on Oversight and Government Reform, Testimony of Secretary Henry M. Paulson, *Bank of America and Merrill Lynch: How Did a Private Deal Turn Into a Federal Bailout? Part III*, 111th Cong., at 6 (online at oversight.house.gov/index.php?option=com_content&task=view&id=3690&Itemid=2); *see also* U.S. Department of the Treasury, *Letter from Assistant Secretary for Legislative Affairs Kevin I. Fromer to Senate Finance Committee staff* (Mar. 28, 2008) (online at finance.senate.gov/press/Bpress/2008press/prb040108a.pdf) (describing Treasury's role in the negotiations between the Federal Reserve Bank of New York (FRBNY), Bear Stearns, and JPMorgan Chase).

[43] Simon Johnson and James Kwak, *Lehman Brothers and the Persistence of Moral Hazard*, Washington Post (Sept. 15, 2009) (online at www.washingtonpost.com/wp-dyn/content/article/2009/09/15/AR2009091500943.html).

[44] Barclays PLC, a British firm, had been interested in buying parts of Lehman's operations prior to Lehman's failure, and eventually bought significant parts of the Lehman business as part of the bankruptcy. AIG's biggest counterparties included Societe Generale, a French firm, and Deutsche Bank, a German firm. *See* Barclays PLC, *Form 6–K* (Sept. 15, 2008) (online at sec.gov/Archives/edgar/data/312069/000119163808001621/barc200809156k.htm); *see also* Lehman Brothers, Barclays to Acquire Lehman Brothers' Businesses and Assets (Sept. 16, 2008) (online at www.lehman.com/press/pdf_2008/0916_barclays_acquisition.pdf); AIG, *Counterparty Attachments* (Mar. 18, 2009) (online at www.aig.com/aigweb/internet/en/files/CounterpartyAttachments031809_tcm385-155645.pdf).

and the impact on credit availability—also applied in the case of Lehman Brothers.[45]

If policymakers hoped that Lehman's demise would end the cycle of bailouts, their strategy failed. Instead, the efforts to save the financial sector became more extensive and more frantic in the following days. One of the most urgent problems, AIG's illiquidity, suddenly emerged on the radar of top policymakers.[46] With roughly 70 U.S. insurance companies, tens of billions of dollars of exposure to counterparties, and operations in 130 countries, AIG was another firm that was seen as posing a systemic risk.[47] Within days, the Federal Reserve had agreed to lend the massive insurance company up to $85 billion.[48] In this atmosphere of panic, Chairman Bernanke and Secretary Paulson concluded that their only remaining option was to convince Congress to authorize an overwhelming fiscal response. This idea—that the government needed to respond to the crisis in a more comprehensive way—was the kernel of the Troubled Asset Relief Program, or the TARP.

Even after Secretary Paulson and Chairman Bernanke decided that a more systematic response was needed, they continued to improvise in response to the rapidly changing landscape. On September 19, the day after they held an emergency meeting with Congressional leaders,[49] Treasury announced a temporary government guarantee of holdings in money-market funds.[50] And in another effort to restore confidence in money-market funds, the Federal Reserve announced the creation of yet another special liquidity facility.[51] Top officials at Treasury and the Federal Reserve also worked behind the scenes to encourage numerous potential bank

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[45] *But see* Peter Van Doren, *Lehman Brothers and Bear Stearns: What's the Difference?* (Sept. 25, 2008) (online at www.cato.org/pub_display.php?pub_id=9665). This article notes that firms in market economies go bankrupt all the time, and it explores the issue of whether the failure of investment banks such as Lehman Brothers and Bear Stearns can lead to contagion to firms that have no direct relationship with those bankrupt firms. The article describes without endorsing the view that investment banks can pose a contagion threat because of their use of over-the-counter financial derivatives. The article also briefly discusses the possibility that Bear Stearns played a more important role in the derivatives market than Lehman Brothers, and therefore posed a greater threat of contagion, as well as the possibility that Bear Stearns did not pose a contagion threat and therefore should not have been rescued.

[46] *See* U.S. Department of the Treasury, Letter from Assistant Secretary Herbert M. Allison, Jr. to Special Inspector General Neil M. Barofsky re: SIGTARP Official Draft Report, in *Factors Affecting Efforts to Limit Payments to AIG Counterparties,* at 41–42 (Nov. 16, 2009) (online at www.sigtarp.gov/reports/audit/2009/FactorsAffecting_Efforts_to_Limit_Payments_to_AIG_Counterparties.pdf) ("Literally overnight, government officials were faced with a difficult choice, and a choice that had to be made immediately: either let AIG go bankrupt or provide support").

[47] AIG later revealed that after receiving government assistance, it paid more than $90 billion to counterparties, including $12.9 billion to Goldman Sachs, $11.9 billion to Societe Generale, and $11.8 billion to Deutsche Bank. American International Group, *Counterparty Attachments* (Mar. 18, 2009) (online at www.aig.com/aigweb/internet/en/files/CounterpartyAttachments031809_tcm385-155645.pdf); *see also* Scott E. Harrington, *The Financial Crisis, Systemic Risk, and the Future of Insurance Regulation, Issue Analysis: A Public Policy Paper of the National Association of Mutual Insurance Companies,* at 9 (Sept. 2009) (online at www.namic.org/advocatenews/pdfs/090922_harrington.pdf).

[48] *See* September 16 Press Release, *supra* note 22.

[49] *See* Speaker of the House of Representatives, *Pelosi Comments on Bipartisan Congressional Leaders' Meeting with Paulson, Bernanke, and Cox* (Sept. 18, 2008) (online at speaker.house.gov/newsroom/pressreleases?id=0825).

[50] The guarantee was announced following the news that one money-market fund, the Reserve Fund, had broken the buck. The Reserve Fund held Lehman Brothers debt, which sparked fears in the marketplace following Lehman's failure. U.S. Department of the Treasury, *Treasury Announces Guaranty Program for Money Market Funds* (Sept. 19, 2008) (online at www.treasury.gov/press/releases/hp1147.htm).

[51] This facility was called the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility. *See* Board of Governors of the Federal Reserve System, *Press Release* (Sept. 19, 2008) (online at www.federalreserve.gov/monetarypolicy/20080919a.htm).

mergers, including Citigroup-Goldman Sachs, Citigroup-Morgan Stanley, Citigroup-Wachovia, Wachovia-Goldman Sachs, Wachovia-Morgan Stanley, and JPMorgan Chase-Morgan Stanley.[52] In the end, none of those mergers happened.[53] Then on September 21, the Federal Reserve announced that Goldman Sachs and Morgan Stanley would be allowed to become bank holding companies, which was interpreted as a signal that the government would not allow those two firms to fail.

The decision by Chairman Bernanke and Secretary Paulson on September 18 to enlist the help of Congress led to a three-page legislative proposal from Treasury on September 20. The plan would have given Treasury the authority to spend up to $700 billion to purchase "troubled assets," namely "residential and commercial mortgage-related assets."[54] Over the next two weeks, the administration's proposal was significantly modified and expanded, and even defeated once in the House of Representatives, prior to being signed into law on October 3, 2008. The law authorizes the Treasury Secretary to purchase not only mortgage-related securities under the TARP, but also "any other financial instrument" the purchase of which the Secretary determines to be "necessary to promote financial market stability."[55]

What started as a contraction in the U.S. housing sector had now spread around the globe, prompting emergency responses by numerous countries in September-October 2008.[56] Shortly after the comprehensive fiscal response was adopted in the United States, European governments decided to respond in a similar fashion. On October 8, British Prime Minister Gordon Brown announced a financial stability plan that included £50 billion ($87.5 billion) in capital injections, £200 billion ($349.8 billion) in a special liquidity program, and £250 billion ($437.2 billion) in guarantees to encourage inter-bank lending.[57] On October 13, France announced a plan that included €320 billion ($429.4 billion) in guarantees and €40 billion ($53.7 billion) in capital injections.[58] On October 16, the Swiss government used a capital injection of 6 billion francs ($5.3 billion) to take a 9.3 percent stake in UBS.[59] And on October 17, Germany's parliament approved a €480 billion ($645.6 billion) bank bailout package.[60]

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[52] *See* Andrew Ross Sorkin, *Too Big To Fail* (2009).

[53] Wachovia was soon bought by Wells Fargo and Morgan Stanley was stabilized by a capital infusion from a Japanese bank, Mitsubishi UFJ Financial Group.

[54] *See* U.S. Department of the Treasury, *Fact Sheet: Proposed Treasury Authority to Purchase Troubled Assets* (Sept. 20, 2008) (online at www.ustreas.gov/press/releases/hp1150.htm).

[55] The same law also establishes the Congressional Oversight Panel. Emergency Economic Stabilization Act of 2008 (EESA), Pub. L. No. 110–343.

[56] Bans or restrictions on short selling were imposed from Australia to the Netherlands. Ireland stepped in to guarantee deposits at its six largest banks. The Russian government injected many billions of dollars into its banking system. Iceland nationalized its three largest banks. For a lengthier discussion of the international response, see the Panel's April report. Congressional Oversight Panel, *April Oversight Report: Assessing Treasury's Strategy: Six Months of TARP,* at 60–70 (Apr. 7, 2009) (online at cop.senate.gov/documents/cop-040709-report.pdf).

[57] *See* British Prime Minister's Office, *£50 Billion Banking Package* (Oct. 8, 2008) (online at www.number10.gov.uk/Page17112).

[58] Henry Samuel, *Banking Bail-out: France Unveils €360bn Package,* Telegraph (U.K.) (Oct. 13, 2008) (online at www.telegraph.co.uk/finance/financetopics/financialcrisis/3190311/Banking-bail-out-France-unveils-360bn-package.html).

[59] David Gow, *Switzerland Unveils Bank Bail-out Plan,* Guardian (U.K.) (Oct. 16, 2008) (online at www.guardian.co.uk/business/2008/oct/16/ubs-creditsuisse).

[60] *See* Simon Morgan, *Germany Adopts 480-bln-euro Bank Bail-out,* Agence France-Presse (Oct. 17, 2008) (online at uk.biz.yahoo.com/17102008/323/germany-adopts-480-bln-euro-bank-bail.html).

For American families, the financial crisis caused a vast destruction of wealth. By September 2008, the bursting of the housing bubble sent home prices down by 22 percent from their peak in 2006.[61] When the financial markets reached their low point, in the first quarter of 2009, the value of households' financial assets had also plummeted by about 20 percent from their 2007 peak.[62] From peak to trough, the net worth of households and non-profit organizations fell by $12.7 trillion.[63] As a point of comparison, the U.S. gross domestic product, which measures the market value of the country's annual output of final goods and services in a year, is $14.3 trillion.[64]

C. The TARP's Evolution

Although Secretary Paulson and Chairman Bernanke initially had proposed to use TARP funds to buy troubled assets on the books of the largest U.S. financial institutions, they soon realized that this was impractical given the need for quick action. On October 14, 2008, Secretary Paulson summoned the heads of the nine largest U.S. banks to Washington and told them that Treasury was making direct capital injections into each of their institutions, using a total of $125 billion of TARP resources. Over the following weeks and months, under both Secretary Paulson and incoming Secretary Geithner, Treasury made further capital stock purchases[65] in another 692 banks and used the TARP in conjunction with Federal Reserve support to implement the extraordinary rescue of AIG. Treasury also used TARP resources to provide assistance to two major U.S. automobile companies and to fund a mortgage foreclosure relief grant program as part of the new Administration's efforts to combat the unprecedented level of mortgage defaults and foreclosures in the United States. Finally, the TARP was used in conjunction with Treasury and Federal Reserve efforts to try to restart small business and consumer lending.

1. Capital Programs and Banking Sector Health

a. Background

The largest and most prominent use of TARP funding has been the government's efforts to provide capital assistance to U.S. banks. The Capital Purchase Program (CPP), which provides capital injections into banks, was the first and largest TARP program. The Targeted Investment Program (TIP) and the Systemically Significant Failing Institution (SSFI) Program also provide capital injections, but they are narrower efforts aimed at providing exceptional assistance to large institutions considered critical to the functioning of

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[61] *See* S&P/Case-Shiller Home Price Indices, *supra* note 1.

[62] *See* Board of Governors of the *Federal Reserve System, Federal Reserve Statistical Release: Flow of Funds Accounts of the United States, Flows and Outstandings Second Quarter 2009,* at 104 (Sept. 17, 2009) (online at www.federalreserve.gov/releases/z1/Current/z1.pdf) (hereinafter "Federal Reserve Statistical Release: Second Quarter 2009").

[63] *Id.* at 104.

[64] U.S. Department of Commerce, Bureau of Economic Analysis, *Gross Domestic Product: Third Quarter (Advance Estimate)* (Oct. 29, 2009) (online at www.bea.gov/newsreleases/national/gdp/gdpnewsrelease.htm).

[65] These capital stock purchases, discussed in this section, were made through the TARP's Capital Purchase Program, Targeted Investment Program, and Systemically Significant Failing Institution Program.

the financial system. Another exceptional assistance program is the Asset Guarantee Program (AGP), under which the government has guaranteed approximately $301 billion in Citigroup assets, thereby insulating Citigroup from potential capital losses on those assets. The Public-Private Investment Program (PPIP) provides yet another form of capital assistance by attempting to restart the markets for troubled securities that are currently weighing down bank balance sheets. By removing these troubled securities from bank balance sheets, or guaranteeing assets, the PPIP and AGP, respectively, alleviate some of the banks' capital needs. Lastly, while the FDIC's Temporary Liquidity Guarantee Program (TLGP) does not rely on TARP funds, it is another key part of the government's support for the banking system.

i. Capital Purchase Program[66]

Treasury used the CPP to provide capital to banks and other financial institutions, usually by purchasing senior preferred stock.[67] Treasury has stated that it only provided CPP funds to viable banks.[68] In order to give taxpayers an opportunity to participate in the upside if a bank's stock price rose, Treasury also received warrants to purchase common stock. The program has gone through several phases; the application period for the final phase closed on November 21, 2009.[69] Financial institutions that have already received CPP funds may keep their money according to the terms of the program, but Treasury will not disburse additional funds.[70] Over the life of the program, the CPP has provided nearly $205 billion in capital to 692 financial institutions, including more than 300 small and community banks.[71]

Fifty financial institutions have redeemed their preferred stock, and 30 of them have also repurchased their warrants.[72] CPP recipi-

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[66] For more detail on the CPP, see the Panel's February and July Reports. Congressional Oversight Panel, *February Oversight Report: Valuing Treasury's Acquisitions,* at 5–11 (Feb. 6, 2009) (online at cop.senate.gov/documents/cop-020609-report.pdf) (hereinafter "February Oversight Report"); Congressional Oversight Panel, *July Oversight Report: TARP Repayments, Including the Repurchase of Stock Warrants,* at 8–17 (July 10, 2009) (online at cop.senate.gov/documents/cop-071009-report.pdf) (hereinafter "July Oversight Report").

[67] Treasury has stated that for every $100 Treasury invested, it received preferred stock and warrants worth about $100. However, in its February Report, the Panel performed a valuation of Treasury's initial investments under the capital programs and found that Treasury received stock and warrants worth only approximately $66 for every $100 invested. February Oversight Report, *supra* note 66, at 4.

[68] U.S. Department of the Treasury, *Capital Purchase Programs* (updated Nov. 3, 2009) (online at www.financialstability.gov/roadtostability/capitalpurchaseprogram.html) (accessed Dec. 7, 2009). However, as discussed in Section (C)(1)(a), *infra,* there are questions as to whether Treasury adhered to this guideline.

[69] U.S. Department of the Treasury, *Frequently Asked Questions regarding the Capital Purchase Program (CPP) for Small Banks* (online at www.financialstability.gov/docs/CPP/FAQonCPPforsmallbanks.pdf) (hereinafter "FAQs on CPP for Small Banks") (accessed Dec. 7, 2009).

[70] U.S. Department of the Treasury, *The Next Phase of Government Financial Stabilization and Rehabilitation Policies,* at 36 (Sept. 14, 2009) (online at www.treas.gov/press/releases/docs/Next%20Phase%20of%20Financial%20Policy,%20Final,%202009-09-14.pdf) (hereinafter "Next Phase of Government Financial Stabilization").

[71] See U.S. Department of the Treasury, *Troubled Asset Relief Program Transactions Report for Period Ending November 25, 2009* (Nov. 30, 2009) (online at www.financialstability.gov/docs/transaction-reports/11-30-09%20Transactions%20Report%20as%20of%2011-25-09.pdf) (hereinafter "November 25 Transactions Report"); U.S. Department of the Treasury, *Assistant Secretary Allison Written Testimony for Congressional Oversight Panel* (Oct. 24, 2009) (online at www.financialstability.gov/latest/tg_10222009.html). The 20 top recipients of capital assistance under the CPP, the TIP, and the SSFI Program received 89 percent of the $319.5 billion total of these three programs' funds.

[72] This is as of November 25, 2009. November 25 Transactions Report, *supra* note 71. Treasury has stated that it will not hold the warrants after the preferred stock has been redeemed.

ents may redeem their preferred stock only after receiving approval from the federal banking agency that serves as their primary regulator.[73] The redemption price of the preferred stock is set contractually, but Treasury repurchases the warrants at fair market value, which is determined through a negotiation and appraisal process between Treasury and the financial institution.[74] Treasury has determined that it will not hold warrants after a financial institution redeems its preferred stock.[75] If a financial institution does not wish to repurchase the warrants or if Treasury and the financial institution cannot agree on a price through the appraisal process, Treasury will auction them to the public.[76]

In the first half of this year, Treasury and the bank supervisors engaged in the Supervisory Capital Assessment Program (SCAP), comprehensive stress tests of the nation's largest banks. According to Treasury, these tests were a forward-looking exercise aimed at determining whether these institutions had sufficient capital to weather a longer and more severe economic downturn.[77] The results showed that 10 of the 19 stress-tested institutions required additional capital.[78] The other nine were allowed to redeem their preferred stock, subject to the approval of their primary federal

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Three of these banks have agreed to allow Treasury to auction their warrants. Of the remaining banks, Treasury is either currently negotiating the repurchase price or, for those which declined to continue discussions, is preparing to auction the warrants. Treasury communications with Panel staff (Dec. 4, 2009).

[73] For a full discussion of the history and legal aspects of CPP repayment, see the Panel's July report. July Oversight Report, *supra* note 66, at 8–20.

[74] U.S. Department of the Treasury, *Securities Purchase Agreement: Standard Terms,* at §§4.4, 4.9(c)(i) (online at www.financialstability.gov/docs/CPP/spa.pdf) (accessed Dec. 8, 2009); 12 U.S.C. 5223(a)(2)(B). For a more complete discussion of this topic, please see the Panel's July Oversight Report. *See* July Oversight Report, *supra* note 66, at 10–17. The process is different for private banks. Treasury immediately exercised the warrants of private banks. The redemption price of the shares received on exercise was set in the contracts. The process is different for private banks. Treasury immediately exercised the warrants of private banks. The redemption price of the shares received on exercise was set in the contracts.

[75] U.S. Department of the Treasury, *Treasury Announces Warrant Repurchase and Disposition Process for the Capital Purchase Program* (June 26, 2009) (online at www.financialstability.gov/docs/CPP/Warrant-Statement.pdf).

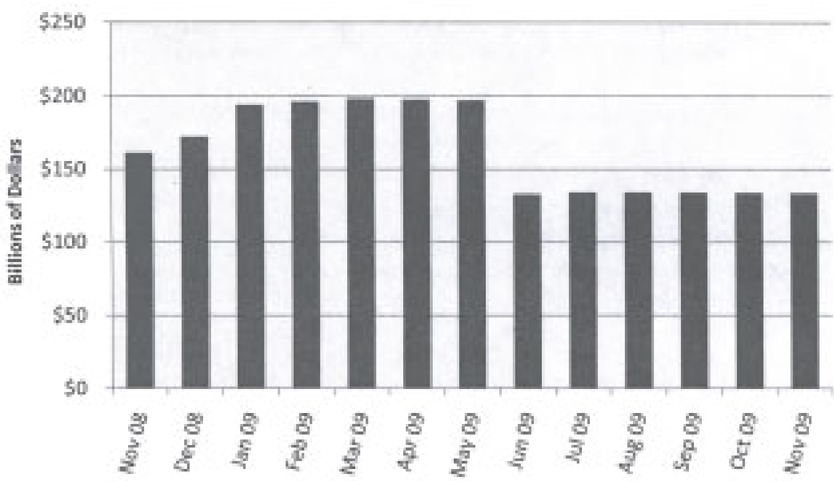
[76] Treasury has announced it will auction the warrants of JPMorgan Chase, Capital One, and TCF Financial Corporation through a modified Dutch auction process. U.S. Department of the Treasury, *Treasury Announces Intent to Sell Warrant Positions in Public Dutch Auction* (Nov. 19, 2009) (online at www.financialstability.gov/latest/tg__11192009b.html). Treasury will allow the banks to bid on their own warrants. On December 3, 2009, Treasury held a public auction to sell Capital One's warrants. At the auction, the warrants were priced at $146.5 million. U.S. Department of the Treasury, *Treasury Department Announces Pricing of Public Offering of Warrants to Purchase Common Stock of Capital One Financial Corporation* (Dec. 4, 2009) (online at www.financialstability.gov/latest/tg__12042009.html) (hereinafter "Capital One Warrant Purchase").

[77] For a discussion of the stress tests, see the Panel's June report. Congressional Oversight Panel, *June Oversight Report: Stress Testing and Shoring Up Bank Capital* (June 9, 2009) (online at cop.senate.gov/documents/cop-060909-report.pdf) (hereinafter "June Oversight Report"). If a stress-tested institution required additional capital and could not raise it in the private markets, it could have access to additional TARP funds through the Capital Assistance Program (CAP). The terms of this program were less favorable to the banks than were the terms of the CPP.

[78] Federal Reserve Board of Governors, *The Supervisory Capital Assessment Program: Overview of Results,* at 3 (May 7, 2009) (online at www.federalreserve.gov/newsevents/press/bcreg/bcreg20090507a1.pdf). Nine of these 10 have raised the required capital in the private markets. To date, GMAC is the only institution that has returned to the government for more financial support. Treasury announced that it will provide any support to GMAC through the AIFP. U.S. Department of the Treasury, *Treasury Announcement Regarding the Capital Assistance Program* (Nov. 9, 2009) (online at www.financialstability.gov/latest/tg__11092009.html) (hereinafter "Treasury Announcement Regarding the CAP"). Treasury staff has told the Panel that GMAC will receive AIFP and not CAP funds because its previous injections had been through the AIFP. In addition, Treasury staff stated that the terms of the AIFP are substantially similar to the CAP. Treasury communications with Panel staff (Nov. 17, 2009).

regulator.[79] The 10 banks that required additional capital had to raise this money in the private markets before they could redeem their preferred stock. On June 17, 2009, 10 of the 19 stress-tested banks repurchased their preferred stock.[80] Together, they repurchased approximately $70 billion in preferred stock. Figure 1 shows the total amount of CPP funds outstanding by month, with the drop-off in June 2009 resulting from the wave of stock repurchases. Though 10 of the 19 stress-tested banks have already repaid their CPP funds, three of the four largest banks still hold their TARP funds. Measured by assets, these three institutions constitute approximately 40 percent of the banking system.[81] One of these three, Bank of America, announced on December 2, 2009 that it would repay all of its TARP funds after the completion of a securities offering.[82]

FIGURE 1: CPP FUNDS OUTSTANDING BY MONTH (AS OF NOVEMBER 30, 2009)[83]



[79] U.S. Department of the Treasury, *FAQs on Capital Purchase Program Repayment and Capital Assistance Program* (online at www.financialstability.gov/docs/FAQ__CPP-CAP.pdf) (accessed Dec. 7, 2009). A stress tested institution seeking to repay was also required to "be able to demonstrate its financial strength by issuing senior unsecured debt for a term greater than five years not backed by FDIC guarantees, in amounts sufficient to demonstrate a capacity to meet funding needs independent of government guarantees." U.S. Department of the Treasury, *FAQs on Capital Purchase Program Repayment and Capital Assistance Program* (online at www.financialstability.gov/docs/FAQ__CPP-CAP.pdf) (accessed Dec. 7, 2009).

[80] The 10 banks that repaid are JPMorgan Chase, Goldman Sachs, Morgan Stanley, U.S. Bancorp, Capital One, American Express, Bank of New York, State Street, Northern Trust, and BB&T. November 25 Transactions Report, *supra* note 71.

[81] *See* National Information Center, *Top 50 BHCs* (online at www.ffiec.gov/nicpubweb/nicweb/Top50form.aspx) (accessed Dec. 7, 2009); Federal Reserve Board of Governors, *Assets and Liabilities of Commercial Banks in the United States—H.8* (Dec. 4, 2009) (online at www.federalreserve.gov/releases/h8/current/default.htm).

[82] Bank of America, *Bank of America to Repay Entire $45 Billion in TARP to U.S. Taxpayers* (Dec. 2, 2009) (online at newsroom.bankofamerica.com/index.php?s=43&item=8583) (hereinafter "Bank of America Repayment").

[83] November 25 Transactions Report, *supra* note 71.

Unlike other lending categories, Treasury only began publishing small business lending information as of April 2009. U.S. Department of the Treasury, Treasury Department Monthly Lending and Intermediation Snapshot Data for April 2009–September 2009 (Nov. 16, 2009) (online at www.financialstability.gov/impact/monthlyLendingandIntermediationSnapshot.htm) (hereinafter "Treasury Department Monthly Lending and Intermediation Snapshot Data for April 2009–September 2009").

ii. Exceptional Assistance Programs

Treasury has used additional TARP funds to bolster the capital bases of financial institutions that were deemed "critical to the functioning of the financial system." [84] The three beneficiaries of this assistance have been AIG, Bank of America, and Citigroup. Because these institutions are deemed to have received "exceptional assistance," they are subject to more stringent guidelines on executive compensation than other TARP recipients.[85]

Systemically Significant Financial Institutions Program. The SSFI Program was "established to provide stability and prevent disruptions to financial markets from the failure of institutions that are critical to the functioning of the nation's financial system." [86] AIG, which has received nearly $70 billion in capital under the SSFI Program,[87] is the only recipient of funds under the program. AIG can continue to draw on the SSFI Program through April 17, 2014. In exchange for each drawdown, Treasury will receive additional preferred AIG stock in the amount of the drawdown. The preferred stock carries a 10 percent dividend.[88] Treasury has also received warrants to purchase common stock.[89]

Targeted Investment Program. Like the SSFI Program, the TIP was intended to "stabilize the financial system by making investments in institutions that are critical to the functioning of the fi-

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[84] *See* U.S. Department of the Treasury, *Targeted Investment Program* (online at www.financialstability.gov/roadtostability/targetedinvestmentprogram.html) (hereinafter "Targeted Investment Program") (accessed Dec. 7, 2009) (the TIP "focuses on the complex relationships and reliance of institutions within the financial system. Investments made through the TIP seek to avoid significant market disruptions resulting from the deterioration of one financial institution that can threaten other financial institutions and impair broader financial markets and pose a threat to the overall economy"); U.S. Department of the Treasury, *Programs* (online at www.financialstability.gov/roadtostability/programs.htm) (hereinafter "Treasury Programs") (accessed Dec. 7, 2009) (the SSFI Program "was established to provide stability and prevent disruptions to financial markets from the failure of institutions that are critical to the functioning of the nation's financial system").

[85] *See* 31 C.F.R. §§ 30.0–30.17; U.S. Department of the Treasury, *Interim Final Rule on TARP Standards for Compensation and Corporate Governance* (online at www.treas.gov/press/releases/reports/ec%20ifr%20fr%20web%206.9.09tg164.pdf) (accessed Dec. 7, 2009).

[86] Treasury Programs, *supra* note 84.

[87] The first round came through a purchase of $40 billion in preferred stock, on November 25, 2008. The initial purchase was of cumulative preferred stock. In April 2009, this was exchanged for $41.6 billion of non-cumulative preferred shares. This represented no change in Treasury's initial investment. *See* U.S. Department of the Treasury, *Transactions Report* (Oct. 27, 2009) (online at www.financialstability.gov/docs/transaction-reports/10-27-09%20Transactions%20Report%20as%20of%2010-23-09.pdf). The second was through the April 17, 2009 creation of an equity capital facility of approximately $30 billion. *See* U.S. Department of the Treasury, *Transactions Report* (Oct. 27, 2009) (online at www.financialstability.gov/docs/transaction-reports/10-27-09%20Transactions%20Report%20as%20of%2010-23-09.pdf).

[88] *See* U.S. Department of the Treasury, *Term Sheet Exchange of Series D Fixed Rate Cumulative Perpetual Preferred Stock for Series E Fixed Rate Non-Cumulative Perpetual Preferred Stock* (Mar. 2, 2009) (online at www.financialstability.gov/docs/agreements/030209_AIG_Term_Sheet.pdf).

[89] Treasury's funding of AIG is not the only government assistance to the insurance giant. AIG has also received $96 billion in assistance from the Federal Reserve through a revolving credit facility and loans extended to special purpose vehicles to buy AIG assets.

nancial system."[90] Just two financial institutions have received TIP funds: Bank of America and Citigroup. Treasury announced that it was providing a capital injection to Citigroup on November 23, 2008, and purchased $20 billion in preferred Citigroup stock on December 31, 2008. The term sheet accompanying the announcement portrays the capital injection as a modified version of the CPP.[91] It was not until January 2, 2009 that TIP was given a name and its guidelines were announced.[92] Then on January 16, 2009, Treasury bought $20 billion in preferred stock from Bank of America.[93] The assistance provided under this program was in addition to the $25 billion that Citigroup had already received, and the $15 billion that Bank of America (subsequently increased to $25 billion, with the inclusion of Merrill Lynch's funds) has already received in CPP funds on October 28, 2008.[94]

Treasury required changes in senior management, and diluted the interests of shareholders when the government received a 79.9 percent equity interest in AIG.[95] By contrast, despite providing Bank of America and Citigroup with exceptional assistance, Treasury did not require them to make changes in management. Furthermore, it did not dilute shareholder interests in Bank of America. Treasury has not explained the rationale behind the differences in treatment.

Asset Guarantee Program.[96] The AGP is an initiative by Treasury, along with the FDIC and the Federal Reserve, that initially guaranteed approximately $301 billion of Citigroup's assets.[97] After Citigroup received $25 billion in CPP funds in late October 2008, its financial status continued to deteriorate. On November 23, 2008, Treasury, the FDIC and the Federal Reserve agreed to share with Citigroup potential losses on a pool of its assets that Citigroup identified as some of its riskiest.[98] Treasury announced the aid in

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[90] Targeted Investment Program, *supra* note 84.

[91] *See* U.S. Department of the Treasury, *Summary of Terms: Preferred Securities* (Nov. 23, 2008) (online at www.treas.gov/press/releases/reports/cititermsheet_112308.pdf) ("Redemption: In stock or cash, as mutually agreed between UST and Citi. Otherwise, redemption terms of CPP preferred terms apply . . . Repurchases: Same terms as preferred issued in CPP").

[92] U.S. Department of the Treasury, *Treasury Releases Guidelines for Targeted Investment Program* (Jan. 2, 2009) (online at treasury.gov/press/releases/hp1338.htm); U.S. Department of the Treasury, *Joint Statement by Treasury, Federal Reserve and the FDIC on Citigroup* (Nov. 23, 2008) (online at www.treas.gov/press/releases/hp1287.htm). The announcement on November 23, 2008 did not specify under which program Citigroup's second injection fell. In fact, at that time, the CPP was the only named program under the TARP.

[93] *See* November 25 Transactions Report, *supra* note 71.

[94] *See* November 25 Transactions Report, *supra* note 71.

[95] *See* U.S. Department of the Treasury, *Monthly 105(a) Report* (Nov. 10, 2009) (online at www.financialstability.gov/docs/105CongressionalReports/October%20105(a)_11.10.2009.pdf) ("the FRBNY received convertible preferred shares representing approximately 79.8% of the current voting power of the AIG common shares. These preferred shares were deposited in a trust, created by the FRBNY. The U.S. Treasury (i.e., the general fund) is the beneficiary of this trust").

[96] For a full discussion of the AGP, see the Panel's November report. Congressional Oversight Panel, *November Oversight Report: Guarantees and Contingent Payments in TARP and Related Programs*, at 13–27 (Nov. 6, 2009) (online at cop.senate.gov/documents/cop-110609-report.pdf) (hereinafter "November Oversight Report").

[97] Treasury had also entered into an agreement with Bank of America to provide a similar guarantee, but it was never finalized. For a full description of the Citigroup and Bank of America guarantees, see the Panel's November report. November Oversight Report, *supra* note 96, at 13–27. From the beginning, Treasury had stated that AGP assistance would not be "widely available." U.S. Department of the Treasury, *Report to Congress Pursuant to Section 102 of the Emergency Economic Stabilization Act*, at 1 (Dec. 31, 2008) (online at www.financialstability.gov/docs/AGP/sec102ReportToCongress.pdf).

[98] Board of Governors of the Federal Reserve System, *Joint Statement by Treasury, Federal Reserve, and the FDIC on Citigroup* (Nov. 23, 2008) (online at www.federalreserve.gov/newsevents/press/bcreg/20081123a.htm).

conjunction with its announcement of Citigroup's second capital infusion, this one under TIP.[99]

iii. Public-Private Investment Program [100]

PPIP, which is aimed at removing troubled assets from the balance sheets of financial institutions, was announced on March 23, 2009.[101] The program aims to aid the recapitalization of financial institutions and ultimately to support renewed lending by discovering prices in the illiquid market for troubled mortgage-related assets.[102] It has two components: a program to be administered by the FDIC that would fund the purchase of troubled whole loans, and a program administered by Treasury that funds the purchase of troubled securities. The first component has yet to exit its trial phase,[103] although Treasury recently stated that government officials are continuing to review applications from firms that would share the cost of funding whole-loan purchases.[104] Under the second component, known as the Legacy Securities PPIP (S–PPIP), Treasury has agreed to invest up to $30 billion in both equity and debt to buy troubled securities.

As of November 30, Treasury had invested roughly $23.3 billion, which is slightly more than two-thirds of the funds designated for the program.[105] Treasury's current $30 billion commitment to PPIP is scaled down considerably from its initial plan of investing a total of $75-$100 billion in the program's two components.[106] Eight of the nine fund managers closed their funds between September 30

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[99] Overall, Treasury has provided $49 billion in capital assistance to Citigroup. Treasury's initial CPP holdings of preferred stock were subsequently converted to 7.7 billion shares of common stock priced at $3.25 per share, for a total value of $25 billion at the time of the conversion. Treasury has also converted the form of its TIP and AGP holdings. On July 23, 2009, Treasury, along with both public and private Citigroup debt holders, participated in a $58 billion exchange. As of November 30, 2009, Treasury's common stock investment in Citigroup had a market value of $31.6 billion and represented 34 percent of the value of Citigroup common stock outstanding.

[100] For a complete discussion of the PPIP, see the Panel's August report. Congressional Oversight Panel, *August Oversight Report: The Continued Risk of Troubled Assets*, at 48 (Aug. 11, 2009) (online at cop.senate.gov/documents/cop-081109-report.pdf) (hereinafter "August Oversight Report").

[101] The troubled assets, which Treasury refers to as legacy securities, include residential and commercial mortgage-backed securities issued before 2009. *See* U.S. Department of the Treasury, *Legacy Securities Investment Program (Legacy Securities PPIP) Additional Frequently Asked Questions,* at 13 (July 8, 2009) (online at www.treas.gov/press/releases/reports/legacy__securities__faqs.pdf); U.S. Department of the Treasury, *Treasury Department Releases Details on Public Private Partnership Investment Program* (Mar. 23, 2009) (online at www.ustreas.gov/press/releases/tg65.htm).

[102] *See* U.S. Department of the Treasury, *Troubled Assets Relief Program Eighth Tranche Report to Congress,* at 8–9 (Oct. 7, 2009) (online at www.financialstability.gov/docs/Eighth%20Tranche%20Report__2009%2010%2007.pdf) (hereinafter "TARP Eighth Tranche Report").

[103] The FDIC recently announced a pilot sale of troubled whole loans, which it conducted as a test of the program's funding mechanism. However, the pilot sale did not accomplish the program's goal of removing toxic assets from bank balance sheets because the loans that were sold came from a failed bank that the FDIC had already taken into receivership. *See* Federal Deposit Insurance Corp., *Legacy Loans Program—Winning Bidder Announced in Pilot Sale* (Sept. 16, 2009) (online at www.fdic.gov/news/news/press/2009/pr09172.html).

[104] *See* TARP Eighth Tranche Report, *supra* note 102, at 8.

[105] *See* U.S. Department of the Treasury, *Treasury Department Announces Additional Initial Closing of Legacy Securities Public-Private Investment Fund* (Nov. 30, 2009) (online at www.financialstability.gov/latest/tg__11302009.html) (hereinafter "Treasury Announces Additional Initial Closing of Legacy Securities Public-Private Investment Fund").

[106] *See* U.S. Department of the Treasury, *Joint Statement by Secretary of the Treasury Timothy F. Geithner, Chairman of the Board of Governors of the Federal Reserve System Ben S. Bernanke, and Chairman of the Federal Deposit Insurance Corporation Sheila Bair: Legacy Asset Program* (July 8, 2009) (online at www.financialstability.gov/latest/tg__07082009.html).

and November 30, 2009.[107] According to Treasury, these closed funds were able to begin purchasing securities within a few weeks of the closing.[108]

iv. Total Government Funding for Financial Institutions

Figure 2 shows how the government has used TARP funds in conjunction with funding from the Federal Reserve and FDIC to develop a package of capital programs. With a combination of direct outlays, loans, and guarantees, the government has committed $617.8 billion to capital programs, well more than the $292.1 billion committed from the TARP. The Federal Reserve has committed $315.7 billion through guarantees and loans to AIG and Citigroup. In addition, the FDIC has $10 billion of exposure through its share of the Citigroup guarantee.[109]

FIGURE 2: FEDERAL GOVERNMENT'S CAPITAL PROGRAMS (AS OF NOVEMBER 30, 2009)[110]

[In billions of dollars]

Program	Treasury (TARP)	Federal Reserve	FDIC[111]	Total
AIG:				
Outlays[112]	$69.8	$0	$0	$69.8
Loans	0	95.3	0	95.3
Guarantees	0	0	0	0
AIG subtotal	69.8	95.3	0	165.1
PPIP (Securities):				
Outlays	10	0	0	10
Loans	20	0	0	20
Guarantees	0	0	0	0
PPIP (securities) subtotal	30	0	0	30
PPIP (Loans):				
Outlays	0	0	0	0
Loans	0	0	0	0
Guarantees	0	0	0	0
PPIP (loans) subtotal	0	0	0	0
Bank of America:				
Outlays	45	0	0	45
Loans	0	0	0	0
Guarantees	....	....	....	0
Bank of America subtotal	45	0	0	45
Citigroup:				
Outlays	45	0	0	45
Loans	0	0	0	0
Guarantees	5	220.4	10	235.4
Citigroup subtotal	50	220.4	10	280.4
Capital Purchase Program (Other than Citigroup, Bank of America):				
Outlays	97	0	0	97

[107] Treasury Announces Additional Initial Closing of Legacy Securities Public-Private Investment Fund, supra note 105; U.S. Department of the Treasury, *Treasury Department Announces Additional Initial Closing of Legacy Securities Public-Private Investment Fund* (Nov. 5, 2009) (online at www.financialstability.gov/latest/tg_11052009.html).

[108] Treasury communications with Panel staff (Sept. 29, 2009).

[109] The Panel has broadly classified the resources that the federal government has devoted to stabilizing the economy through a myriad of new programs and initiatives as outlays, loans, or guarantees. Although the Panel calculates the total value of these resources at over $3 trillion, this would translate into the ultimate "cost" of the stabilization effort only if: (1) assets do not appreciate; (2) no dividends are received, no warrants are exercised, and no TARP funds are repaid; (3) all loans default and are written off; and (4) all guarantees are exercised and subsequently written off.

FIGURE 2: FEDERAL GOVERNMENT'S CAPITAL PROGRAMS (AS OF NOVEMBER 30, 2009)[110]—Continued

[In billions of dollars]

Program	Treasury (TARP)	Federal Reserve	FDIC[111]	Total
Loans	0	0	0	0
Guarantees	0	0	0	0
CPP (other than Citigroup, Bank of America) subtotal	97	0	0	97
Capital Programs Total	$291.8	$315.7	$10	$617.58

[110] November 25 Transactions Report, *supra* note 71. The Panel's methodology and source citations for these figures can be found in the corresponding endnotes for Figure 27.
[111] This table does not include the FDIC's Temporary Liquidity Guarantee Program.
[112] The term "outlays" is used in this table as well as in Figure 27 to describe the disbursement of funds under the TARP, which are broadly classifiable as purchases of debt or equity securities (*e.g.*, debentures, preferred stock, exercised warrants, etc.). The outlays figures are based on: (1) Treasury's actual reported expenditures; and (2) Treasury's anticipated funding levels as estimated by a variety of sources, including Treasury pronouncements and GAO estimates. Anticipated funding levels are set at Treasury's discretion, have changed from initial announcements, and are subject to further change. Outlays as used here represent investments and assets purchases and commitments to make investments and asset purchases and are not the same as budget outlays, which under section 123 of EESA are recorded on a "credit reform" basis. Credit reform accounting is discussed in further detail in the Panel's November report. November Oversight Report, *supra* note 96, at 11.

Return on Investment. It is not yet possible to calculate the amount of money that the capital programs as a whole will earn or lose, and it will not be for some time. However, certain sources of income and losses, such as the internal rate of return for banks that have repurchased all of their CPP funds, are already apparent. Financial institutions that received CPP assistance have bought back approximately $70 billion in preferred stock. As shown in Figure 29, those funds comprise most of the $86.9 billion in cash inflows that the TARP has generated through November 30, 2009. This includes $10.2 billion in dividends and interest payments. In addition, Treasury has collected $3.2 billion in payments for warrant repurchases.

In its July Report, the Panel analyzed the prices at which Treasury was allowing the financial institutions to repurchase their warrants. The Panel was concerned that Treasury was undervaluing the warrants and/or not negotiating strongly enough.[113] After the July Report was released, several banks repurchased their warrants for prices very close to the Panel's valuation: notably, Goldman Sachs, Morgan Stanley, and American Express. Figure 3 shows the Panel's estimates for the values of warrants outstanding as of November 30, 2009.

For banks that have fully repaid their TARP funds, the Panel has calculated an internal rate of return (IRR), as shown in Figure 4. Because the preferred stock under the CPP paid fixed dividends of 5 percent per year, the variation in this return comes from the price the bank paid Treasury to repurchase its warrants. The taxpayers' return has ranged from a low of 5.9 percent for Centerstate Banks of Florida, which repurchased its warrants on October 28, 2009, to a high of 29.5 percent for American Express, which repurchased its warrants on July 29, 2009. Recent repurchases appear to trend lower. This may be because these are small- and medium-sized banks to which Treasury applies a liquidity discount in its valuation, while the Panel does not. This results in a lower price

[113] July Oversight Report, *supra* note 66, at 8–17. For example, Old National Bancorp of Evansville, Indiana, paid $1.2 million for warrants that analysts had valued at between $1.5 and $6.9 million.

to estimate ratio for banks whose stock is either thinly traded or not traded at all. The overall return is 17.1 percent for the 25 banks that have repurchased both their preferred stock and warrants. Had the warrants all been repaid at the Panel's estimated market value, the taxpayers would have received approximately $198 million more than the banks paid. It is important to note, however, that this return reflects only the healthiest banks, which were able to repay their TARP funds already. As of November 30, 2009, 642 banks still held their CPP funds. It is still unknown when they will repay and how much they will pay for their warrants.

FIGURE 3: WARRANTS OUTSTANDING VALUATION AS OF NOVEMBER 30, 2009

[In millions of dollars]

Institution	Investment date	Low estimate	High estimate	Best estimate
Capital Purchase Program (CPP):				
JPMorgan Chase	10/28/2008	$798.7	$2,035.8	$1,115.7
Wells Fargo	10/28/2008	300.9	1,734.9	857.0
Hartford Financial	6/26/2009	695.3	1,068.2	813.4
Bank of America	10/28/2008	86.9	1,135.3	381.2
PNC	12/31/2008	91.4	530.8	249.0
Capital One [114]	11/14/2008	179.0	343.7	232.0
Discover Financial	3/13/2009	149.4	217.0	178.9
Fifth Third Bancorp	12/31/2008	57.9	313.7	171.4
Lincoln National	7/10/2009	130.9	225.0	163.7
Comerica	11/14/2008	31.5	144.5	93.8
Targeted Investment Program (TIP):				
Bank of America	1/15/2009	487.4	1,465.2	811.9
Citigroup	12/31/2008	13.4	454.5	112.7
Asset Guarantee Program (AGP):				
Citigroup	1/15/2009	4.8	160.6	40.0
Systemically Significant Failing Institutions (SSFI) Program:				
AIG	11/25/2008	6.9	72.6	53.5
All Other Banks		313.1	2,038.4	1,089.3
Total		$3,347.5	$11,940.3	$6,363.4

[114] Capital One TARP warrants were sold through a Dutch auction process. The secondary public offering of the warrants was auctioned on December 3, 2009 for $146.5 million. Capital One Warrant Purchase, *supra* note 76.

FIGURE 4: WARRANT REPURCHASES AS OF NOVEMBER 30, 2009

Institution	Investment date	QEO [115]	Repurchase date	Repurchase amount	Panel valuation (best est.)	Price/estimate (%)	IRR (%)
Old National Bancorp	12/12/08	No	5/8/09	$1,200,000	$2,150,000	56	9.3
Iberiabank Corporation	12/5/08	Yes	5/20/09	1,200,000	2,010,000	60	9.4
FirstMerit Corporation	1/9/09	No	5/27/09	5,025,000	4,260,000	118	20.3
Sun Bancorp, Inc.	1/9/09	No	5/27/09	2,100,000	5,580,000	38	15.3
Independent Bank Corp.	1/9/09	No	5/27/09	2,200,000	3,870,000	57	15.6
Alliance Financial Corporation	12/19/08	No	6/17/09	900,000	1,580,000	57	13.8
First Niagara Financial Group	11/21/08	Yes	6/24/09	2,700,000	3,050,000	89	8.0
SCBT Financial Corporation	1/16/09	No	6/24/09	1,400,000	2,290,000	61	11.7
Berkshire Hills Bancorp, Inc.	12/19/08	No	6/24/09	1,040,000	1,620,000	64	11.3
Somerset Hills Bancorp	1/16/09	No	6/24/09	275,000	580,000	47	16.6

FIGURE 4: WARRANT REPURCHASES AS OF NOVEMBER 30, 2009—Continued

Institution	Investment date	QEO [115]	Repurchase date	Repurchase amount	Panel valuation (best est.)	Price/estimate (%)	IRR (%)
HF Financial Corp. ...	11/21/08	No	6/30/09	650,000	1,240,000	52	10.1
State Street Corporation	10/28/08	Yes	7/8/09	60,000,000	54,200,000	111	9.9
U.S. Bancorp	11/14/08	No	7/15/09	139,000,000	135,100,000	103	8.7
Old Line Bancshares, Inc.	12/5/08	No	7/15/09	225,000	500,000	45	10.4
The Goldman Sachs Group, Inc.	10/28/08	No	7/22/09	1,100,000,000	1,128,400,000	97	22.8
BB&T Corp.	11/14/08	No	7/22/09	67,000,000	68,200,000	98	8.7
American Express Company	1/9/09	No	7/29/09	340,000,000	391,200,000	87	29.5
The Bank of New York Mellon Corp.	10/28/08	No	8/5/09	136,000,000	155,700,000	87	12.3
Morgan Stanley	10/28/08	No	8/12/09	950,000,000	1,039,800,000	91	20.2
Northern Trust Corporation	11/14/08	No	8/26/09	87,000,000	89,800,000	97	14.5
Bancorp Rhode Island, Inc.	12/19/08	No	9/30/09	1,400,000	1,400,000	100	12.6
Manhattan Bancorp	12/5/08	No	10/14/09	63,364	140,000	45	9.8
CVB Financial Corp	12/5/08	Yes	10/28/09	1,307,000	2,800,000	47	6.4
Centerstate Banks of Florida Inc.	11/21/08	Yes	10/28/09	212,000	440,000	48	5.9
Bank of Ozarks	12/12/08	No	11/24/09	2,650,000	3,500,000	76	9.0
Total	....	....	....	$2,903,547,364	$3,099,410,000	94	17.1

[115] Some banks engaged in a qualified equity offering, or QEO. A QEO is defined in the Securities Purchase Agreement as a sale before 2010 of shares that qualify as tier I capital that raises an amount of cash equal to the value of the preferred shares issued to Treasury. A QEO would therefore lessen the value of the warrant.

The TARP recently incurred its first direct losses. The failures of three institutions—CIT Group, and two smaller banks—have resulted in a potential loss to taxpayers of up to $2.63 billion.[116] In addition, dozens of TARP recipients have missed dividend payments to Treasury. As of October 31, 2009, 38 banks have missed dividend payments, and six additional banks have deferred November dividends.[117] Banks have a variety of reasons for the missed payments. Some have reported that they have the funds to pay the dividends, but that safety and soundness laws restrict their ability to pay dividends to any investor if the bank does not meet certain levels of retained or cumulative earnings.[118] A failure to pay dividends, however, can foretell larger problems for a bank. On November 5, Pacific Coast National Bancorp was the subject of an enforcement order from the Federal Reserve preventing it from paying

[116] On November 1, 2009, small business lender CIT filed for bankruptcy, probably resulting in a complete loss of the $2.3 billion in CPP funds that it had received in December 2008. CIT has announced that all existing common and preferred shares will be cancelled in the bankruptcy. *See* CIT Group, *CIT Board of Directors Approves Proceeding with Prepackaged Plan of Reorganization with Overwhelming Support of Debtholders* (Nov. 1, 2009) (online at phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MTkxNjh8Q2hpbGRJRD0tMXxUeXBlPTM=&t=1). United Commercial Bank failed on November 7, 2009; it had received $298.7 million in CPP funds on November 14, 2008. Finally, on November 13, 2009, Pacific Coast National Bancorp, which received $4.1 million in TARP funds on January 16, 2009, failed.

[117] See Appendix I for a list of banks that have missed dividend payments.

[118] *See* Christine Mitchell, *Regulatory Hurdles Hinder Ability to Make TARP Dividend Payments,* SNL Financial (Nov. 5, 2009) (online at www.snl.com/interactivex/article.aspx?Id=10294060&KPLT=2).

dividends without prior approval from federal regulators.[119] A week later it failed.[120]

In addition to costing taxpayers, the recent bank failures call into question Treasury's assertion that CPP funds were only available to "healthy" or "viable" banks.[121] Furthermore, *The Wall Street Journal* recently performed an analysis of regulatory enforcement actions against TARP-recipient banks; such actions are a sign that a bank's health is deteriorating. The Journal found that, in addition to the three banks that have failed, 24 other TARP-recipient banks have received regulatory sanctions in 2009. At least eight banks received TARP funds when regulators had already voiced concerns about the banks' health.[122] Citigroup's need for TIP funds only five weeks after Treasury provided it with CPP funds further calls into question the assertion that CPP funds were only available to "healthy" banks.[123]

b. Health of Banking Sector

i. Bank Capital Levels

Capital levels are one measure of the banking sector's health. The stress tests measured the capital levels of the 19 largest bank holding companies, requiring a capital buffer to protect them through a more severe downturn.[124] Eighteen banks either already

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[119] *See* Federal Reserve Bank of San Francisco, *Written Agreement by and between Pacific Coast National Bancorp, San Clemente, California* at 2 (Nov. 5, 2009) (online at www.federalreserve.gov/newsevents/press/enforcement/enf20091110a1.pdf).

[120] *See* Federal Deposit Insurance Corporation, *Failed Bank Information for Pacific Coast National Bank, San Clemente, CA* (Nov. 13, 2009) (online at www.fdic.gov/bank/individual/failed/pacificcoastnatl.html).

[121] *See* SIGTARP, *Emergency Capital Injections Provided to Support the Viability of Bank of America, Other Major Banks, and the U.S. Financial System* (Oct. 5, 2009) (online at sigtarp.gov/reports/audit/2009/Emergency__Capital__Injections__Provided__to__Support__the__Viability__of__Bank__of__America . . . __100509.pdf) (determining that several of the initial CPP banks were not "healthy" at the time the investements were made); U.S. Department of the Treasury, *Factsheet on Capital Purchase Program* (Mar. 17, 2009) (online at www.financialstability.gov/roadtostability/CPPfactsheet.htm) (hereinafter "Factsheet on CPP") ("Participation is reserved for healthy, viable institutions"). CIT Group is an example of an institution of questionable health that received CPP funds. It is a leading lender to small businesses, and also has a depository bank. It suffered accelerating losses since 2Q 2007, and had difficulty accessing credit in short-term debt markets, on which its business model was heavily reliant. Treasury approved CIT's application for CPP funds because it was the leading source of financing for small business, and it deemed it systemically significant—at least in the early days of the crisis. It received $2.3 billion of CPP funds in December 2008. Immediately following its receipt of TARP money, CIT sought to enter the TLGP. CIT's TLGP application with the FDIC was pending for several months and was finally rejected in July 2009. Also in July, FRBNY completed a stress-test of CIT Group and concluded that it would need to raise up to $4 billion of funding. Treasury declined to make an additional CPP investment in CIT Group because it did not believe that CIT had presented a viable business plan. CIT filed for Chapter 11 bankruptcy protection on November 1, 2009. CIT's inability to access credit outside of the TLGP calls into question whether other CPP institutions would be healthy without the government guarantee programs.

[122] David Enrich, *TARP Can't Save Some Banks,* Wall Street Journal (Nov. 17, 2009) (online at online.wsj.com/article/SB100014240527487 04538404574539954068634242.html).

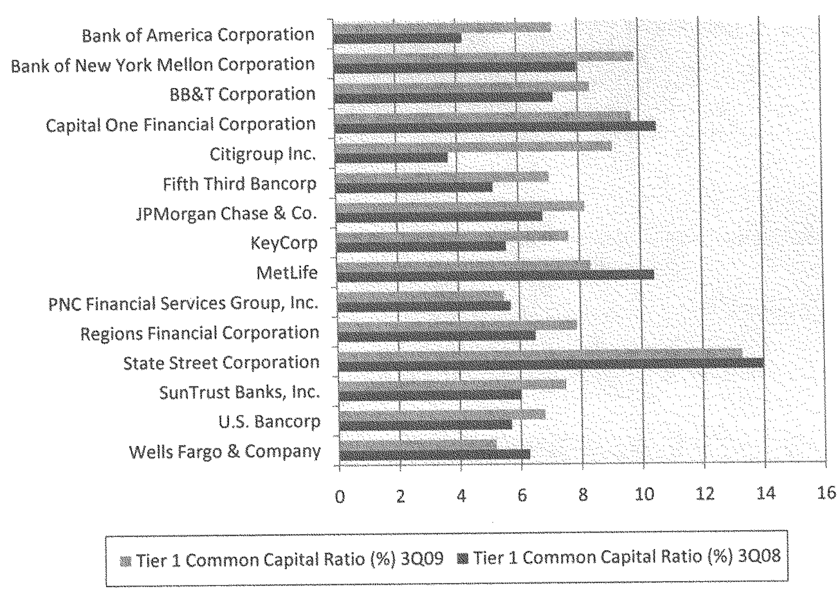
[123] *See* SIGTARP, *supra* note 121. In addition, Merrill Lynch was selected to receive CPP funds in October 2008, after Bank of America had agreed to acquire it in order to prevent Merrill's dissolution. See November 25 Transactions Report, *supra* note 71 ("This transaction was included in previous Transaction Reports with Merrill Lynch & Co., Inc. listed as the qualifying institution and a 10/28/2008 transaction date, footnoted to indicate that settlement was deferred pending merger. The purchase of Merrill Lynch by Bank of America was completed on 1/1/2009, and this transaction under the CPP was funded on 1/9/2009").

[124] The Federal Reserve developed the metrics for the more adverse scenario in February 2009. The most recent figures for those three metrics are a 2.8 percent increase in annual GDP as of third quarter 2009, a 9.2 annualized unemployment rate as of November 2009, and a 8.5 annualized percent decrease in housing prices as of the end of September 2009. Compare this to the more adverse scenario for calendar year 2009 having GDP falling 3.5 percent, housing falling 22 percent, and unemployment at 8.9 percent.

held capital that the supervisors considered adequate, or were subsequently able to raise additional capital in the private markets. Tier 1 capital—also called core capital—is the highest quality capital that a bank can hold.[125] A bank's tier 1 capital ratio is the ratio of its tier 1 capital to its risk-weighted assets.[126] Figure 5 shows the stress tested institutions' tier 1 capital levels in 3Q 2008 and in 3Q 2009. Most of these institutions have higher tier 1 capital levels than they did a year ago. A number of these have already repaid their CPP funds, making their higher capital levels due in part to capital raised in the private markets.[127]

Public confidence in the adequacy of bank capital levels would be enhanced through consistent financial reporting practices. The absence of consistent financial reporting practices and agreed upon interpretations of relevant accounting rules make it difficult to compare capital levels of different financial institutions.[128]

FIGURE 5: TIER 1 CAPITAL RATIOS OF STRESS-TESTED INSTITUTIONS, THIRD QUARTER 2008 V. 2009[129]



[125] Tier 1 capital is the sum of the following capital elements: (1) common stockholders' equity; (2) perpetual preferred stock; (3) senior perpetual preferred stock issued by Treasury under the TARP; (4) certain minority interests in other banks; (5) qualifying trust preferred securities; and (6) a limited amount of other securities.

[126] Calculating risk-weighted assets is a complex process, but the concept is as simple as it sounds. Assets are weighted based on their level of risk.

[127] These higher capital levels are also due in part to earnings, some of which are a result of various government guarantee programs and low-cost funds available to banks.

[128] The Panel discussed this issue in depth in its August Report. August Oversight Report, *supra* note 100.

[129] This figure excludes four stress-tested institutions: Goldman Sachs, Morgan Stanley, GMAC, and American Express. These institutions were excluded because data on their tier 1 capital levels for 3Q 2009 was not available. This is because they became bank holding companies at the end of or after the 3Q 2008. SNL Financial, *Bank & Thrift Stress Test Tear Sheet*

Continued

ii. Bank Capital Raising

Since the inception of the TARP, 211 banks, thrifts, and specialty lenders have raised a total of $264.3 billion in capital from the private markets.[130] One hundred and thirty of these institutions were TARP recipients. Banks' ability to raise capital in the private markets shows that investors are regaining confidence in the banking sector. However, investor confidence may reflect the assumption of an implicit guarantee hanging over the financial system. Investors saw that the government stepped in to support institutions such as Bank of America without wiping out shareholder stakes. This may signal to the markets that shareholders in large institutions are protected from total loss of their investment.

iii. Borrowing by Financial Institutions

Borrowing by banks is crucial to maintaining sufficient liquidity in the financial system. But at the height of the financial crisis, bank debt issuance ground nearly to a halt. In September 2008, banks issued only $661 million in debt, as compared to $109 billion a year before. In October 2008, the FDIC announced that it would guarantee bank debt under the TLGP, a program designed to promote borrowing by financial institutions.[131] This voluntary FDIC program, which is not a part of the TARP, provided a full guarantee to senior unsecured debt issued by participating banks.

In the last two months of 2008, participating institutions issued $108 billion in senior unsecured debt. At the height of the program, 101 institutions had $346 billion in debt outstanding.[132] There is currently $315 billion in debt outstanding under the program, covering 88 institutions.[133] Though the program ended on October 31, 2009, borrowing by financial institutions has continued. As of November 10, 2009, banks that had participated in the TLGP issued a total of $5.5 billion of non-guaranteed debt.[134] Banks are continuing to issue debt without the support of the FDIC guarantee, though at lower amounts than they were issuing under the TLGP.[135] Figure 6 shows debt issued under the TLGP compared to

(online at www.snl.com/interactivex/TemplateBrowser.aspx?V =V&Format=XLS&Doc=9676136&File=7970111&SaveFileAs= Bank & Thrift Stress Test Tear Sheet) (accessed Dec. 7, 2009).

[130] This is through November 30, 2009. *See* SNL Financial, *Capital Raises Among Banks and Thrifts* (online at www.snl.com/InteractiveX/doc.aspx?ID=10162420) (accessed Dec. 4, 2009). This includes common equity, perpetual preferred stock, and trust preferred stock. These three are all elements of tier 1 capital. Of the four largest banks, Citigroup is the only one that has not raised capital in the private markets. JPMorgan raised $5 billion in June, and Wells Fargo raised $11 billion in November 2008. SNL Financial. Bank of America raised $13.4 billion in May 2009, and announced that it will raise additional capital before repaying its TARP funds. *See* Bank of America Repayment, *supra* note 82.

[131] The TLGP has two programs: the debt guarantee program, and a second program that guarantees deposit accounts above the $250,000 FDIC insurance limit. The Panel will only discuss the debt guarantee program here. A third government guarantee program, Treasury's Temporary Guarantee Program for Money Market Funds, guaranteed money market funds and not banks, so the Panel does not include it as a capital assistance program. The Panel discusses the TGPMMF, and has a full discussion of the TLGP, in its November Report. *See* November Oversight Report, *supra* note 96.

[132] *See* Federal Deposit Insurance Corporation, *Monthly Reports on Debt Issuance Under the Temporary Liquidity Guarantee Program* (May 31, 2009) (online at www.fdic.gov/regulations /resources/TLGP/total__issuance5-09.html).

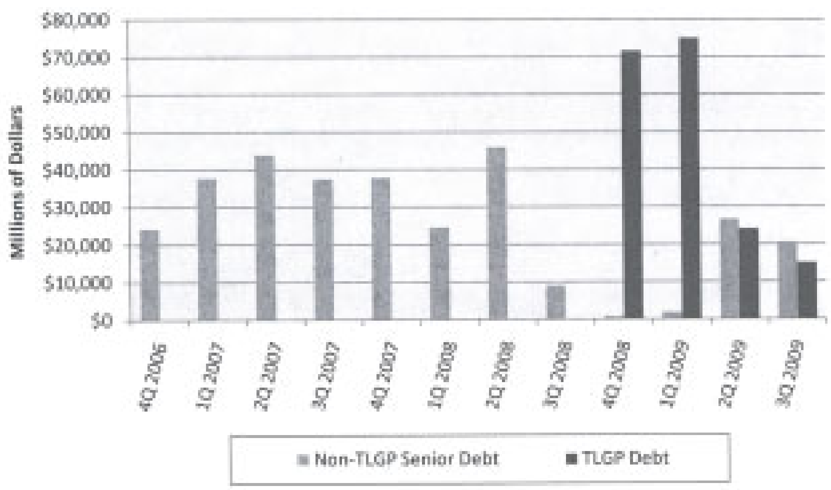
[133] *See* Federal Deposit Insurance Corporation, *Monthly Reports on Debt Issuance Under the Temporary Liquidity Guarantee Program* (Oct. 31, 2009) (online at www.fdic.gov/regulations /resources/TLGP/total__issuance10-09.html).

[134] Data provided under subscription by SNL Financial.

[135] The $5.5 billion issued in November is lower than the $10.23 billion, a mixture of TLGP and non-TLGP debt, issued in October 2009.

non-TLGP senior debt issued by banks prior to and during the term of the TLGP. Bank borrowing increased during the first two quarters of the TLGP. This could be due to the availability of lower cost guaranteed debt,[136] or could be attributed to restored confidence in the financial system.

FIGURE 6: NON-TLGP SENIOR DEBT SINCE 4Q 2006, AND TLGP DEBT SINCE 4Q 2008 [137]



iv. Market Perception of Banks' Health

The price of a credit default swap (CDS) contract on a specific bank trading in the market offers an indication of the market's view of that bank's health. Credit default swap contracts function in a similar manner to insurance contracts.[138] If a bank's bondholders are worried about the bank defaulting on its debt, they can buy default protection through a credit default swap to hedge their bets. Therefore, the less healthy a bank is perceived to be, the more expensive a CDS contract against that bank will be. As shown in Figure 7, the 5-year CDS spreads for institutions AIG, JPMorgan Chase, Wells Fargo, Goldman Sachs, Citigroup, Morgan Stanley, Bank of America, Capital One, and American Express skyrocketed in fall of 2008 and early 2009.[139] CDS spreads remained high in early 2009 because of continued uncertainty in the markets.[140]

[136] As shown in the Panel's November report, banks saved between $13.4 and $29 billion in borrowing costs by participating in the TLGP. *See* November Oversight Report, *supra* note 96, at 69.

[137] SNL Financial, *Financial Institutions Offering Activity* (online at www1.snl.com/interactivex/Template Browser.aspx?V=V&Doc=10022881&File=8302325&Format=XLS&SaveFileAs=Financial Institutions Offering Activity) (accessed Dec. 7, 2009). SNL template modified to provide specific data necessary to conduct analysis.

[138] A credit default swap contract has a similar payoff structure to a put option.

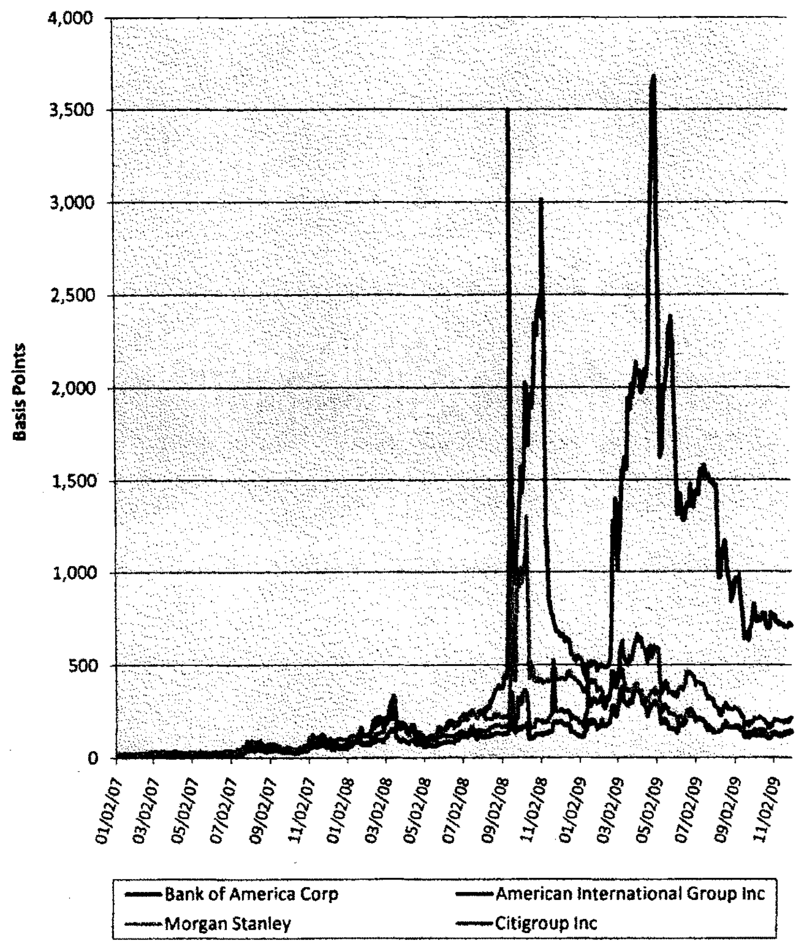
[139] Five-year CDS spread refers to the difference between the price of a CDS contract maturing in five years and the price of Treasury bonds with a similar maturity.

[140] Even with the explicit and implicit guarantees of government support, U.S. banks remained exposed to overseas financial institutions.

On average, five-year CDS spreads on these institutions went up by 636 basis points at the height of the crisis, and have now fallen 532 basis points, to 104 basis points above the trough. Excluding AIG from the list, on average the five-year CDS spreads went up by 410 basis points at the height of the crisis, and have now fallen 371 basis points, to 39 basis points above the trough.[141] This decline in CDS spreads shows a clear increase in CDS market participants' confidence in major bank creditworthiness. It is unclear the extent to which this decline in CDS spreads is due to confidence in major banks' stand-alone creditworthiness and to what degree this decline reflects CDS market confidence in implicit government guarantees of large banks. While it is no doubt true that the perception of an implicit guarantee has grown in the wake of the government response to the crisis, market participants lack a clear understanding of the scope of any such guarantee and the circumstances under which it would be exercised.

[141] Data provided under subscription by BLOOMBERG Data Services.

FIGURE 7: FIVE-YEAR CDS SPREADS OF SELECTED TARP RECIPIENTS[142]



[142] Data provided under subscription by BLOOMBERG Data Services, *Credit Default Swap Spreads*.

c. Macro Indicators of the Health of the Banking Sector

While it is difficult to isolate the effects of the TARP on the banking sector, macroeconomic indicators provide some insight into the effectiveness of the program in promoting the liquidity and stability of the sector. These gauges—lending levels, bank failures, and bank consolidations—are relevant to assessing the impact of the TARP. But because of the influence of other external factors, they do not imply causation.

i. Lending by Financial Institutions [143]

Bank lending activities are an indicator of financial sector health, though it is important not to oversimplify the relationship between the two. Treasury has stated that it limited capital injections from the CPP to healthy banks in order to ensure that the funds were used for lending, and not merely to bolster recipient banks' balance sheets.[144] Even healthy banks, however, have a need to recapitalize after the losses of the past year. A bank looking to build its capital levels will allocate more funds to capital and less to lending.

Figure 8 shows loan originations of the top 20 CPP recipients through the life of the TARP. It includes all lending: consumer, real estate, and commercial.[145] The chart shows the degree to which lending tightened for the period of October 2008 through September 2009. Since the enactment of EESA, loan originations by these 20 institutions have decreased by 13.7 percent. Total average loan balances decreased by 1 percent.[146]

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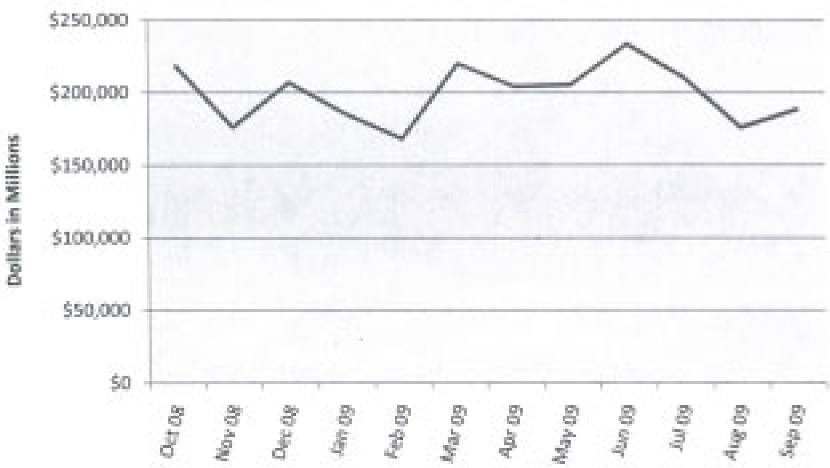
[143] The report discusses small business lending in section C2b *infra* at 57.

[144] *See* Factsheet on CPP, *supra* note 121 ("Participation [in the CPP] is reserved for healthy, viable institutions that are recommended by their applicable federal banking regulator. Treasury's intent is to provide immediate capital to stabilize the financial and banking system, and to support the economy. . . . A necessary precursor to lending and economic recovery is a stable, healthy financial system. Healthy banks, not weak banks, lend to their communities and the CPP is a program for healthy banks").

[145] Specifically, it includes first mortgage, home equity lines of credit (HELOC), credit card, other consumer, commercial and industrial renewal, commercial and industrial new commitments, CRE renewal, CRE new commitments, and small business lending.

[146] *See* U.S. Department of the Treasury, *Treasury Department Monthly Lending and Intermediation Snapshot Data for April 2009–September 2009* (Nov. 16, 2009) (online at www.financialstability.gov/docs/surveys/Snapshot__Data__September__2009.xls). Data manipulated in order to exclude PNC and Wells Fargo. For further explanation of Panel methodology see footnote 147.

FIGURE 8: TOTAL LOAN ORIGINATIONS OF SELECTED CPP RECIPIENTS SINCE INCEPTION OF EESA[147]



Banks remain cautious with respect to lending, even as they become better capitalized.[148] In the Federal Reserve's October 2009 survey of senior loan officers, 25 percent of respondents reported tightening standards for prime residential real estate loans in the last three months, while 15 percent reported tightening standards for credit card loans in the last three months, and 15 percent reported tightening lending to all size businesses in the past three months.[149]

[147] The Panel uses Treasury's "Monthly Lending and Intermediation Snapshot" of the top 22 CPP participants to track specific categories of lending levels of the financial institutions that benefitted the most from government assistance under the TARP. Two of these institutions, PNC Financial and Wells Fargo, purchased large banks at the end of 2008. PNC Financial purchased National City on October 24, 2008 and Wells Fargo completed its merger with Wachovia Corporation on January 1, 2009. The assets of National City and Wachovia are included as part of PNC and Wells Fargo, respectively, in Treasury's January lending report but are not differentiated from the existing assets or the acquiring banks. As such, there were dramatic increases in the total average loan balances of PNC and Wells Fargo in January 2009. For example, PNC's outstanding total average loan balance increased from $75.3 billion in December 2008 to $177.7 billion in January 2009. The same effect can be seen in Wells Fargo's total average loan balance of $407.2 billion in December 2008 which increased to $813.8 billion in January 2009. The Panel excludes PNC and Wells Fargo in order to have a more consistent basis of comparison across all institutions and lending categories.

Unlike other lending categories, Treasury only began publishing small business lending information as of April 2009. U.S. Department of the Treasury, *Treasury Department Monthly Lending and Intermediation Snapshot Data for April 2009–September 2009* (Nov. 16, 2009) (online at www.financialstability.gov/impact/monthlyLendingandIntermediationSnapshot.htm) (hereinafter "Treasury Department Monthly Lending and Intermediation Snapshot Data for April 2009–September 2009").

[148] Board of Governors of the Federal Reserve System, *October 2009 Senior Loan Officer Opinion Survey on Bank Lending Practices* at 3 (online at www.federalreserve.gov/boarddocs/snloansurvey/200911/fullreport.pdf) (hereinafter "Loan Officer Opinion Survey October 2009") (accessed Dec. 7, 2009) (observing that "domestic banks indicated that they continued to tighten standards and terms over the past three months on all major types of loans to businesses and households").

[149] Loan Officer Opinion Survey October 2009, *supra* note 148 (accessed Dec. 7, 2009).

Banks continued to tighten lending, but less banks reported tightening than in late 2008.[150] Banks might be holding more capital in order to offset potential future losses on loans. The increases in delinquencies and charge-offs shown in Figures 9 and 10 support banks' potential desire to hold cash to offset future losses on loans.

While it might be desirable for TARP recipients to increase lending to help the economy, banks may be reluctant to lend due to legitimate concern about increased default risks.[151] As discussed in Section 1.C.2.b, *infra*, Small Business Loans, for instance, carry added risk in today's economic climate. Chairman Bernanke recently noted that difficulties in obtaining credit may impede the creation and expansion of small- and medium-sized businesses.[152]

Total delinquencies have risen dramatically since the second half of 2007, as shown in Figure 9. While those secured by real estate have the highest levels, delinquencies on loans to consumers have also risen significantly.

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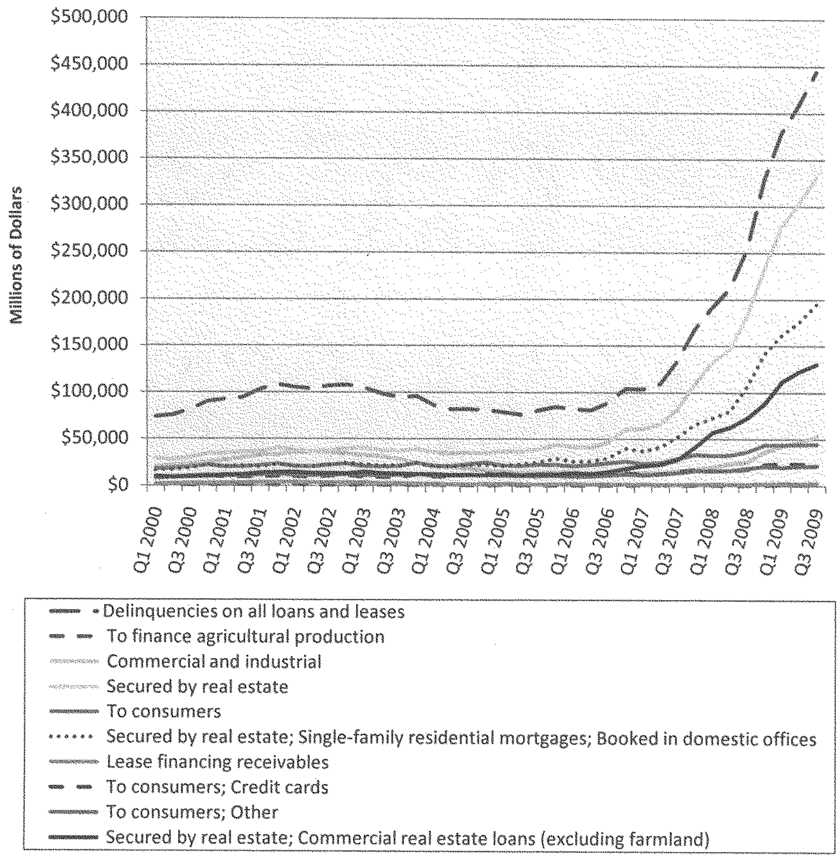
[150] Loan Officer Opinion Survey October 2009, *supra* note 148, at 3 (accessed Dec. 7, 2009). In October 2008, 80 percent of banks reported tightening of lending to all size businesses, 70 percent reported tightening on prime residential real estate lending, and 60 percent reported tightening lending for credit cards. Board of Governors of the Federal Reserve System, *October 2008 Senior Loan Officer Opinion Survey on Bank Lending Practices* (online at www.federalreserve.gov/boarddocs/Snloan Survey/200811/fullreport.pdf) (accessed Dec. 7, 2009).

[151] *See* Board of Governors of the Federal Reserve System, *Remarks by Chairman Ben S. Bernanke at the Economic Club of New York* (Nov. 16, 2009) (online at www.federalreserve.gov/newsevents /speech/bernanke20091116a.htm) (hereinafter "Remarks by Chairman Ben S. Bernanke"). Of course it is not clear how to define desired levels of lending. Few think that the United States should return to 2007 levels of consumer borrowing but there is no broad consensus as to what level of lending would support economic expansion at this time.

[152] Remarks by Chairman Ben S. Bernanke, *supra* note 151. *see also* Federal Reserve Board of Governors, *Minutes of the Federal Open Market Committee* (Nov. 3–4, 2009) (online at www.federalreserve.gov/monetary policy/fomcminutes20091104.htm) ("Limited credit availability, along with weak aggregate demand, was viewed as likely to restrain hiring at small businesses, which are normally a source of employment growth in recoveries").

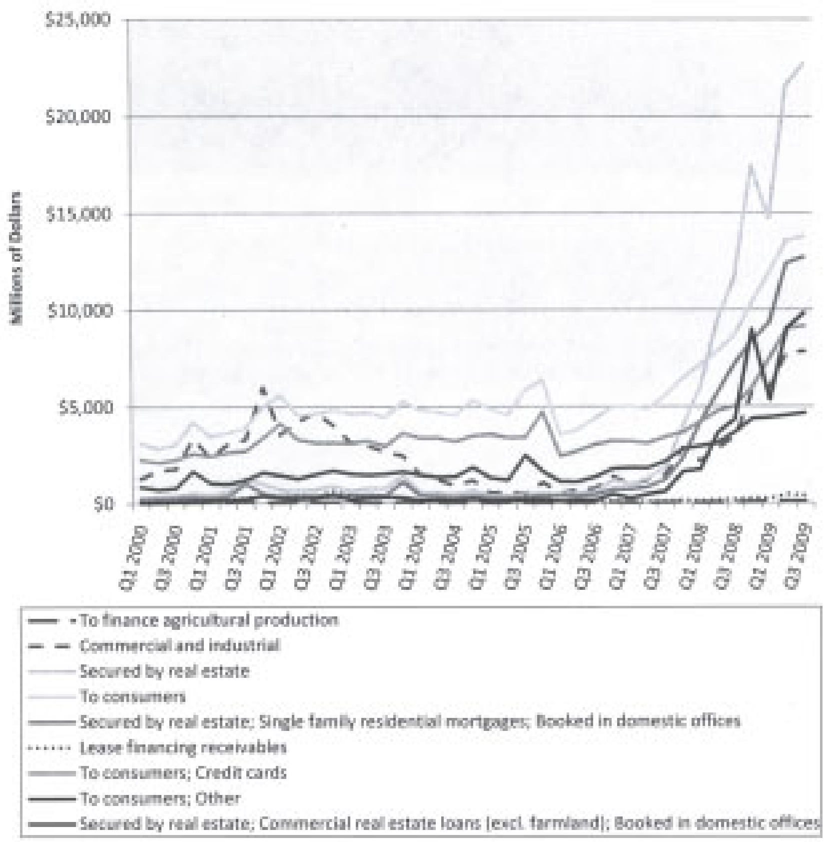
FIGURE 9: TOTAL DELINQUENCIES AT ALL DOMESTIC COMMERCIAL BANKS, BY TYPE [153]



[153] Board of Governors of the Federal Reserve, *Charge-off and Delinquency Rates—Instrument: Delinquencies/All Banks* (online at www.federalreserve.gov/datadownload/Choose.aspx?rel=CHGDEL) (accessed Dec. 7, 2009).

Bank charge-offs have seen a similar rise in 2008 and 2009. In general, a bank charges off a loan when it believes that it will not be able to recover payment on it. The actual and potential for future losses on existing loans goes some way toward explaining why banks, despite recapitalization, are reluctant to lend.

FIGURE 10: NET-CHARGE-OFFS AT ALL DOMESTIC COMMERCIAL BANKS, BY TYPE [154]



[154] *Id.*

A number of factors could cause banks to pull back on lending. A bank might decide to hold increased capital in the wake of the severe impairment of bank funding markets or uncertainty regarding future changes in regulatory capital standards. Though they are regaining strength, the continued impairment of securitization markets reduces funding for bank loans. And banks might be concerned about upcoming changes to accounting rules that will require banks to move a large volume of securitized assets onto their balance sheets.[155] Some commentators have explained that current credit tightening has followed historical patterns from recessions, when credit risk understandably increases.[156] There is also considerable concern that some of this decrease in credit may arise—as in past banking crises—from the increased scrutiny given by bank examiners to loans, including credit determinations and documentation, and the reaction of bank management to the prospect of increased scrutiny.[157]

Banks' willingness to lend is only one factor in the lending equation. A decline in lending levels may also reflect reduced demand from borrowers rather than tightened conditions from creditors. There is considerable evidence that demand for credit has fallen over the past year.[158] As Chairman Bernanke has explained:

> The demand for credit also has fallen significantly: For example, households are spending less than they did last year on big-ticket durable goods typically purchased with credit, and businesses are reducing investment outlays and thus have less need to borrow. Because of weakened balance sheets, fewer potential borrowers are creditworthy, even if they are willing to take on more debt. Also, write-downs of bad debt show up on bank balance sheets as reductions in credit outstanding.[159]

ii. Bank Failures

Banks of all sizes were affected by the shock to the financial sector. While many of the largest banks received unprecedented support, smaller banks have been allowed to fail and to be seized by regulators. There were 149 bank failures between January 1, 2008 and November 30, 2009;[160] 124 of these failures occurred in 2009, with assets totaling $141.6 billion.[161] This is the most bank failures since 1992, when 181 banks failed. Two of these 124 banks

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155 Remarks by Chairman Ben S. Bernanke, *supra* note 151.

156 *See* Baker COP Testimony, *supra* note 28, at 4–5 (contending that "[t]here is no reason to believe that the tightening of credit during this downturn is any greater than what should be expected given the severity of the recession" and "to insist that [banks] make loans [to small businesses] on which they expect to lose money" would "be questionable economic policy"). *But see* Remarks by Chairman Ben S. Bernanke, *supra* note 151 ("Nevertheless, it appears that, since the outbreak of the financial crisis, banks have tightened lending standards by more than would have been predicted by the decline in economic activity alone").

157 *See* Congressional Oversight Panel, Testimony of Charles Calomiris, *Taking Stock: Independent Views on TARP's Effectiveness* (Nov. 19, 2009) (online at cop.senate.gov/hearings/library/hearing-111909-economists.cfm).

158 Loan Officer Opinion Survey October 2009, *supra* note 148, at 3.

159 Remarks by Chairman Ben S. Bernanke, *supra* note 151.

160 Data provided under subscription by SNL Financial.

161 *See* Federal Deposit Insurance Corporation, *Failures and Assistance Transactions* (online at www2.fdic.gov/hsob/SelectRpt.asp?EntryTyp=30) (hereinafter "Failures and Assistance Transactions") (accessed Dec. 7, 2009).

were TARP recipients.[162] Many of these failed banks were small- and medium-sized banks with higher proportions of commercial real estate loans.[163] The FDIC's Deposit Insurance Fund is feeling the stress of these failures—it now carries a balance of negative $8.2 billion.[164] This is only the second time in the FDIC's history that the Fund balance has been below zero.

There are currently 552 banks on the FDIC's watch list.[165] This implies that while the TARP may have stabilized the elements of the banking sector that received TARP funds, there are still areas of weakness in the sector stemming from the ongoing problems of the general economy. FDIC Chairman Sheila Bair has predicted bank failures will peak in 2010 and then decline.[166]

Figure 11 shows numbers of failed banks, and total assets of failed banks since 1970. It shows that, although the number of failed banks was significantly higher in the late 1980s than it is now, the aggregate assets of failed banks during the current crisis far outweigh those from the 1980s. At the high point in 1988 and 1989, 763 banks failed, with total assets of $309 billion.[167] Compare this to 149 banks failing in 2008 and 2009, with total assets of $473 billion.[168]

[162] CIT Group is not an FDIC insured institution, so it is not included on failed bank lists.

[163] *See* Federal Deposit Insurance Corporation, *Failed Bank List* (online at www.fdic.gov/bank/individual/failed/banklist.html) (accessed Dec. 7, 2009); *see also* Office of the Comptroller of the Currency, *Comptroller Dugan Expresses Concern About Commercial Real Estate Concentrations* (Jan. 31, 2008) (online at www.occ.gov/ftp/release/2008-9.htm) (Describing that according to data from the Office of the Comptroller of the Currency, between 2002 and 2008, the ratio of commercial real estate loans to capital at community banks nearly doubled to a record 285 percent. By early 2008, nearly one-third of all community banks had commercial real estate concentrations that exceeded 300 percent of their capital.); Maurice Tamman and David Enrich, *Local Banks Face Big Losses*, Wall Street Journal (May 19, 2009) (online.wsj.com/article/SB124269114847832587.html) (analyzing the relationship between commercial real estate loans and small/medium-size banks, and concluding that many such banks could fail because of their commercial real estate loan portfolios). For a more complete discussion of this topic, please see the Panel's August Oversight report. *See* August Oversight Report, *supra* note 100, at 4–5, 12, 18.

[164] This negative balance includes a $38.9 billion contingent loss reserve that the FDIC has already set aside to cover losses in the next year. *See* Federal Deposit Insurance Corporation, *FDIC-Insured Institutions Earned $2.8 Billion in the Third Quarter of 2009* (Nov. 24, 2009) (online at www.fdic.gov/news/news/press/2009/pr09212.html.) As the FDIC explains "[c]ombining the fund balance with this contingent loss reserve shows total DIF reserves with a positive balance of $30.7 billion." *See id.*

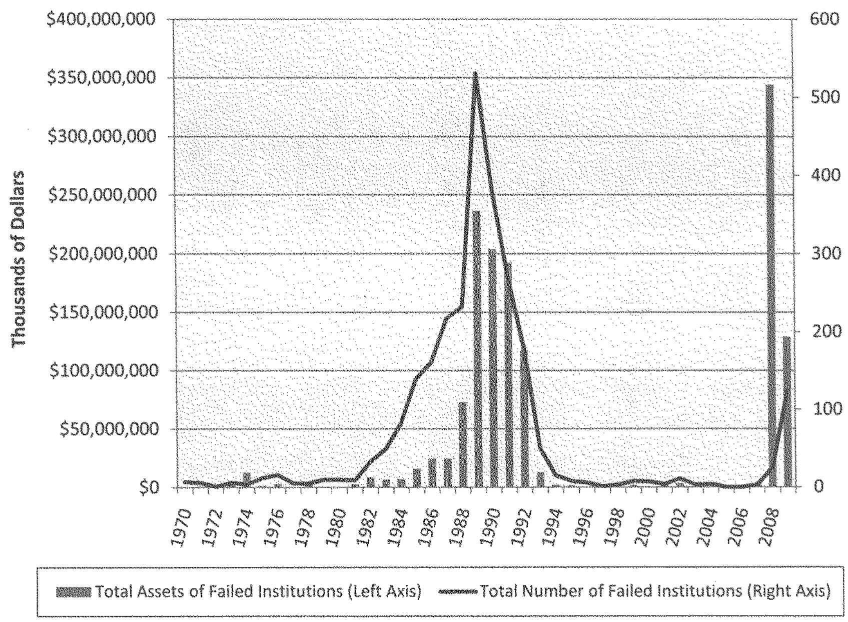
[165] *Id.*

[166] Michael S. Derby, *FDIC's Bair: Bank Failures Will Peak In 2010,* Wall Street Journal (Nov. 10, 2009) (online at online.wsj.com/article/BT-CO-20091110-715147.html).

[167] This is in 2005 inflation-adjusted numbers. Failures and Assistance Transactions, *supra* note 161 (accessed on Dec. 7, 2009). The number of bank failures from 1988 and 1989 includes the casualties of the savings and loan crisis. During these years regulatory changes forced closures of some institutions.

[168] This is in 2005 inflation-adjusted numbers. Bank failures for 2009 are as of November 30, 2009. Failures and Assistance Transactions, *supra* note 161 (accessed on Dec. 7, 2009). This figure includes the failures of Washington Mutual and IndyMac, with assets of $307 billion and $32 billion, respectively.

FIGURE 11: BANK FAILURES THROUGH NOVEMBER 30, 2009 (IN 2005 DOLLARS)[169]

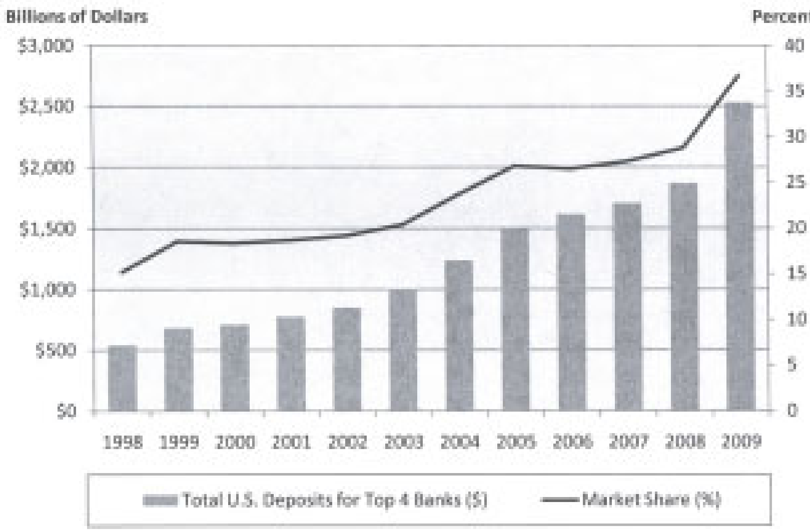


iii. Bank Consolidation

While an increasing number of small banks have failed over the past year, the largest banks have grown larger. Figure 12 shows the increasing market share held by the four largest U.S. banks in the years 1998 through 2009.

[169] Failures and Assistance Transactions, *supra* note 161. Data total assets are adjusted for inflation into 2005 dollars using the GDP price deflator. U.S. Department of Commerce: Bureau of Economic Analysis, *Gross Domestic Product: Implicit Price Deflator* (online at research.stlouisfed.org/fred2/data/GDPDEF.txt) (accessed Dec. 7, 2009). This chart does not include the six banks that failed on December 4, 2009. One of these, AmTrust Bank, had total assets of approximately $12.0 billion. Federal Deposit Insurance Company, *Failed Bank List* (online at www.fdic.gov/bank/individual/failed/banklist.html) (accessed Dec. 7, 2009).

FIGURE 12: MARKET SHARE OF THE FOUR U.S. BANKS WITH THE MOST DEPOSITS IN MARKET SINCE 1998[170]



[170] SNL Financial, *Deposit Market Share,* 1998–2009 (online at www.snl.com/interactivex/InDeposit MarketshareDetail.aspx?ID=US&Number= 10&Refreshed=1&Year=2009&Market=0&Ownership=0) (accessed Dec. 7, 2009).

Bank consolidation has worrisome implications for moral hazard, as long as there continues to be a perception in the market of an implicit guarantee. As a small number of banks acquire a larger share of the market and competition decreases, the systemic risk they pose rises.[171]

d. Summary

As TARP capital assistance efforts wind down, the current condition of the banking sector is mixed. Treasury and regulators have stated that the stress tests show that large banks, most of them current or former TARP recipients, are in general adequately capitalized. That assertion is challenged by leading economists and experts on financial crises.[172] Many small and medium banks, however, are in a more precarious situation.

2. Credit for Consumers and Small Business

Treasury has emphasized the use of the TARP "to restore the flow of credit to small businesses and consumers." [173] It has chosen to allocate TARP funds directly for these purposes (i) by launching a program with FRBNY to revive the loan securitization market and providing $20 billion as a credit backstop as part of that program, and (ii) by committing up to $15 billion to purchase directly securitized Small Business Administration loans. In addition, Treasury has recently announced the broad outlines of a program to provide capital assistance to small banks in return for commitments to lend to small business.[174]

a. Asset Securitization—The Term Asset-Backed Securities Loan Facility

Since the mid-1980s, banks have increasingly chosen to finance their consumer loans (primarily credit card, student, and auto loans) by packaging those loans into securities sold to investors through a process called securitization, creating an important channel for providing credit.[175] The financial crisis froze the markets for these "asset-backed securities," in part in reaction to the general credit crunch and in part in reaction to the crisis in the larger markets for securitized residential mortgages. Thus, Treasury and the Federal Reserve Board saw revival of the securitization market as

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[171] This does not imply that bank consolidation is an intended policy, but it can be a side effect of many bank failures. The FDIC is under a statutory mandate to achieve the "least cost resolution" of a failing or failed bank, and in the case of large failed banks such as Washington Mutual and Wachovia, the least cost solution requires them to be acquired by other large banks. The statute does provide an exception from the least cost resolution mandate in situations in which its application would cause "serious adverse effects on economic conditions or financial stability" and an alternative action "would avoid or mitigate such adverse effects." 12 U.S.C. § 1A1823(c)(4)(G)(i).

[172] *See* Section D of this report, *infra*.

[173] U.S. Department of the Treasury, *The Financial Stability Plan: Deploying our Full Arsenal to Attack the Credit Crisis on All Fronts* (online at www.financialstability.gov/roadtostability) (hereinafter "Financial Stability Plan") (accessed Dec. 7, 2009).

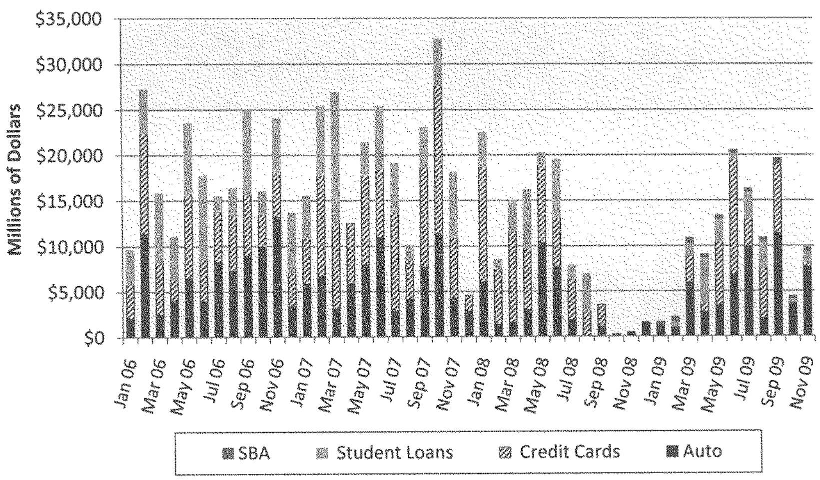
[174] *See* White House, *President Obama Announces New Efforts to Improve Access to Credit for Small Businesses* (Oct. 21, 2009) (online at www.whitehouse.gov/assets/documents/small_business_final.pdf) (hereinafter "President Obama Announces Small Business Efforts"). The nature of the market for consumer and small business loans and the impact of the crisis on those markets are discussed in detail in the Panel's May 2009 report. *See* Congressional Oversight Panel, *May Oversight Report: Reviving Lending to Small Businesses and Families and the Impact of TALF* (May 7, 2009) (online at cop.senate.gov/documents/cop-050709-report.pdf) (hereinafter "May Oversight Report").

[175] The securitization process is described in the Panel's May oversight report. May Oversight Report, *supra* note 174, at 34–39.

the way to revive credit to consumers and created the Temporary Asset-Backed Securities Loan Facility (TALF) to produce that revival.[176]

The volume of asset-backed securities representing classes of consumer loans before the financial crisis, the drop in that volume during the crisis, and its movement upward beginning in March 2009 are shown in Figure 13:

FIGURE 13: MONTHLY TOTAL SBA, STUDENT LOAN, CREDIT CARD, AND AUTO ABS ISSUANCES, 2006–2009 [177]



[176] According to the Federal Reserve Board and Treasury, "over the past few years around a quarter of all non-mortgage consumer credit" has been financed through securitization. U.S. Department of the Treasury, *White Paper: Term Asset-Backed Securities Loan Facility* (Mar. 3, 2009) (online at www.treas.gov/press/releases/reports/talf_white_paper.pdf) (hereinafter "TALF White Paper").

[177] Chart prepared by Panel staff using U.S. monthly ABS issuances data provided by Securities Industry and Financial Markets Association (SIFMA). As of the date of the report, data on small business ABS issuances is unavailable prior to January 2009.

The TALF is a credit facility through which FRBNY originally committed up to $200 billion to lend to investors for the purchase of securitized credit card, student, and automobile loans.[178] The investors post the assets they purchase as collateral (security) for the loans; because the loans are made on a "non-recourse" basis,[179] FRBNY cannot recover more than the then-value of the assets if the loan is not paid. Thus, whatever the amount of the original loan, the risk that the loan will not be repaid lays with the government, not with the investors. The non-recourse feature creates an economic subsidy—measured by the difference between the interest rates that would be required by investors to buy asset-backed securities with and without non-recourse loans. The subsidy is reduced somewhat because FRBNY will only make loans for something less than the full value of the asset-backed securities the loans are used to buy.[180]

The choice of non-recourse financing reflects the assessment of Treasury and FRBNY that the risk of high levels of default had made securitized loans largely unsalable during the financial crisis, due to the high interest rates investors required to offset what they perceived as increased risk; the ultimate result, in the agencies' view, was reduction in the availability and an increase in the cost of consumer credit.[181] The TALF subsidy is intended to reduce or eliminate that difference in two ways: (i) by creating competitive conditions to drive down interest rates for securitized products, and (ii) by funding a series of financings in which the feared level of defaults do not occur.

Treasury's economic commitment to the TALF is a relatively minor one in relation to the originally projected size of the program, but it has committed $20 billion of TARP funds to bear and is at risk for the first $20 billion of losses from TALF loans. At present, approximately $62 billion in TALF loans has been requested,[182] making the $20 billion Treasury backstop a significant figure; posted collateral would have to decline in value by more than 33 percent before the Treasury backstop would be exhausted and loan losses would begin to be borne by FRBNY.

[178] As discussed below, *infra* pages 54–60, the program also included Small Business Administration loans.

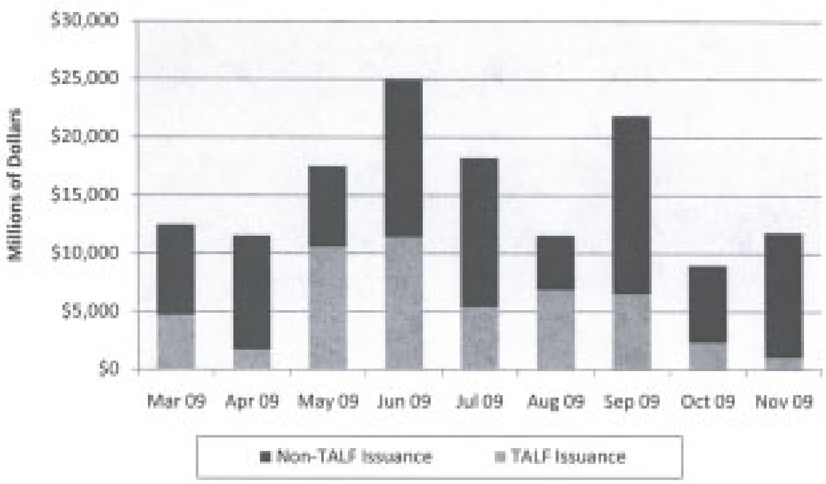
[179] A non-recourse loan is one in which the lender has no right to look to the borrower for repayment, but only to take control of the collateral, whatever its actual value.

[180] *See, e.g.*, Federal Reserve Bank of New York, *Term Asset-Backed Securities Loan Facility: Terms and Conditions* (Apr. 21, 2009) (online at www.newyorkfed.org/markets/talf__terms.html). As explained in the May report, this reduction is called a "haircut." The haircut varies for the asset class against which a loan is made and the duration of that loan. For a more complete discussion of this topic, please see the Panel's May Oversight Report. *See* Congressional Oversight Panel, *May Oversight Report: Reviving Lending to Small Businesses and Families and the Impact of TALF*, at 42 (May 7, 2009) (online at cop.senate.gov/documents/cop-050709-report.pdf).

[181] *See* TALF White Paper, *supra* note 176.

[182] This figure includes both CMBS and non-CMBS loans requested as of December 3, 2009. Federal Reserve Bank of New York, *Term Asset-Backed Securities Loan Facility: Non-CMBS—Recent Operations* (online at www.newyorkfed.org/markets/TALF__recent__operations.html) (hereinafter "Term Asset-Backed Securities Loan Facility: Non-CMBS—Recent Operations") (accessed Dec. 7, 2009); Federal Reserve Bank of New York, *Term Asset-Backed Securities Loan Facility: CMBS—Recent Operations* (online at www.newyorkfed.org/markets/cmbs__operations.html) (accessed Dec. 4, 2009).

FIGURE 14: TALF V. NON-TALF ABS ISSUANCE, MARCH 2009–NOVEMBER 2009 [183]

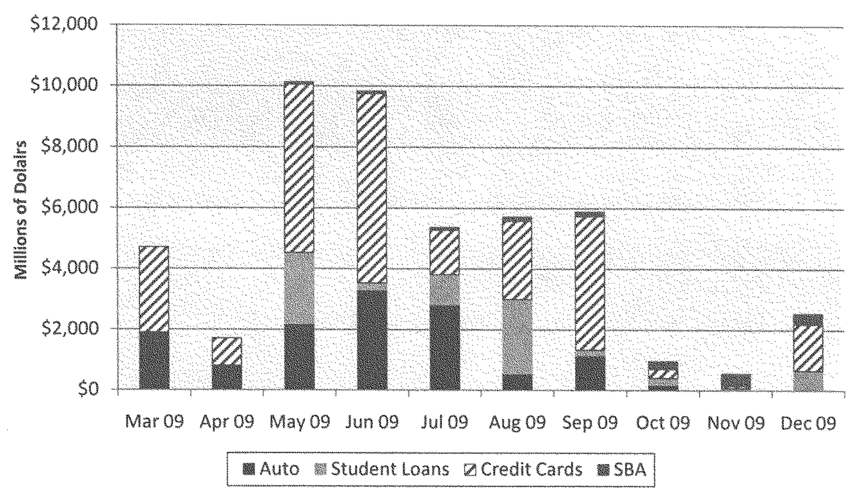


[183] Chart prepared by Panel staff using U.S. monthly ABS issuances data provided by SIFMA and FRBNY. For FRBNY source data, *see* Federal Reserve Bank of New York, *Term Asset-Backed Securities Loan Facility: Recent Operations* (online at www.newyorkfed.org/markets/TALF_recent_operations.html) (hereinafter "TALF Recent Operations") (accessed Dec. 3, 2009).

Three metrics can help evaluate the results of the TALF.

1. *Changes in Amount of Securitizations*. TALF's direct contribution to credit for consumers is illustrated by Figure 14, which shows that since TALF's March 2009 launch, 39 percent of the total amount of all credit card, student, and auto loan ABS has been funded through the program.[184] Over this period, total ABS origination, excluding commercial mortgage-backed securities, increased, ranging from a low of $11.3 billion in April 2009 to a high of $24.9 billion in June 2009, and averaging approximately $15.4 billion per month. While this represents an eightfold increase over the average monthly level of such securitizations from September 2008 to February 2009, securitization levels have not returned to pre-crisis levels.[185] Figure 13 provides some sense of the historical base level against which the contribution of the TALF (illustrated in Figure 14) should be compared. A comparison of Figures 13 and 14 provides some sense of the historical base level against which the contribution of the TALF, for the months TALF has been in existence, should be compared. Figure 15 below outlines the amount of loans for various types of ABS that the TALF has financed.

FIGURE 15: TALF LOAN FACILITIES BY COLLATERAL TYPE, MARCH 2009–NOVEMBER 2009[186]



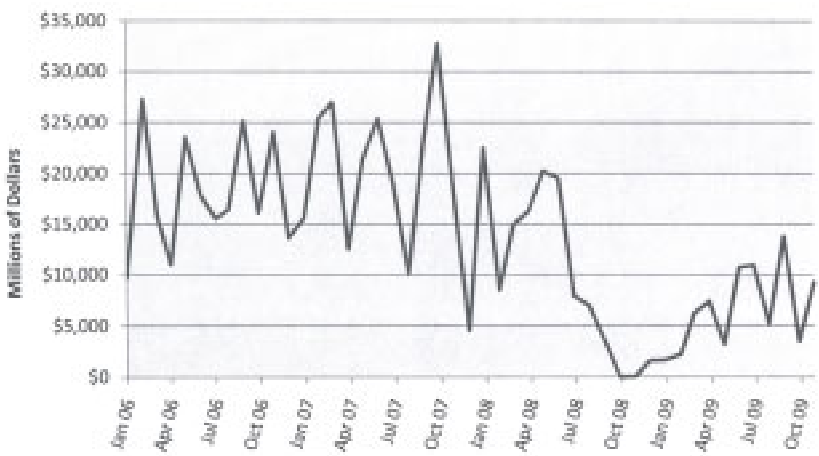
[184] *Compare* Federal Reserve Bank of New York, *Term Asset-Backed Securities Loan Facility: Non-CMBS—Recent Operations* (online at www.newyorkfed.org/markets/TALF_recent_operations.html) (accessed Dec. 7, 2009) *with* US ABS Issuance, *supra* note 16. The text does not mean that 39 percent of every class of loans was the subject of TALF financing.

[185] Pre-crisis securitization levels may not be an accurate measure of healthy securitization practices; a portion of the growth of the ABS market was attributable to inflated demand for these products during the pre-crisis credit bubble.

[186] Chart prepared by Panel staff using U.S. monthly non-CMBS ABS issuances data provided by FRBNY. *See* TALF Recent Operations, *supra* note 183.

It is less clear that the TALF has increased the relative volume of non-TALF securitizations. As seen in Figure 16, non-TALF consumer and small business ABS origination has yet to stabilize at 2008 levels. On average, during the first nine months of 2009, these types of securitizations were down 23.3 percent versus 2008. It is difficult to draw firm conclusions from these data, because without further data it is extremely difficult to separate out the various factors—continuing uncertainty about the risks of ABS, insufficient transparency in the ABS markets, and a general decline in demand in a severe recession—that contribute to ABS levels.

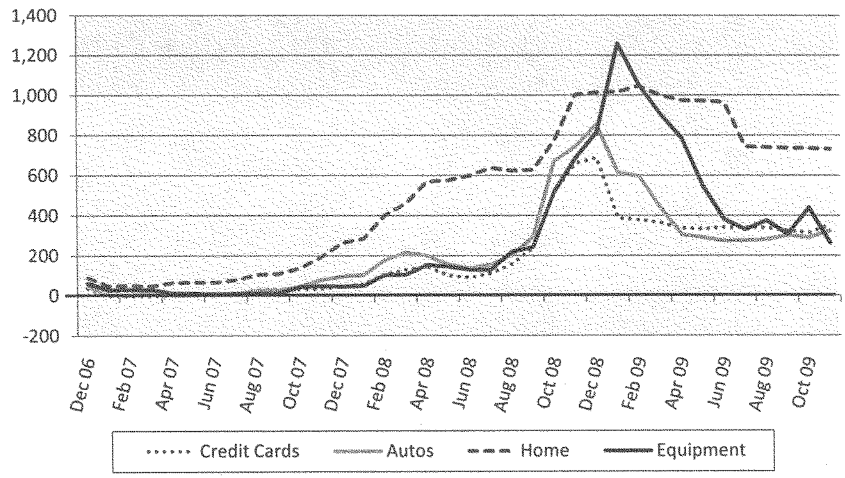
FIGURE 16: ABS ISSUANCE WITHOUT TALF, 2006–2009 [187]



2. *Changes in Interest Rate Spreads.* FRBNY and Treasury have pointed to the narrowing of interest rate spreads for privately-financed securitizations as a metric for judging the TALF's success, because the closing of the spread indicates that investors are again willing to enter the market based on the TALF's pricing bellwether. Figure 17 reflects both the widening of credit spreads during the crisis as well as tightening of spreads since the establishment of TALF.

[187] Chart prepared by Panel staff using U.S. monthly ABS issuances data provided by SIFMA and FRBNY. For FRBNY source data, *see* TALF Recent Operations, *supra* note 183.

FIGURE 17: ABS SPREADS OF SELECTED INDICATORS SINCE DECEMBER 2006 [188]

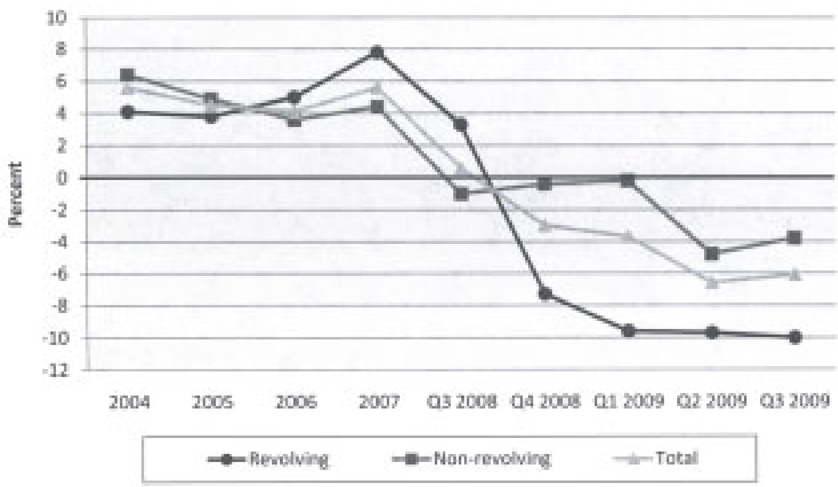


A comparison of Figure 17 above with Figure 16 on the previous page indicates that the narrowing of spreads is to some degree reflected in the volume of non-TALF ABS.

3. *Changes in credit availability.* The premise of the TALF is that increasing the volume of asset securitizations will increase the overall level of consumer credit. Figure 18, derived from statistics published by the Federal Reserve System, provides a general picture of the continuing decline in consumer credit. Statistical evidence is hard to evaluate, however, because it is impossible to disentangle the continuation of the credit crisis from bank deleveraging and the reduction of credit demand that reflects underlying difficulties in the economy.

[188] Chart prepared by Panel staff using data provided under subscription by BLOOMBERG Data Services.

FIGURE 18: PERCENT CHANGE IN CONSUMER CREDIT OUTSTANDING [189]



Two additional facts should be noted. First, although the TALF was originally to be devoted to consumer and small business loans, various ABS categories were added throughout the program and, on May 19, 2009, FRBNY announced that the TALF could also be used by investors in pools of certain commercial mortgages—expanding the program beyond its original purpose. To date, $7.5 billion has been borrowed for commercial mortgage-backed securities (CMBS) investments.

Second, the TALF is scheduled to end on March 31, 2010 for ABS and legacy CMBS, and on June 30, 2010 for newly issued CMBS. Given the small percentage of the $200 billion originally allocated for the TALF that has been used thus far, and the fact that loan requests have fallen off since their height in May ($10.6 billion requested) and June ($11.5 billion), it seems unlikely that the full $200 billion will be used. During a meeting with Panel staff in October, Treasury staff stated that the decline in requests was attributable to the increase in the availability of less expensive financing from private sources and therefore illustrated TALF's success in its goal of re-opening the ABS markets.

[189] Chart prepared by Panel staff using U.S. monthly non-CMBS ABS issuances data provided by FRBNY. *See* TALF Recent Operations, *supra* note 183.

b. Loans to Small Business

During the financial crisis, small business credit froze along with the rest of the lending markets.[190] On March 17, 2009, Treasury outlined measures to "jumpstart credit markets for small businesses."[191] Again, those measures were aimed at stimulating the market for securitized loans. One measure was the inclusion in the TALF of securities backed by the government-guaranteed portion of Small Business Administration (SBA) 7(a) loans and the non-government-guaranteed first-lien mortgage loans affiliated with the SBA's 504 loan program in the TALF. The second was the direct purchase of up to $15 billion in securities backed by SBA loans; both measures were directed at the securitized loan market.[192] (From 2006 through 2008, between 40 and 45 percent of the SBA guaranteed portion of 7(a) loans were sold into the secondary market.)[193]

The TALF originally attracted no interest from investors in securitized 7(a) and 504 loans. The first TALF borrowing for a pool of such loans, in the amount of approximately $86 million, occurred as part of the May 5 TALF facility. To date, TALF loans based on small business ABS originations represent only 2.98 percent of all non-CMBS TALF transactions.[194]

Treasury has not yet made any purchases under its direct purchase program although it has allocated approximately $3 billion for the program for 2009.[195] It hopes to create its first actual pooling structure by year-end.[196] It has noted that the lack of an earlier start to the program reflects both the typical uncertainties investors in the TALF exhibited,[197] as well as the fact that "the secondary market [has begun] to return to more normal conditions."[198]

Unlike the TALF, Treasury's program to purchase SBA-guaranteed securities does not utilize private-sector pricing. Rather, Treasury would purchase securities directly from "pool assemblers"

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[190] *See* May Oversight Report, *supra* note 174, at 52 (referring to the market freezing because of (1) the tightening of the Prime versus LIBOR spread, which reduced the attractiveness of investment in securitized 7(a) loans (indeed, the return for investors had disappeared); (2) the strained capacity of broker-dealers, who were unable to sell their current inventory and thereby free up capital to buy and pool additional loans; (3) the reduced access to and increased cost of credit for broker-dealers, who could not sell off inventory to pay off existing loans; and (4) general uncertainty and fear in the marketplace).

[191] *See* Financial Stability Plan, *supra* note 173.

[192] Unable to shed the risk from their books, commercial lenders significantly curtailed their lending activities.

[193] Government Accountability Office, *Small Business Administration's Implementation of Administrative Provisions in the American Recovery and Reinvestment Act of 2009,* at 6 (Apr. 16, 2009) (online at www.gao.gov/new.items/d09507r.pdf).

[194] Calculation based upon data provided by FRBNY. *See* Term Asset-Backed Securities Loan Facility: Non-CMBS—Recent Operations, *supra* note 182.

[195] Government Accountability Office, *Troubled Asset Relief Program: One Year Later, Actions are Needed to Address Remaining Transparency, and Accountability Challenges,* at 80 (Oct. 8, 2009) (online at www.gao.gov/new.items/d1016.pdf) (hereinafter "GAO: TARP One Year").

[196] Treasury hired Earnest Partners, an independent investment manager with SBA-guaranteed loan experience, to guide its efforts to buy securitized SBA loans directly. U.S. Department of the Treasury, *Financial Agency Agreement for Asset Management Services for SBA Related Loans and Securities* (Mar. 16, 2009) (online at www.financialstability.gov/docs/ContractsAgreements/TARP%20FAA%20SBA%20Asset%20Manager%20-%20Final%20to%20be%20posted.pdf) (updated Nov. 12, 2009); *see also* SIGTARP, *Quarterly Report to Congress,* at 112 (Apr. 21, 2009) (online at www.sigtarp.gov/reports/congress/2009/April2009_Quarterly_Report_to_Congress.pdf).

[197] *See* May Oversight Report, *supra* note 174, at 50.

[198] U.S. Department of the Treasury, *Unlocking Credit for Small Businesses: FAQ on Implementation* (Mar. 17, 2009) (online at www.financialstability.gov/docs/FAQ-Small-Business.pdf) (hereinafter "Unlocking Credit for Small Businesses: FAQ").

and banks.[199] Under the program, if Treasury engages in direct purchases, it plans either to sell the securities to private investors or pursue a buy-and-hold strategy, depending on market conditions.[200] According to Treasury's implementation documents, "Treasury and its investment manager will analyze the current and historical prices for these securities" in order to "identify opportunities to purchase the securities at reasonable prices."[201] Treasury defines such prices as those that fulfill the dual objective of "[providing] sufficient liquidity to encourage banks to increase their small business lending and [protecting] taxpayers' interest."[202] To date, Treasury has not made any direct purchases under this program.[203]

On October 21, 2009, the White House announced a third small business lending initiative, part of which uses TARP funds. Under this initiative, Treasury will provide lower cost capital to community banks[204] to be used in small business lending.[205] Participating banks must submit small business lending plans and will be required to submit quarterly reports describing their small business lending activities. If their lending plans are accepted, banks will have access to capital at a dividend rate of 3 percent, more attractive terms than the 5 percent rate under the Capital Purchase Program. These small banks will be able to receive capital totaling up to 2 percent of their risk weighted assets.[206] For community development financial institutions[207] that can document that 60 percent of their small business lending targets low-income communities or underserved populations, this dividend rate will be only two percent.[208] As currently conceived,[209] this capital will be available after the bank submits a small business lending plan, and may only be used to make qualifying small business loans.[210] Further implementing details for this program have not been announced as of the date of this report.

This program could be a more direct response to the problem of small business lending because over 90 percent of small business loans are not securitized.[211]

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[199] Pursuant to EESA, Treasury expects to receive warrants from the pool assemblers as additional consideration for the purchase of 7(a) and 504 first-lien securities. The pricing and exact nature of the warrants is still under consideration by Treasury. Unlocking Credit for Small Businesses: FAQ, *supra* note 198.

[200] *Id.*

[201] *Id.*

[202] *Id.*

[203] According to Treasury's *FAQ on Implementation,* purchases of securities backed by SBA 7(a) loans were to begin by the end of March 2009, while purchases of securities backed by first-lien 504 loans were to begin by May due to "Treasury's need to conduct a thorough risk analysis, given that these securities are not government guaranteed." Unlocking Credit for Small Businesses: FAQ, *supra* note 198; *see also* November 25 Transactions Report, *supra* note 71.

[204] Community banks are banks with $1 billion or less in assets.

[205] Small- and medium-sized banks are seen as effective vehicles for supporting small business lending because banks with less than $1 billion in assets hold greater proportions of small business loans to all business loans. *See* President Obama Announces Small Business Efforts, *supra* note 174.

[206] *See* President Obama Announces Small Business Efforts, *supra* note 174 at 2.

[207] Community development financial institutions, which are certified by the federal government, provide loans to underserved communities.

[208] *See* President Obama Announces Small Business Efforts, *supra* note 174.

[209] *Id.*

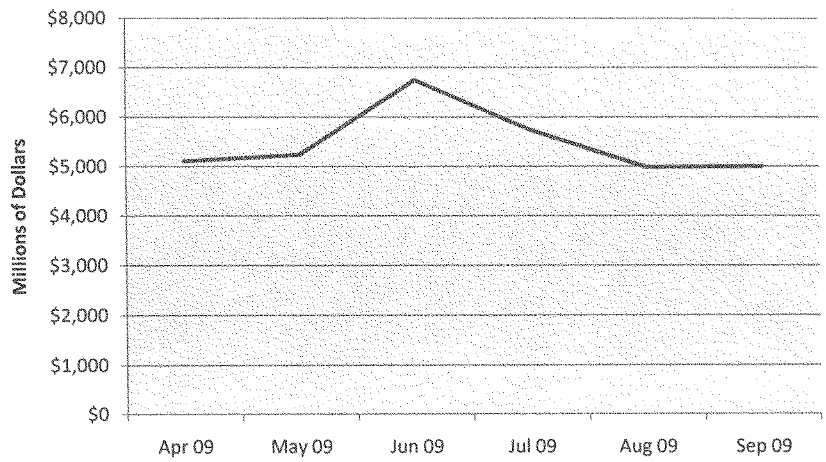
[210] *Id.*

[211] For a discussion of the relationship between small business lending and the securitization of small business loans, see the Panel's May report. *See* May Oversight Report, *supra* note 174, at 50–52.

c. Impact of Small Business Program

There is evidence that a rejuvenated secondary market for SBA loans may negate Treasury's need for direct purchases. Between May and October, the total volume of loans settled from lenders to brokers averaged $345 million, exceeding pre-crisis levels.[212] By comparison, in January total volume was $283.4 million. But it should be noted that the amount of SBA lending is small in relation to the overall number of loans to small business.

FIGURE 19: SMALL BUSINESS ORIGINATIONS OF SELECTED CPP RECIPIENTS SINCE MARCH 2009 (WITHOUT PNC OR WELLS FARGO)[213]

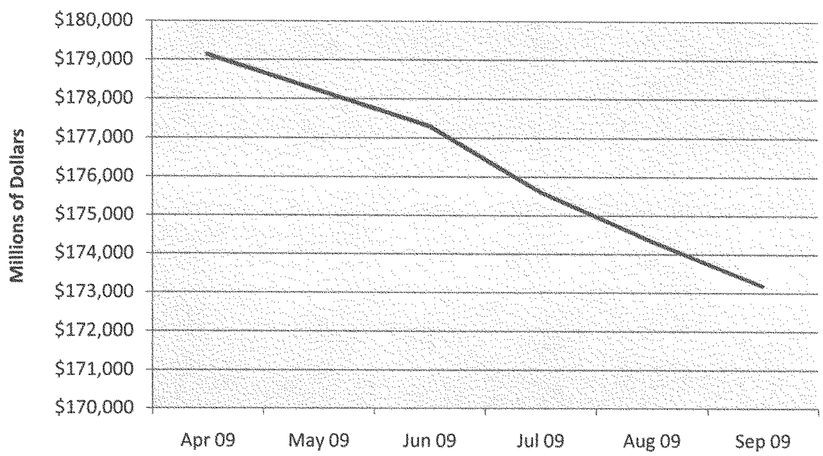


[212] Calculation based on data provided by SIFMA.

[213] Prior to February 2009, information on new bank loan originations was sparse, untimely, and incomplete. At Treasury's request, the top 22 CPP banks began reporting this data in February 2009. *See* U.S. Department of the Treasury, *Treasury Releases First Monthly Bank Lending Survey* (Feb. 17, 2009) (online at www.financialstability.gov/latest/tg30.html). However, it was not until the April 2009 lending survey that these banks first specified their small business lending activities. *Compare* U.S. Department of the Treasury, *Treasury Department Monthly Lending and Intermediation Snapshot: Summary Analysis for April 2009,* at 5 (June 15, 2009) (online at www.financialstability.gov/docs/surveys/SnapshotAnalysisApril2009.pdf) *with* U.S. Department of the Treasury, *Treasury Department Monthly Lending and Intermediation Snapshot: Summary Analysis for March 2009,* at 5 (May 15, 2009) (online at www.financialstability.gov/docs/surveys/SnapshotAnalysisMarch2009.pdf). *See* footnote 147 *supra* for an explanation of the exclusion from Figures 19 and 20 of lending by Wells Fargo and PNC.

Other CPP banks did not have the same monthly reporting requirement as the top 22 banks, and have not provided any data on their small business lending activities. As a whole, the CPP banks were only required to track average consumer loans outstanding, average commercial loans outstanding, and average total loans outstanding. *See* U.S. Department of the Treasury, *About the Capital Purchase Program Monthly Lending Report,* at 1 (online at www.financialstability.gov/docs/About%20the%20CPP%20Monthly%20Lending%20Report.pdf) (accessed Dec. 3, 2009).

FIGURE 20: SMALL BUSINESS AVERAGE TOTAL LOANS OF SELECTED CPP RECIPIENTS SINCE MARCH 2009 (WITHOUT PNC AND WELLS FARGO) [214]



Small business lending has not returned to its pre-crisis levels. And as seen in Figures 19 and 20, direct small business lending across the top 22 CPP recipients has fallen or remained stagnant since TALF's inception. One explanation for this outcome is that the top 22 CPP recipient banks have not resumed lending at pre-crisis levels in any loan category, increasing further the competition smaller businesses face to obtain a part of the shrinking loan pool.[215] Another explanation is that small business loans are currently not as lucrative for large banks as other types of lending.[216] In either case, small business loans remain difficult to obtain.[217] TALF has not necessarily succeeded in encouraging a broader expansion of consumer and small business credit. In the face of continued economic stagnation, such inaction could have drastic consequences for banks, businesses, and consumers alike.[218]

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[214] *See id.*

[215] *See* Treasury Department Monthly Lending and Intermediation Snapshot Data for April 2009–September 2009, *supra* note 147.

[216] Baker COP Testimony, *supra* note 28, at 4.

[217] *See* Baker COP Testimony, *supra* note 28, at 4; Congressional Oversight Panel, Written Testimony of Chief Economist and Co-founder of Moody's Economy.com Mark Zandi, *Taking Stock: Independent Views on TARP's Effectiveness,* at 1 (Nov. 19, 2009) (online at cop.senate.gov/documents/testimony–111909–zandi.pdf) (hereinafter "Zandi COP Testimony").

[218] *See* Congressional Oversight Panel, Transcript of Hearing, *Taking Stock: Independent Views on TARP's Effectiveness* (Nov. 19, 2009) (Testimony of Mark Zandi) (publication forthcoming Jan. 2010) (online at cop.senate.gov/hearings/library/hearing-111909-economists.cfm) (hereinafter "COP November Hearing Transcript").

3. Mortgage Foreclosure Relief

a. Background

On February 18, 2009, Treasury launched two foreclosure mitigation programs under an initiative that became known as Making Home Affordable (MHA).[219] These programs seek to refinance or restructure loans made during the housing boom in order to prevent foreclosures, which result in homeowners losing their homes, lenders incurring significant losses, and a wide range of costs imposed on communities.[220]

One of the MHA initiatives, the Home Affordable Refinancing Program (HARP), is designed to assist homeowners in refinancing mortgages owned or guaranteed by Fannie Mae or Freddie Mac (the government-sponsored enterprises, or GSEs). HARP refinances do not subsidize payment reductions or reduce principal; consequently, no government or GSE funds are used. The program permits borrowers who are current on their mortgages to refinance into more stable or affordable loans even if they have minimal or no equity in their homes. Borrowers are eligible for this program if the amount owed on their mortgage is up to 125 percent of the home's current value.[221] Delinquent homeowners and those with non-GSE mortgages are ineligible.[222] To the extent that default losses avoided due to HARP refinancings exceed the reduced yield on the refinanced mortgages owned by the GSEs, the program will improve the long-term financial outlook for the GSEs, thereby reducing their need for federal government support.

The other major MHA initiative, the Home Affordable Modification Program (HAMP), uses TARP dollars to facilitate the modification of delinquent mortgages. All loans under the conforming loan limit, which is the amount above which the GSEs cannot purchase mortgages, are HAMP-eligible; GSE ownership or guarantee is not required. HAMP modifications are available for delinquent borrowers.[223]

HAMP facilitates modifications by making incentive payments: to loan servicers, homeowners, and lenders. Unlike the capital assistance programs and the assistance to the auto industry, HAMP incentive payments are grants, so Treasury will not recover any of

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[219] Prior foreclosure mitigation initiatives include the private sector HOPE NOW Alliance, created in October 2007 and the Hope for Homeowners program within the Federal Housing Administration, signed into law in July 2008, as part of the Housing and Economic Recovery Act of 2008.

[220] *See* U.S. Department of the Treasury, *Making Home Affordable Summary of Guidelines* (Mar. 4, 2009) (online at www.treas.gov/press/releases/reports/guidelines—summary.pdf) (hereinafter "Making Home Affordable Summary of Guidelines"); *see also* Congressional Oversight Panel, *October Oversight Report: An Assessment of Foreclosure Mitigation Efforts After Six Months*, at 6–7 (Oct. 9, 2009) (online at cop.senate.gov/documents/cop-100909-report.pdf) (hereinafter "October Oversight Report").

[221] The decision to accept loans with a loan-to-value ratio of up to 125 percent was announced in July 2009, but implementation did not begin until September 1 at Fannie Mae and until October 1 at Freddie Mac. The minimum loan-to-value ratio for HARP loans is 80 percent.

[222] U.S. Department of the Treasury, *Making Home Affordable Borrower Frequently Asked Questions* (July 16, 2009) (online at makinghomeaffordable.gov/borrower-faqs.html#a2) (hereinafter "Making Home Affordable Borrower FAQs").

[223] Borrowers must be at least 60 days delinquent before they can seek a loan modification. *See* Making Home Affordable Summary of Guidelines, *supra* note 220; *see also* Making Home Affordable Borrower FAQs *supra* note 222.

the funds paid out.[224] Altogether, Treasury has designated $75 billion for HAMP, including $50 billion in TARP funds.[225] Using that $50 billion pool of funds, which is for modifying loans that are not owned or guaranteed by Fannie Mae or Freddie Mac, Treasury has signed agreements with 79 servicers (representing over 85 percent of all mortgages serviced in the United States under the agreements signed so far); under the current contracts, the maximum payout of TARP funds from Treasury is $27.4 billion.[226]

HAMP's goal is to make mortgage payments more affordable and thus avert defaults. HAMP does so by requiring participating servicers and lenders to offer modifications to all eligible borrowers in their portfolios where the net present value of the modified loan would exceed the net present value of the unmodified loan.[227] Servicers are expected to comply with any private contractual restrictions on loan modifications, however.

HAMP modifications follow a standard template. The servicer or lender is to offer to reduce the monthly mortgage payment to 31 percent of the borrower's monthly income.[228] This is done by first capitalizing all arrearages, then reducing interest rates incrementally to as low as 2 percent, then stretching out the loan's term if possible, and then stretching out the loan's amortization period (forbearing on principal).[229]

HAMP modifications begin with a three-month trial modification. If the borrower is current on payments at the end of the three-month trial period and has provided full supporting documentation, such as proof of income, then the modification becomes "permanent."[230] Permanent modifications, however, only have fixed monthly payments for five years. After five years, interest rates on the modified loans are increased up to a cap.[231] In addition, Treasury contributes cash toward interest-rate reductions, and it also provides a variety of incentive payments to the defaulted homeowner, servicer, and lender. Treasury does not make any incentive payments unless a modification becomes permanent.[232]

As of October 31, 2009, Treasury has expended $2,307,776 of the $50 billion in TARP funding set aside for modification of non-GSE loans. Of the money expended, $1,828,000 was used for servicer incentives; $82,500 went to servicers as a bonus for modifying current loans; $238,500 went to investors as a bonus for modifying

[224] *See* Congressional Budget Office, *The Troubled Asset Relief Program: Report on Transactions Through June 17, 2009* (June 2009) (online at www.cbo.gov/ftpdocs/100xx/doc10056/06–29–TARP.pdf).

[225] The remaining $25 billion, which is being used to perform HAMP modifications on loans owned or guaranteed by Fannie Mae and Freddie Mac, comes from the Housing and Economic Recovery Act of 2008 (HERA).

[226] *See* November 25 Transactions Report, *supra* note 71.

[227] The formula that is used to determine eligibility is known as a net present value test, or NPV test. *See* Jordan D. Dorchuck, *Net Present Value Analysis and Loan Modifications* (Sept. 15, 2008) (online at www.mortgagebankers.org/files/Conferences/2008/RegulatoryComplianceConference08/RC08SEPT24ServicingJordanDorchuck.pdf).

[228] This ratio, a measure of loan affordability, is known as debt-to-income ratio or DTI.

[229] U.S. Department of the Treasury, *Home Affordable Modification Program Guidelines* at 6–7 (March 4, 2009) (online at www.treas.gov/press/releases/reports/modification_program_guidelines.pdf) (hereinafter "HAMP Guidelines").

[230] Making Home Affordable Summary of Guidelines, supra note 220; October Oversight Report, *supra* note 220.

[231] *See* U.S. Department of the Treasury, *Making Home Affordable Updated Detailed Program Description*, at 4 (Mar. 4, 2009) (online at www.treas.gov/press/releases/reports/housing_fact_sheet.pdf).

[232] HAMP Guidelines, *supra* note 229.

current loans; and $158,776 was expended for investor cost sharing subsidies.[233] Payments only occur for loans that have achieved permanent modification status. In total, 10 servicers have received payments under HAMP.[234]

b. Impact

The refinancing of loans under HARP began in April 2009.[235] According to data from Treasury, 136,271 loans have been refinanced under the program as of October 31, 2009.[236] HARP accounted for about 5 percent of the Fannie Mae and Freddie Mac loans that were refinanced from April 1–September 30.[237] Additional data from Treasury show that 12.5 percent of HARP refinancings (17,091 mortgages) have involved mortgages where the homeowner has negative equity, but only .2 percent (272 mortgages) have been for properties with a loan-to-value ratio (LTV) over 105 percent.[238] These numbers should increase, however, as the program's maximum LTV was only recently increased from 105 percent to 125 percent. While more information is needed to evaluate HARP fully, the data that are currently available raise questions about whether the program, as currently configured, will have a substantial impact on the foreclosure problem.

Over the next several years, Treasury aims to modify up to three million to four million mortgages under the HAMP program.[239] Yet, projections for foreclosure range from 8.1 million over the next four years to as high as 13 million over the next five-plus years.[240] Under the HAMP program between March 1 and October 31, 2009, 919,965 offers of trial modifications were extended to borrowers.[241] From the offers extended, the program commenced 600,739 cumulative trial modifications, including restarts on duplicate borrowers. In total, the program has started 595,536 trial modifications on unique borrowers for the same time period.[242] Although trial modifications started each month held steady or increased from February through September, no doubt due to the ramp up of the program, trials dropped off sharply in October, dropping from 155,875

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[233] In response to Panel requests, Treasury provided a broad range of data related to the mortgage market. Although not all of the data are confidential, portions are. These data are cited in numerous places throughout the report, and are hereinafter cited as "Treasury Mortgage Market Data."

[234] Treasury Mortgage Market Data, *id.*

[235] *See* Federal Housing Finance Agency, *FHFA Refinance Report Shows Refinance Volumes Dropped in September; Mortgage Rates Still Higher than the Spring*, at 3 (Nov. 2, 2009) (online at www.fhfa.gov/webfiles/15153/Sept__Refinance__Final__report__and__release__11__2__09.pdf) (hereinafter "FHFA Refinance Report").

[236] Treasury Mortgage Market Data, *supra* note 233.

[237] FHFA Refinance Report, *supra* note 235.

[238] Treasury Mortgage Market Data, *supra* note 233.

[239] U.S. Department of the Treasury, *Making Home Affordable: Updated Detailed Program Description* (March 4, 2009) (online at www.treas.gov/press/releases/reports/housing__fact__sheet.pdf).

[240] Goldman Sachs Global ECS Research, *Home Prices and Credit Losses: Projections and Policy Options*, at 16 (Jan. 13 2009) (available online at garygreene.mediaroom.com/file.php/216/Global+Paper+No++177.pdf); Rod Dubitsky et al., *Foreclosure Update: Over 8 Million Foreclosures Expected*, Credit Suisse Fixed Income Research (Dec. 8, 2008) (online at www.nhc.org/Credit%20Suisse%20
Update%2004%20Dec%2008.doc).

[241] U.S. Department of the Treasury, *Making Home Affordable Program: Servicer Performance Report Through October 2009*, at 3 (online at www.makinghomeaffordable.gov/docs/MHA%20Public%20111009%20FINAL.PDF) (hereinafter "MHA Servicer Performance Report Through October 2009").

[242] Treasury Mortgage Market Data, *supra* note 233.

trials started the previous month to 99,183.[243] It is unclear why the number of trials dropped and whether or not this trend will continue into the future.

It is important to note two points regarding the trial modifications initiated so far under HAMP. First, many trial modifications may fail to convert to permanent modifications. At the Panel's October 22 hearing, Assistant Secretary Allison stated that Treasury's internal estimate before the program was launched was that 50–75 percent of the trial modifications would be converted into longer-term modifications.[244] As of October 31, 2009, there were only 10,187 permanent modifications, with a conversion rate, or roll rate, of 4.69 percent for trial modifications commenced at least three months ago.[245] While this does not mean that the other 95.31 percent of trial modifications begun three months ago are failures, it does mean that the vast majority of trial modifications have failed to convert to permanent modifications on the three-month timeline originally announced by Treasury.

These rates are not necessarily indicative of future HAMP performance, but Treasury has not provided the Panel with sufficient information to determine fully why there have been so few conversions from trial to permanent modifications. Treasury has stated that it will not be able to produce a more statistically accurate roll rate until the first quarter of next year.[246]

One factor contributing to the paucity of permanent modifications is issues in gathering borrower documentation. HAMP trial modifications can be initiated before homeowners provide any documentation of their income and assets,[247] and that documentation, which in many cases borrowers did not have to show in order to get their original loans, is required to be produced before a loan modification can exit the trial period. Because of difficulties in compiling documentation, Treasury has granted a two-month extension to the trial periods of trial modifications commenced before September 1, 2009. The roll rate for loans made five months ago is more encouraging at 38.24 percent,[248] although the success of the program over the long term will certainly require a much higher rate.

A second major concern about HAMP is that many homeowners who receive permanent modifications may redefault and ultimately lose their homes in foreclosure sales.[249] Data on loans modified during the first quarter of 2008, prior to the launch of HAMP, show that within one year of modification, 54 percent of the borrowers

[243] *Id.*
[244] *See* Congressional Oversight Panel, Testimony of Treasury Assistant Secretary for Financial Stability Herbert M. Allison, Jr., *Congressional Oversight Panel Hearing with Assistant Treasury Secretary Herbert M. Allison, Jr.* (Oct. 22, 2009) (publication forthcoming January 2010) (online at cop.senate.gov/hearings/library/hearing-102209-allison.cfm) (hereinafter "Allison COP Hearing, Oct. 22").
[245] Treasury Mortgage Market Data, *supra* note 233.
[246] Allison COP Hearing, Oct. 22, *supra* note 246.
[247] *See* U.S. Department of the Treasury, *Obama Administration Kicks Off Mortgage Modification Conversion Drive* (Nov. 30, 2009) (online at www.ustreas.gov/press/releases/tg421.htm).
[248] Treasury Mortgage Market Data, *supra* note 233.
[249] *See* Manuel Adelino, Kristopher Gerardi, & Paul S. Willen, *Why Don't Lenders Renegotiate More Home Mortgages? Redefaults, Self-Cures, and Securitization, Federal Reserve Bank of Boston Working Paper* 09–4 (July 6, 2009) (online at www.bos.frb.org/economic/ppdp/2009/ppdp0904.pdf). *See also* October Oversight Report, supra note 220.

were again delinquent by at least 60 days.[250] As the Panel noted in its October report, redefault rates are lower for modifications that reduce monthly payments, with greater percentage decreases in payments resulting in lower subsequent redefault rates. Nonetheless, redefault rates, even on modifications reducing payments by 20 percent or more, were still a very high 34.1 percent.[251] At the Panel's Oct. 22 hearing, Assistant Secretary Allison noted that HAMP results in material reductions in borrowers' payments.[252] He later noted that Treasury's baseline assumption for redefault rates is 40 percent over the next five years.[253] This assumption is not based on the actual characteristics of HAMP modified loans; adjusting for the actual characteristics of the loans, the predicted redefault rate could be substantially higher.

HAMP is still too new to have conclusive data regarding redefaults. HAMP only began converting trials to permanent modifications in July, and 94 percent of the conversions to permanent status happened in September and October. This means that only 580 permanent modifications have been in place for more than two months. For the four months during which permanent modifications have been in place, the program has already seen eight redefaults.[254] The causes of those redefaults are not known. If the 40 percent redefault estimate offered by Assistant Secretary Allison holds true, approximately 4,075 of the current 10,187 permanent modifications could be expected to redefault. It should also be noted here that although HAMP is structured to protect taxpayers against losses in cases where homeowners redefault on their modified loans, that protection is limited.[255] Redefaults during the five-year modification period mean that taxpayer funds will be paid out for modifications that nevertheless end in foreclosure.

The combination of failure to convert trial modifications to permanent modifications and redefaults on permanent modifications means that HAMP's ultimate impact may be significantly less than the number of trial modifications initiated. The Panel emphasizes that it is the number of foreclosures averted, not the number of trial modifications offered or even trial modifications commenced, that is the proper metric for evaluating HAMP.

The Panel has other serious concerns about the impact of Treasury's efforts to reduce foreclosures. While many of the foreclosures earlier in the financial crisis were the result of mortgages resetting to higher rates, an issue that HAMP is designed to combat, an increasingly pressing problem involves foreclosures caused by unemployment, as the Panel showed in its October report.[256] Since that report was released, the U.S. unemployment rate has reached 10

[250] These data only cover about two-thirds of the mortgage market. *See* Office of the Comptroller of the Currency and Office of Thrift Supervision, *OCC and OTS Mortgage Metrics Report, Second Quarter 2009,* at 29 (online at www.occ.treas.gov/ftp/release/2009–118a.pdf) (hereinafter "OCC and OTS Mortgage Metrics Second Quarter 2009") (accessed Dec. 7, 2009).

[251] *Id.*

[252] Allison COP Hearing, Oct. 22, *supra* note 246.

[253] *See* U.S. Department of the Treasury, *Questions for the Record for U.S. Department of the Treasury Assistant Secretary Herbert M. Allison Jr.,* at 3 (Oct. 22, 2009) (online at cop.senate.gov/documents/testimony-102209-allison-qfr.pdf) (hereinafter "Questions for the Record for Assistant Secretary Allison").

[254] Treasury Mortgage Market Data, *supra* note 233.

[255] *See* HAMP Guidelines, *supra* note 229.

[256] *See* October Oversight Report, *supra* note 220, at 9–21.

percent for the first time in 26 years.[257] By comparison, when the financial markets seized up in September 2008, the U.S. unemployment rate was at 6.2 percent, and when HAMP was announced in February, unemployment had risen, but only to 8.1 percent.[258] Furthermore, between September 2008 and November 2009, the more expansive unemployment rate, which includes people who are working less than they want to and those who have stopped looking for a job, rose from 11.2 percent to 17.2 percent.[259] HAMP was simply not designed to address foreclosures caused by unemployment, a point that Assistant Secretary Allison acknowledged at the Panel's Oct. 22 hearing, when he said that people with extremely low incomes will not qualify for the program.[260] Assistant Secretary Allison said that Treasury is actively looking at ways to address unemployment-related foreclosures.[261]

Treasury's foreclosure prevention efforts thus far also do not counteract the problem of negative equity. As the Panel's October report stated, there is a correlation between owing more than one's home is worth and defaulting on the mortgage—a higher correlation, in fact, than any other factor that has been identified, besides the mortgage's affordability.[262] In the third quarter of 2009, 23 percent of U.S. single-family homes with mortgages had negative equity, and 11 percent owed more than 120 percent of their homes' value, according to FirstAmerican CoreLogic, an increase from the previous quarter.[263] Another methodology calculates that nearly 34 percent of U.S. single-family homes with mortgages have negative equity.[264] This means that somewhere between one in four and one in three mortgage holders have no home equity cushion in the event of a major change in life circumstances, such as a divorce or job relocation.[265] And while Treasury's programs have made mort-

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[257] Labor Force Statistics, *supra* note 17.

[258] *Id.*

[259] U.S. Department of Labor, Bureau of Labor Statistics, *Data Retrieval: Labor Force Statistics—Instrument: U–6, seasonally adjusted* (online at www.bls.gov/webapps/legacy/cpsatab12.htm) (accessed Dec. 7, 2009).

[260] Assistant Secretary Allison did point out that that the Administration has taken other steps to address unemployment. In addition, as Allison suggested, people who have the prospect of getting unemployment insurance payments for at least nine months can count those payments as income when applying for a HAMP modification. See Congressional Oversight Panel, Testimony of Treasury Assistant Secretary for Financial Stability Herbert M. Allison, Jr., *Congressional Oversight Panel Hearing with Assistant Treasury Secretary Herbert M. Allison, Jr.* (Oct. 22, 2009) (publication forthcoming Jan. 2010) (online at cop.senate.gov/hearings/library/hearing-102209-allison.cfm) (hereinafter "COP Hearing with Assistant Secretary Allison"). *See also* U.S. Department of the Treasury, *Supplemental Documentation—Frequently Asked Questions Home Affordable Modification Program,* at 20 (Nov. 12, 2009) (online at www.hmpadmin.com/portal/docs/hamp_servicer/hampfaqs.pdf).

[261] *See* First American CoreLogic, *Negative Equity Report as of September 30, 2009* (Nov. 24, 2009) (online at www.facorelogic.com/newsroom/marketstudies/negative-equity-report.jsp) (subscription required). *See also* COP Hearing with Assistant Secretary Allison, *supra* note 260, at 54, 55.

[262] October Oversight Report, *supra* note 220, at 97.

[263] *See* First American CoreLogic, *Negative Equity Report as of September 30, 2009* (Nov. 24, 2009) (online at www.facorelogic.com/newsroom/marketstudies/negative-equity-report.jsp) (subscription required). *See also* Ruth Simon and James R. Hagerty, *One in Four Borrowers Is Underwater*, Wall Street Journal (Nov. 24, 2009) (online at online.wsj.com/article/SB125903489722661849.html).

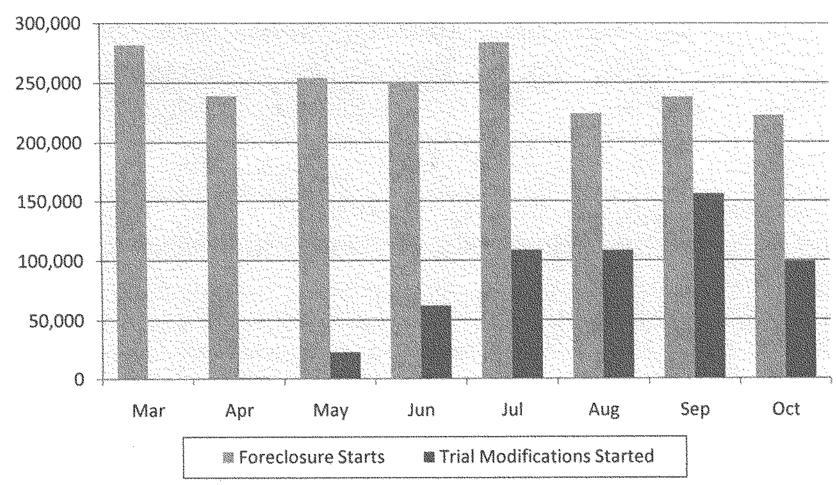
[264] *Id.*

[265] Nearly 10.7 million mortgages were in negative equity as of September 2009, out of 75.6 million owner-occupied residences. Nearly 13.0 million mortgages were in or near negative equity. *See* First American CoreLogic, Media Alert: First American CoreLogic Releases Q3 Negative Equity Data (available with registration online at www.facorelogic.com/newsroom/marketstudies/negative-equity-report.jsp) (accessed Dec. 7, 2009); *see also* U.S. Census Bureau, *American Hous-*

gages more affordable, they have not significantly reduced the amount of negative equity in modified and refinanced loans.[266] Reducing loan principal is the only way to eliminate negative equity, so Treasury should consider how its existing programs might be adapted in ways that result in principal reductions.

Perhaps the most important way to evaluate the mortgage foreclosure relief efforts under the TARP is in relation to the number of foreclosures. Are foreclosures rising or declining? Are Treasury's programs making a major dent in the problem? There has been a small downturn in the number of new foreclosure filings since July, but the data also show that foreclosures easily continue to outpace HAMP modifications, as Figure 21 shows.

FIGURE 21: FORECLOSURE STARTS V. TRIAL MODIFICATIONS STARTED [267]



In October 2009, there were 222,107 foreclosure starts, significantly more than the 99,183 HAMP trial modifications initiated in the same month.[268] In October there were also 94,450 completed foreclosure sales. To keep pace, 95 percent of trial modifications in October would have to convert to permanent modifications with no redefaults on the modifications.

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ing Survey—Frequently Asked Questions (online at www.census.gov/hhess/www/housing/ahs/ahsfaq.html) (accessed Dec. 4, 2009).

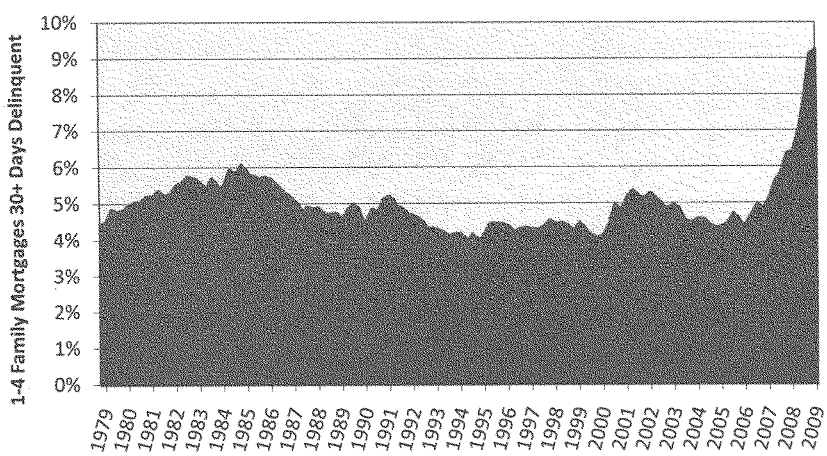
[266] Treasury Mortgage Market Data, *supra* note 233.

[267] MHA Servicer Performance Report Through October 2009, *supra* note 241, at 3; HOPE NOW, *Latest HOPE NOW Data Shows Workout Solutions Outpace Foreclosures More than 3 to 1* (Dec. 2, 2009) (online at www.hopenow.com/press—release/files/October%202009%20Data%20Release.pdf); *Workout Plans (Repayment Plans + Modifications) and Foreclosure Sales, July 2007–September 2009* (online at www.hopenow.com/industry-data/HOPE%20NOW%20National%20 Data%20July07%20to%20Sep09%20v2.pdf) (accessed Dec. 7, 2009).

[268] Treasury Mortgage Market Data, *supra* note 233. Mortgage Bankers Association, *Delinquencies Continue to Climb in Latest MBA National Delinquency Survey* (Nov. 19, 2009) (online at www.mortgagebankers.org/NewsandMedia/PressCenter/71112.htm).

In addition, as Figures 22 and 23 show, both mortgage delinquencies and homes in foreclosure are substantially above their level in February, when Treasury unveiled its foreclosure mitigation plans. According to the Mortgage Bankers Association's National Delinquency Survey, 14.41 percent of all mortgages are delinquent or currently in foreclosure, an all-time high in the survey's 37-year history.[269] Cumulatively, since July 2007, there have been more than two million foreclosure sales completed, and five and a half million foreclosure starts, with prime foreclosures now surpassing subprime.[270] As currently structured, HAMP appears capable of preventing only a fraction of foreclosures.

FIGURE 22: PERCENTAGE OF 1–4 FAMILY MORTGAGES IN 30–90 DAYS DELINQUENT[271]

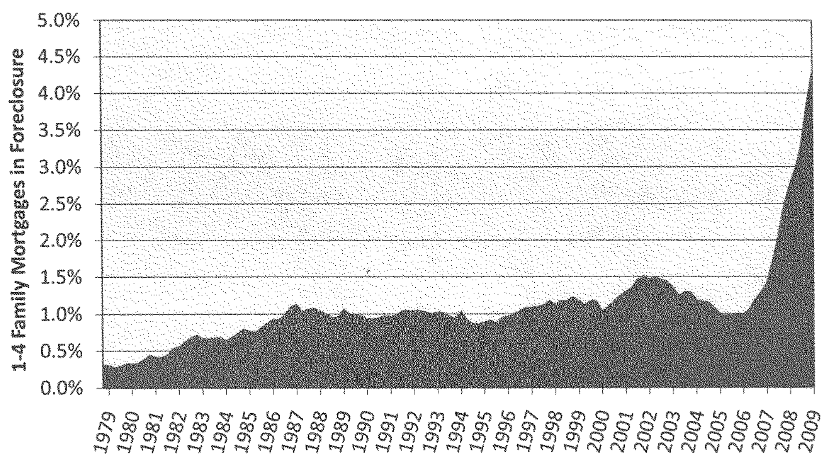


[269] Mortgage Bankers Association, *Delinquencies Continue to Climb in Latest MBA National Delinquency Survey* (Nov. 19, 2009) (online at www.mortgagebankers.org/NewsandMedia/PressCenter/71112.htm).

[270] HOPE NOW, *Workout Plans (Repayment Plans + Modifications) and Foreclosure Sales, July 2007–September 2009* (online at www.hopenow.com/industrydata/HOPE%20NOW%20National%20Data%20July07%20to%20Sep09%20v2.pdf) (accessed Dec. 7, 2009).

[271] Mortgage Bankers Association, National Delinquency Survey.

FIGURE 23: PERCENTAGE OF 1–4 FAMILY MORTGAGES IN FORECLOSURE[272]



4. Auto Industry Assistance

a. Background

Apart from its efforts to use the TARP to help stabilize the financial system, Treasury has deployed more than $80 billion in TARP funds to assist two U.S. auto manufacturers and their finance affiliates. With the onset of the financial crisis in the fall of 2008, the challenges facing the auto industry—including rising gas prices, tightening credit markets, declining consumer confidence, and rising unemployment—had become acute. By December, two major domestic auto makers—Chrysler and GM—faced a sharp downturn in income and a crippling lack of access to credit.[273]

On December 19, 2008, Chrysler and GM received bridge loans totaling $17.4 billion.[274] The government funding, which did not end with those initial loans, came from a new TARP initiative called the Automotive Industry Financing Program (AIFP). The terms of the loans required both Chrysler and GM to demonstrate their ability to achieve financial viability,[275] and both companies submitted their viability plans on February 17, 2009.

[272] Mortgage Bankers Association, National Delinquency Survey.

[273] Robert Nardelli, Written Testimony before the United States Senate Committee on Banking, Housing and Urban Affairs Committee, *Hearing Examining the State of the Domestic Automobile Industry* (Dec. 4, 2008) (online at banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=c41857b2-7253-4253-95e3-5cfd7ea81393).

[274] *See* U.S. Department of the Treasury, *Loan and Security Agreement [GM]* (Dec. 31, 2008) (online at www.financialstability.gov/docs/agreements/GM%20Agreement%20Dated%2031%20December%202008.pdf); U.S. Department of the Treasury, *Loan and Security Agreement [Chrysler]* (Dec. 31, 2008) (online at www.financialstability.gov/docs/agreements/Chysler_12312008.pdf).

[275] *See* White House, *Fact Sheet: Financing Assistance to Facilitate the Restructuring of Auto Manufacturers to Attain Financial Viability* (Dec. 19, 2008) (online at georgewbush-whitehouse.archives.gov/news/releases/2008/12/20081219-6.html). The loans also imposed conditions related to operations, expenditures, and reporting.

The results of the Obama Administration's review of those plans, announced on March 30, were not encouraging with respect to either automaker. The Administration concluded that Chrysler could not achieve viability as a stand-alone company and that it would have to develop a partnership with another automotive company or face bankruptcy.[276] As for GM, the Administration concluded that the automaker's financial viability plan relied on overly optimistic assumptions about the company and future economic developments.[277]

Both companies ultimately entered bankruptcy and, with the active involvement of the federal government, underwent radical restructurings.[278] Following those restructurings, American taxpayers owned about 10 percent of what is now known as New Chrysler and 61 percent of New GM.[279] The Administration has stated that it intends to divest of its equity stakes in these companies as soon as practicable, and that it intends to manage those stakes in a "hands-off" manner.[280] Nevertheless, the federal government has exercised some initial influence over the companies' corporate governance by appointing 10 members of GM's 13–member board and four members of Chrysler's nine-member board.[281]

Auto lender GMAC has been another large beneficiary of AIFP, receiving $12.5 billion from the program between December 2008 and May 2009.[282] Last month, Treasury announced that it expected to provide additional AIFP funds to GMAC.[283] The firm requested more money because it has been unable to meet the capital requirements imposed by the stress tests.[284] The government has not yet formally announced its rationale for granting GMAC's request, nor has it finalized the size, form, or structure of GMAC's latest round of federal assistance.[285]

The AIFP includes two additional initiatives. The Auto Supplier Support Program (ASSP), under which the government agreed to

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[276] *See* U.S. Department of the Treasury, *Chrysler February 17 Plan: Determination of Viability,* at 1 (Mar. 30, 2009) (online at www.financialstability.gov/docs/AIFP/Chrysler-Viability-Assessment.pdf).

[277] *See* U.S. Department of the Treasury, *GM February 17 Plan: Determination of Viability,* at 1 (Mar. 30, 2009) (online at www.financialstability.gov/docs/AIFP/GM-Viability-Assessment.pdf).

[278] For a discussion of the details of the bankruptcy, see the Panel's September report. *See* Congressional Oversight Panel, *September Oversight Report: The Use of TARP Funds in the Support and Reorganization of the Domestic Automotive Industry,* at 7–8 (Sept. 9, 2009) (online at cop.senate.gov/documents/cop-090909-report.pdf) (hereinafter "September Oversight Report").

[279] General Motors, *The New General Motors Company Launches Today* (July 10, 2009) (online at www.sec.gov/Archives/edgar/data/1467858/000119312509150199/dex991.htm); First Lien Credit Agreement (Chrysler) at § 2.17(a) (June 10, 2009) (online at www.financialstability.gov/docs/AIFP/newChrysler.pdf)

[280] Congressional Oversight Panel, Written Testimony of Treasury Senior Advisor Ron Bloom, *Congressional Oversight Panel Field Hearing on the Auto Industry,* at 10 (July 27, 2009) (online at cop.senate.gov/documents/testimony-072709-bloom.pdf).

[281] *See* Chrysler Group LLC, *Formation of Chrysler Group LLC Board is Completed* (July 5, 2009) (online at www.chryslergroupllc.com/en/news/article/?lid=formation__board&year=2009&month=7); General Motors Company, *Form 8–K* (Aug. 7, 2009) (online at www.sec.gov/Archives/edgar/data/1467858/000119312509169233/d8k.htm).

[282] November 25 Transactions Report, *supra* note 71, at 16 GMAC was the former financing arm of pre-bankruptcy GM, but is now an independent company.

[283] *See* Treasury Announcement Regarding the CAP, *supra* note 78.

[284] *See* Treasury Announcement Regarding the CAP, *supra* note 78.

[285] Treasury communications with Panel staff (Nov. 17, 2009). In answers to questions posed by members of the Panel, Assistant Secretary Herb Allison has suggested that Treasury decided to provide further aid to GMAC to ensure that GMAC is adequately capitalized to "provide a reliable source of financing to both auto dealers and customers seeking to buy cars" to help "stabilize our auto financing market," and to contribute "to the overall economic recovery." Questions for the Record for Assistant Secretary Allison, *supra* note 253, at 9.

guarantee payment for products shipped by participating suppliers, even if the buyers went out of business, has committed $1 billion to Chrysler and $2.5 billion to GM.[286] Treasury also lent Chrysler $280 million and GM $361 million to backstop their new vehicle warranties. Both Chrysler and GM have since repaid those loans.[287]

Figure 24 shows the current state of TARP funds used to support the auto industry. Taking into account repayments and de-obligations, United States taxpayers have spent $49.5 billion of TARP funds in support of GM and New GM, and about $12.5 billion of TARP funds in support of Chrysler and New Chrysler. Investments in GMAC, assistance to automotive suppliers, and other miscellaneous funds account for approximately $17 billion of TARP spending, bringing the TARP net support for the U.S. domestic automotive industry to approximately $79 billion as of November 30, 2009.

FIGURE 24: TARP FUNDS USED IN SUPPORT OF THE AUTO INDUSTRY (AS OF NOVEMBER 30, 2009)

	Cumulative obligations [288]	Total amounts repaid and de-obligated	Amounts invested [289]
Chrysler	$15,222,130,642	[290] $2,691,977,062	$12,530,153,580
General Motors	49,860,624,198	360,624,198	[291] 49,500,000,000
GMAC	12,500,000,000	—	12,500,000,000
Chrysler Financial [292]	1,500,000,000	1,500,000,000	
Loan for GMAC rights offering [293]	884,024,131	—	884,024,131
Auto Supplier Supports	3,500,000,000	—	[294] 3,500,000,000
Total	83,466,778,971	4,552,601,260	78,914,177,711

[288] This column represents Treasury's total obligation, or maximum exposure, to the automotive industry under the AIFP. The figure does not reflect repayments, de-obligations or committed funds that have not been used.

[289] The Amounts Invested are decreased by commitments that were not funded but includes amounts that are no longer owed such as the amounts that were credit bid in the GM bankruptcy. For a more complete discussion, *see* September Oversight Report, *supra* note 273.

[290] This figure reflects de-obligations ($2.4 billion) and repayments ($280 million). *See* November 25 Transactions Report, *supra* note 71, at 16.

[291] This number reflects the $8.8 billion in loans and preferred stock outstanding as well as the original loan amounts that are now in the form of equity.

[292] Chrysler Financial completed its repayment of this obligation on July 14, 2009.

[293] Represents loans to GM that have been converted to shares of GMAC and are currently not obligations of GM or GMAC. The GM loan was terminated.

[294] This figure does not reflect the amount outstanding under the program, but instead is the total amount available under the cap.

b. Impact

The government's investments in Chrysler and GM will ultimately be judged based on the long-term viability of the companies, as well as on the profits or losses the government incurs. Some preliminary information is now available on the recent performance and future plans of the restructured automakers. It is important to note, though, that many factors besides the government's investments, most notably the Cash for Clunkers program, contributed to the two firms' financial results over the last several months.

On November 16, 2009, GM released preliminary results for the third quarter of 2009, providing a first glimpse of the company's post-bankruptcy performance.[295] Indicators were mixed. On one

[286] *See* November 25 Transactions Report, *supra* note 71, at 16.

[287] *See* November 25 Transactions Report, *supra* note 71, at 16.

[295] These preliminary results were not calculated in accordance with Generally Accepted Accounting Principles (GAAP). GM voluntarily filed the results with the SEC in a Form 8–K, in which the company stated that in 2010 it will file financial statements with the SEC that comply with GAAP.

hand, GM lost about $1.2 billion in the third quarter of 2009, its revenues were down significantly from a year earlier, and it continued to be burdened with restructuring costs.[296] On the other hand, the results "showed a healthier balance sheet, ample cash, and factory production much more in line with consumer demand[.]"[297] GM has said that it plans to repay $1 billion in federal loans by December 2009, and that it hopes to repay an additional $6.7 billion by June 2010.[298] Chrysler has not announced its third-quarter results.[299] It recently announced a five-year business plan under which it predicts it will break even in 2010, make money in 2011, and generate enough operating profit to pay back its government loans by 2014.[300]

The most recent monthly U.S. sales data are more positive for GM than for Chrysler. GM's sales of cars and light trucks were up by 4.7 percent between October 2008 and October 2009. Chrysler's sales in October, on the other hand, were down 30.4 percent from a year earlier. Industry-wide sales were unchanged in October, when compared to sales 12 months prior. Meanwhile, the sales data from January to October 2009 are gloomy for both companies. GM's sales were down 33.6 percent compared with the same 10-month period in 2008. Chrysler's sales dropped 38.9 percent for the first 10 months of the year. Across the auto industry, U.S. sales were down 25.4 percent.[301]

Although it may be too early to render a comprehensive verdict on the government's intervention in the auto industry, the assistance almost certainly prevented Chrysler and GM from failing and liquidating. Both the manufacturing sector and the broader economy may have suffered severe harm if the government had allowed Chrysler and GM to disintegrate.[302] On the cost side of the ledger, it is unlikely that Treasury will recoup the full amount of its investment in Chrysler and GM even if the companies remain viable

[296] *See* General Motors, *General Motors Announces the New Company's July 10–September 30 Preliminary Managerial Results* (Nov. 16, 2009) (online at media.gm.com/content/media/us/en/news/news_detail.html/content/Pages/news/us/en/2009/Nov/1116_earnings).

[297] Bill Vlasic, *G.M. Shows Signs of Recovery Despite New Loss,* New York Times (Nov. 16, 2009) (online at www.nytimes.com/2009/11/17/business/17auto.html?_r=2&hp) (hereinafter "G.M. Shows Signs of Recovery Despite New Loss").

[298] *See* G.M. Shows Signs of Recovery Despite New Loss, *supra* note 296.

[299] New Chrysler and New GM are not public companies and are not required to file reports with the Securities and Exchange Commission (SEC). Nevertheless, Ron Bloom, one of the leaders of Treasury's auto team, has stated that both companies agreed to provide public "quarterly report card[s]." *See* "Oversight of TARP Assistance to the Automobile Industry," *Transcript of Hearing before the Congressional Oversight Panel,* at 37–38 (July 27, 2009) (online at cop.senate.gov/documents/transcript-072709-detroithearing.pdf) (explaining that the companies' reports would not rise to the level of "fully SEC-style" reports in the "near future," but that the companies would attempt to provide SEC-style reporting as soon as practicable and likely even before undertaking IPOs). It is not clear whether the auto companies have met all of Treasury's expectations with respect to reporting.

[300] *See* Chrysler Group LLC, *Our Plan Presentation* (Nov. 4, 2009) (online at www.chryslergroupllc.com/business/).

[301] *See* Autodata, *U.S. Light Vehicle Retail Sales* (Oct. 2009) (online at www.motorintelligence.com/fileopen.asp?File=SR-Sales-3.xls).

[302] The Government Accountability Office estimates that the automotive industry, including automakers, dealerships, and automotive parts suppliers, directly employs about 1.7 million people. *See* Government Accountability Office, *Troubled Asset Relief Program: Continued Stewardship Needed as Treasury Develops Strategies for Monitoring and Divesting Financial Interests in Chrysler and GM,* GAO–10–151, at 5 (Nov. 2, 2009) (online at www.gao.gov/new.items/d10151.pdf) (hereinafter "GAO: Continued Stewardship Needed"). According to Steven Rattner, previously one of the leaders of Treasury's auto team, "the short-term effect of a Chrysler shutdown [alone] could [have been] 300,000 more unemployed, similar to what was lost across the entire economy in the month of July [2009]." Steven Rattner, *The Auto Bailout: How We Did It,* CNN.com (Oct. 21, 2009) (online at money.cnn.com/2009/10/21/autos/auto_bailout_rattner.fortune/index.htm?postversion=2009102104).

and dramatically increase their market capitalization.[303] In addition, as was discussed in the Panel's September report, the government has incurred competing responsibilities by taking a significant ownership interest in private firms.[304]

5. The TARP as a Whole

a. Background

This report has heretofore analyzed Treasury's actions within separate parts of the TARP and drawn conclusions about the costs and impacts of those targeted programs, while also studying broad macroeconomic indicators that may shed additional light on individual programs' successes and shortcomings. In this section, the Panel undertakes a similar exercise with respect to the TARP as a whole. This section also places the TARP within the broader context of the financial stabilization efforts of the Federal Reserve and the FDIC by looking at how the Panel counts the money that has been flowing out of and into TARP and the federal government's other financial stabilization programs, and discussing what has happened to numerous macroeconomic indices since the TARP's enactment in October 2008 and what conclusions we can draw from the movements in those economic indicators.

b. Accounting for the TARP and Other Financial Stabilization Programs

i. TARP's Balance Sheet

Treasury is currently committed or obligated to spend $528.9 billion of TARP funds through an array of programs described earlier in this report.[305] Of this total, $401.5 billion is the net disbursement currently outstanding under the $698.7 billion statutory limit for TARP expenditures. That leaves $297.2 billion, or 43 percent of the statutory limit, available for fulfillment of funding commitments under existing programs and, potentially, for funding new programs and initiatives.[306] For each TARP initiative, Figure 25 shows how much money Treasury anticipated spending, how much actually has been spent to date, how much has been returned, how much is currently outstanding, and how much is available for future use.

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[303] *See* September Oversight Report, *supra* note 273, at 55–58; GAO: Continued Stewardship Needed, *supra* note 302, at 25–28.

[304] *See* September Oversight Report, *supra* note 273, at 79–83.

[305] Treasury is scheduled to release detailed accounting statements for TARP in December. For purposes of this report, the Panel must rely upon its own analysis of the financial status of the TARP, and those of the Government Accountability Office (GAO), the Congressional Budget Office (CBO), and the Special Inspector General for the Troubled Asset Relief Program (SIGTARP).

[306] The calculation that $300.5 billion is available under the TARP is based on Treasury's interpretation of EESA. According to Treasury, repaid TARP funds go into the U.S. Treasury's General Fund for the reduction of the public debt, and those repayments also create additional headroom under the $698.7 billion statutory limit for Treasury's use under TARP. The Panel takes no position on Treasury's interpretation of the law. U.S. Department of the Treasury, *Treasury Announces $68 Billion in Expected CPP Repayments* (June 9, 2009) (online at www.treas.gov/press/releases/tg162.htm).

FIGURE 25: TARP ACCOUNTING (AS OF NOVEMBER 30, 2009)

[In billions of dollars]

TARP Initiative	Anticipated funding	Actual funding	Total repayments	Net funding outstanding	Net funding available
Capital Purchase Program (CPP)	$218.0	$204.7	$71.0	$133.7	[307] $13.3
Targeted Investment Program (TIP)	40.0	40.0	0	40.0	0
Systemically Significant Financial Institutions Program (SSFI)	69.8	69.8	0	69.8	0
Automobile Industry Financing Program (AIFP)	77.6	77.6	2.2	75.4	0
Asset Guarantee Program (AGP)	5.0	5.0	0	5.0	0
Capital Assistance Program (CAP):					
Term Asset-Back Securities Lending Facility (TALF)	20.0	20.0	0	20.0	0
Public-Private Investment Partnership (PPIP)	30.0	26.7	0	26.7	3.3
Supplier Support Program (SSP)	[308] 3.5	3.5	0	3.5	0
Unlocking SBA Lending	15.0	0	N/A	0	15.0
Home Affordable	50.0	[309] 27.4	0	27.4	22.7
Modification Program (HAMP):					
Total Committed	528.9	471.3	—	401.5	54.3
Total Uncommitted	169.8	N/A	73.2	N/A	[310] 243.0
TOTAL	698.7	474.7	73.2	401.5	297.2

[307] This figure excludes the repayment of $71 billion in CPP funds. These funds are accounted for as uncommitted.

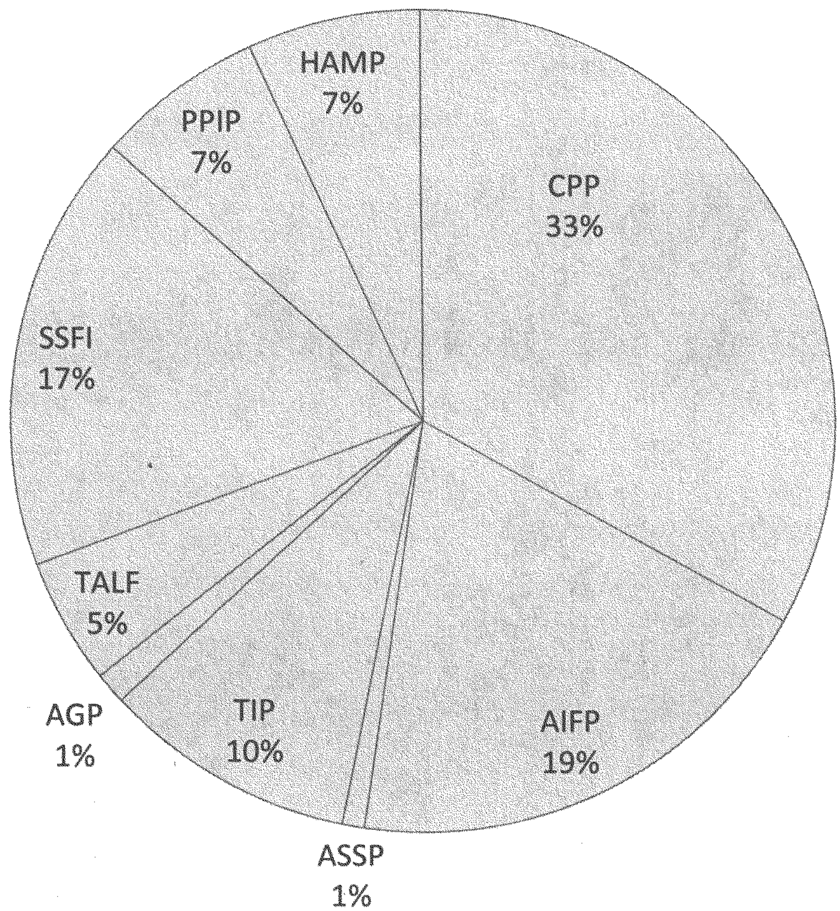
[308] On July 8, 2009, Treasury lowered the total commitment amount for the program from $5 billion to $3.5 billion, reducing GM's portion from $3.5 billion to $2.5 billion and Chrysler's portion from $1.5 billion to $1 billion. *See* U.S. Department of the Treasury, *Troubled Asset Relief Program Transactions Report for Period Ending October 28, 2009,* at 17 (Oct. 30, 2009) (online at financialstability.gov/docs/transaction-reports/10–30–09%20Transactions%20Report%20as%20of%2010-28-09.pdf).

[309] This figure reflects the total of all the caps set on payments to each mortgage servicer. *See* November 25 Transactions Report, *supra* note 71.

[310] This figure is the sum of the uncommitted funds remaining under the $698.7 billion cap ($169.8 billion) and the repayments ($73.2 billion).

Based on the amount of money spent to date, the biggest part of the TARP consists of the programs that provide capital assistance to financial institutions. Five such programs—the CPP, the SSFI, the TIP, the PPIP and the AGP—comprise a total of 68 percent of the net current investments of TARP funds, as Figure 26 shows. By contrast, efforts to help the auto industry make up 20 percent of the total; foreclosure prevention efforts make up 7 percent; and efforts targeted at small business and consumer lending make up just 5 percent of the total money outstanding.

FIGURE 26: NET CURRENT INVESTMENT OF TARP FUNDS [311]



c. The TARP in the Context of Other Federal Government Stablilization Efforts

As was stated above, Treasury's actions under the TARP have been part of a larger stabilization effort that has included programs run by the Federal Reserve and the FDIC. In fact, since the onset of the stabilization effort, both the Federal Reserve and the FDIC have been exposed on a nominal basis to substantially higher losses than Treasury has under the TARP. The nature of the three agencies' exposures, however, has differed based on the structure and risk profile of each specific agency initiative.

[311] *See* November 25 Transactions Report, *supra* note 71.

The Panel has classified the agencies' stabilization efforts into three broad categories: outlays, loans, and guarantees.[312] As Figure 27 shows, currently the vast majority of Treasury's net current investments of $401.5 billion is in the form of outlays,[313] which reflects the fact that the majority of TARP initiatives have been structured as equity investments or have eventually taken that form. The Federal Reserve currently has a maximum possible exposure of $1.73 trillion, which includes loans, principally in the form of programs to enhance liquidity, as well as substantial purchases of GSE mortgage-backed securities and its guarantee of certain Citigroup assets,[314] which exposes the Federal Reserve to potential losses of up to $220.4 billion.[315] The FDIC's maximum possible exposure is $666.7 billion, and 93 percent of that exposure is through the TLGP, with the remaining amount representing the FDIC's provision for losses under its Deposit Insurance Fund.[316] Altogether, the current estimate of the federal government's maximum possible exposure is $3.1 trillion,[317] including uncommitted TARP funds.[318] However, this would translate into the ultimate "cost" of the stabilization effort only if: (1) all uncommitted balances are fully utilized; (2) assets do not appreciate; (3) all loans default and are written off; and (4) all guarantees are exercised and subsequently written off. As many of these programs are phased out and scaled back, it is clear that, while the scale and the attendant risks of the government's various initiatives were unprecedented, the direct financial cost to the government, measured in terms of losses under the programs, will likely be a fraction of the maximum possible exposure.

FIGURE 27—FEDERAL GOVERNMENT'S FINANCIAL STABILIZATION PROGRAMS (AS OF NOVEMBER 25, 2009)—CURRENT MAXIMUM EXPOSURES *

[In billions of dollars]

Program	Treasury (TARP)	Federal Reserve	FDIC	Total
AIG	$69.8	$94.6	$0	$164.4
Outlays	[i] 69.8	0	0	69.8
Loans	0	[ii] 94.6	0	94.6
Guarantees	0	0	0	0
Bank of America	45	0	0	45
Outlays	[iii] 45	0	0	45

[312] Outlays represent disbursements made with TARP funds, such as to purchase debt or equity securities. A guarantee is a promise to stand behind another's obligation to a third party. A guarantee, unlike a loan, requires no transfer of funds or assets. Outlays here do not technically correspond to outlays as measured in the federal budget.

[313] *See* November 25 Transactions Report, *supra* note 71.

[314] *See* Figure 27 *infra*.

[315] *See* Appendix V footnote iv *infra*.

[316] *See* Figure 27 *infra*.

[317] *See* Figure 27 *infra*.

[318] The federal government has significantly reduced its economic stabilization-related exposure in recent months. Since the Panel started tracking maximum possible exposure beginning in its April 2009 report (reflecting data from March 2009), maximum exposure peaked at about $4.5 trillion in May 2009 before gradually declining to its current level of about $3 trillion. The decline in exposure over the last several months is largely attributable to the scaling back of the Federal Reserve's liquidity programs, most notably discount window lending and Term Auction Facility, and the retrenchment of certain guarantee programs. These figures do not include further recent reductions in exposure due to the termination of Treasury's Temporary Guarantee Program for Money Market Mutual Funds, which extended from September 19, 2008 to September 18, 2009 and reflected a maximum potential exposure of about $3.2 trillion in its initial phase, and the AGP's never fully consummated guarantee of certain Bank of America assets under the Asset Guarantee Program that was terminated in September 2009. *See* November Oversight Report, *supra* note 96, at 35, 40–52.

FIGURE 27—FEDERAL GOVERNMENT'S FINANCIAL STABILIZATION PROGRAMS (AS OF NOVEMBER 25, 2009)—CURRENT MAXIMUM EXPOSURES *—Continued

[In billions of dollars]

Program	Treasury (TARP)	Federal Reserve	FDIC	Total
Loans	0	0	0	0
Guarantees	0	0	0	0
Citigroup	50	220.4	10	280.4
Outlays	[v] 45	0	0	45
Loans	0	0	0	0
Guarantees [iv]	5	220.4	10	235.4
Capital Purchase Program (Other)	97	0	0	97
Outlays	[vi] 97	0	0	97
Loans	0	0	0	0
Guarantees	0	0	0	0
Capital Assistance Program	TBD	TBD	TBD	[vii] TBD
TALF	20	180	0	200
Outlays	0	0	0	0
Loans	0	[ix] 180	0	180
Guarantees	[viii] 20	0	0	20
PPIF (Loans) [x]	0	0	0	0
Outlays	0	0	0	0
Loans	0	0	0	0
Guarantees	0	0	0	0
PPIF (Securities)	[xi] 30	0	0	30
Outlays	10	0	0	10
Loans	20	0	0	20
Guarantees	0	0	0	0
Home Affordable Modification Program	50	0	0	[xiii] 50
Outlays	[xii] 50	0	0	50
Loans	0	0	0	0
Guarantees	0	0	0	0
Automotive Industry Financing Program	75.4	0	0	75.4
Outlays	[xiv] 55.2	0	0	55.2
Loans	20.2	0	0	20.2
Guarantees	0	0	0	0
Auto Supplier Support Program	3.5	0	0	3.5
Outlays	0	0	0	0
Loans	[xv] 3.5	0	0	3.5
Guarantees	0	0	0	0
Unlocking Credit for Small Businesses	15	0	0	15.0
Outlays	[xvi] 15	0	0	15
Loans	0	0	0	0
Guarantees	0	0	0	0
Temporary Liquidity Guarantee Program	0	0	609	609
Outlays	0	0	0	0
Loans	0	0	0	0
Guarantees	0	0	[xvii] 609	609
Deposit Insurance Fund	0	0	47.7	47.7
Outlays	0	0	[xviii] 47.7	47.7
Loans	0	0	0	0
Guarantees	0	0	0	0
Other Federal Reserve Credit Expansion	0	1,237.9	0	1,237.9
Outlays	0	1,008.5	0	1,008.5229.4
Loans	0	[xix] 229.4	0	0
Guarantees	0	0	0	0
Uncommitted TARP Funds	243	0	0	24
Outlays	TBA	0	0	TBA
Loans	TBA	0	0	TBA
Guarantees	TBA	0	0	TBA
Total	698.7	1,732.9	666.7	[xxii] 3,054.7
Outlays [xx]	387	1,008.5	47.7	1,443.2
Loans	43.7	504	0	547.7
Guarantees [xxi]	25.0	220.4	619.0	864.4
Uncommitted TARP Funds	243	0	0	243

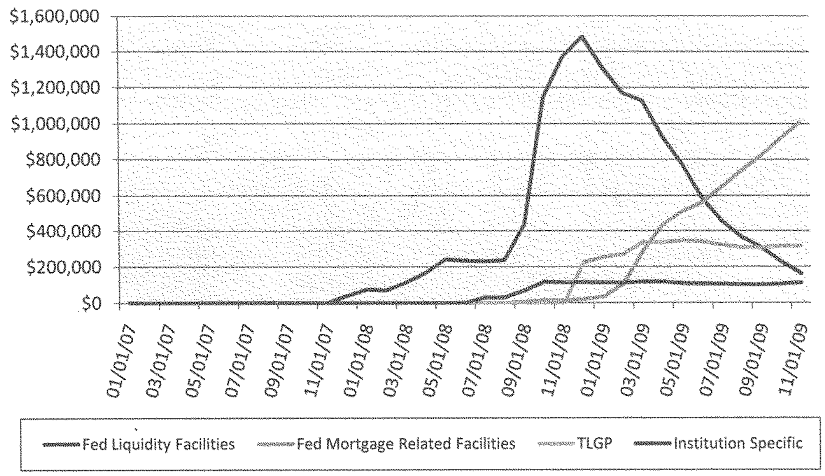
* Associated footnotes are located in Appendix V.

With respect to the Federal Reserve and FDIC's financial stabilization programs, the risk of loss varies significantly across the programs listed here, as do the mechanisms for protecting taxpayers against such risk. The Federal Reserve's liquidity programs have generally included mechanisms designed to protect taxpayers against program losses, most notably the use of loans with recourse to collateral.[319] The use of recourse loans limits the risk of losses to taxpayers to the event of the borrower entering bankruptcy, and losses under the Federal Reserve liquidity programs have not materialized. The Federal Reserve did take on substantial risk in creating three special purpose vehicles to purchase Bear Stearns and AIG assets. However, in aggregate, the current principal on the loans to these facilities is roughly equal to the market value of the purchased real estate assets, which have rebounded from previous lows. For the TLGP, the FDIC assesses a premium of up to one percent on debt guarantees. While potential exposure under the TLGP has been enormous, the premiums collected from participants have so far been more than adequate to protect against program losses.

Furthermore, the federal government's total stabilization-related exposure has been significantly reduced in recent months. Figure 28 shows the Federal Reserve's and FDIC's exposure as it has changed since January 2007. The general trend shows the Federal Reserve phasing out its liquidity programs and continuing to expand its portfolio of GSE mortgage-backed securities through new purchases. Exposure attributable to the TLGP and the Federal Reserve's support of Bear Stearns and AIG has been more stable in recent months.

[319] The Federal Reserve's loans are over-collateralized and with recourse to other assets of the borrower. If the assets securing a Federal Reserve loan realize a decline in value greater than the "haircut" or excess collateral pledged to support the loan, the Federal Reserve is able to demand more collateral from the borrower. Similarly, should a borrower default on a recourse loan, the Federal Reserve can turn to the borrower's other assets to make the Federal Reserve whole.

FIGURE 28: FEDERAL RESERVE AND FDIC ASSISTANCE SINCE JANUARY 2007[320]



d. TARP Repayments and Income

As of November 30, 2009, a total of 50 banks have fully repaid their preferred stock investments under the Capital Purchase Program.[321] Of these banks, 30 have repurchased their CPP warrants as well.[322] The rate of repayments being made by CPP participants has greatly slowed since June 2009, when twelve banks paid $68.4 billion to redeem their preferred shares. Three institutions, Goldman Sachs, JPMorgan Chase, and Morgan Stanley are responsible for over 60 percent of all TARP repayments.[323] As noted in Section 1(C), as of October 30, 2009, the rate of return on TARP investments in financial institutions that have completely exited the program is 17 percent, including preferred shares, dividends, and warrants.

[320] Federal Reserve Liquidity Facilities include: Primary credit, Secondary credit, Central Bank Liquidity Swaps: Primary dealer and other broker-dealer credit, Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, Net portfolio holdings of Commercial Paper Funding Facility LLC, Seasonal credit, Term auction credit, Net Portfolio Holdings of TALF LLC. Federal Reserve Mortgage Related Facilities include: Federal agency debt securities and Mortgage-backed securities held by the Federal Reserve. Institution Specific Facilities include: Credit extended to American International Group, Inc., and the net portfolio holdings of Maiden Lanes I, II, and III. All Federal Reserve figures reflect the weekly average outstanding under the specific programs during the last week of the specified month. Board of Governors of the Federal Reserve System, *Factors Affecting Reserve Balances (H.4.1)* (online at www.federalreserve.gov/datadownload/Choose.aspx?rel=H41) (accessed Nov. 25, 2009). For related presentations of Federal Reserve data, *see* Board of Governors of the Federal Reserve System, *Credit and Liquidity Programs and the Balance Sheet,* at 2 (Nov. 2009) (online at www.federalreserve.gov/monetarypolicy/files/monthlyclbsreport200911.pdf). The TLGP figure reflects the monthly amount of debt outstanding under the program. Federal Deposit Insurance Corporation, *Monthly Reports on Debt Issuance Under the Temporary Liquidity Guarantee Program* (Dec. 2008–Oct. 2009) (online at www.fdic.gov/regulations/resources/TLGP/reports.html).

[321] *See* November 25 Transactions Report, *supra* note 71.

[322] *See* Figure 4 *supra*. The five privately owned banks that repurchased its warrants are omitted from the chart.

[323] November 25 Transactions Report, *supra* note 71.

Figure 29 shows that more than 85 percent of the money that has flowed back to the TARP has been repayments under the CPP. An additional 15 percent of the money has come from CPP dividends and warrant repurchases. The TARP's other sources of income so far have been quite small by comparison.

FIGURE 29: TARP INCOME (AS OF OCTOBER 31, 2009) [324]

[In billions of dollars]

TARP initiative	Repayments	Dividends	Interest	Warrant repurchases	Total
CPP	$71	$6.8	$.01	$3.2	$81
TIP	....	2.3	N/A	0	2.3
Auto Initiatives	2.2	0.5	.3	N/A	3.0
AGP	....	.3	....	....	.3
Bank of America Guarantee	....	....	....	−0.3	....
Total	73.2	9.9	.43	3.2	86.9

[324] U.S. Department of the Treasury, *Cumulative Dividends Report as of Oct. 31, 2009 (Dec. 1, 2009)* (online at www.financialstability.gov/docs/dividends-interest-reports/August2009__DividendsInterestReport.pdf); November 25 Transactions Report, *supra* note 71.

e. The TARP's Impact on the Federal Budget and the Deficit

While most federal expenditures are recorded in the federal budget on a cash basis, credit programs are treated differently. For credit programs, the discounted present value of the cash flows is calculated and only this net gain or loss amount is recorded in the budget. The relationship of this net gain or loss to the government and the total cash disbursed produces a "subsidy rate." EESA requires that TARP expenditures be treated as credit programs and therefore a subsidy rate is calculated for them and only the net loss or gain is recorded in the budget.[325]

In May 2009, the Administration projected that the TARP would disburse $704 billion in federal fiscal year 2009, although TARP outlays and its deficit impact were $261 billion, implying a weighted average subsidy rate of 37 percent. When the Administration closed the books on fiscal year 2009 on September 30, the $261 billion outlay figure had fallen to $151 billion and this was, in effect, TARP's contribution to the federal deficit in 2009. According to recent press accounts, this net cost figure is likely to decline further to approximately $42 billion[326] and the overall subsidy rate to 12 percent.[327] The declining net cost to the federal government for the TARP investments and loan guarantees undertaken in 2009 largely reflects the fact that Treasury now estimates higher returns on its CPP investments due largely to lower losses on, and faster repayments of, those investments, as well as the increased value of the stock warrants Treasury holds.

Because TARP outlays reflect the discounted present value of TARP cash flows, the resulting net cost that is recorded as an out-

[325] Section 123 of EESA requires that TARP be treated on a credit reform basis.

[326] The difference between the amount recorded in the Administration's end of year budget report ($151 billion) and the final amount recorded on the Treasury's books for FY 2009 (now reported at $42 billion) is $109 billion; this implies that an adjustment (outlay reduction) of approximately that amount in the 2010 federal budget will be forthcoming.

[327] *See* Jackie Calmes, *U.S. Forecasts Smaller Loss From Bailout of Banks,* New York Times (Dec. 6, 2009) (online at www.nytimes.com/2009/12/07/business/07tarp.html). Treasury has confirmed the accuracy of this report.

lay in the federal budget provides a good measure of the economic cost of the program. Consequently, the sum of the final outlay figures for each fiscal year provides a good measure of the current projection of the ultimate economic cost of the program to the American taxpayer. The published estimates in the latest budget documents from the OMB show this total cost to be $341 billion for the period 2009 through 2016; the latest estimate from the CBO for the period 2009–2013 puts the total cost at $241 billion. Hence, notwithstanding Treasury's asserted authority to have $698.7 billion in cash disbursed at any point in time, the net cost of the TARP program will in all likelihood be substantially less than $700 billion. This reflects both the fact that (1) the economic cost or subsidy rate has declined from the initial estimate and (2) as seen in Figure 25 above, a large amount of the TARP's authorized disbursement level is currently unutilized.

f. Relevant Macroeconomic Indicators

The TARP was created during a period of severe global financial disruption. In October 2009, the International Monetary Fund (IMF) projected worldwide losses of $3.4 trillion stemming from the crisis.[328] By way of comparison, that is more money than the entire federal government spent—$3.1 trillion—in fiscal year 2009.[329] The IMF estimates that $1.5 trillion in global bank write-downs have yet to be recognized, with most of the losses coming from U.S., UK, and Euro area banks.[330] The expected loss of wealth, though lower than earlier estimates, poses a challenge to governments seeking to reinvigorate their economies. The United States has sought to support its banking sector so that it is able to weather the downtown, and many banks have seen increasing success in raising capital since the stress test results were released. As of November 30, U.S. banks, including both those that did and did not receive government assistance, had raised $72.4 billion in common equity and $49.7 billion in preferred equity in 2009.[331]

While conditions in the banking sector have improved, the overall shape of the recovery remains unclear. Economic contractions that have their source in a banking crisis tend to be prolonged,[332] and the current experience is no exception. There is a risk that a new asset bubble will form, leading to another crash.[333] There are also risks that prices for homes and in the commercial real estate sector will fall further, which would reduce the value of assets held by banks. The economy has begun to expand once again, but unemployment remains high, and millions of American households con-

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[328] International Monetary Fund, *Global Financial System Shows Signs of Recovery, IMF Says* (Sept. 30, 2009) (online at www.imf.org/external/pubs/ft/survey/so/2009/RES093009A.htm).

[329] Office of Management and Budget, *Table S–1. Budget Totals* (online at www.whitehouse.gov/omb/rewrite/budget/fy2009/summarytables.html) (accessed Dec. 7, 2009).

[330] International Monetary Fund, *World Economic Outlook October 2009,* at 5 (online at www.imf.org/external/pubs/ft/weo/2009/02/pdf/text.pdf) (accessed Dec. 7, 2009).

[331] SNL Financial, *Bank and Thrift Capital Raises* (online at www.snl.com/InteractiveX/article.aspx?CDID=A-9619028-11615&KPLT=4) (accessed Dec. 7, 2009).

[332] *See* International Monetary Fund, *World Economic Outlook,* at 103–138 (Apr. 2009) (online at www.imf.org/external/pubs/ft/weo/2009/01/pdf/text.pdf) (finding that recessions that are associated with financial crises have historically been longer and deeper, and featured weak recoveries).

[333] *See, e.g.,* Congressional Oversight Panel, Written Testimony of MIT Sloan School of Management Professor Simon Johnson, *Taking Stock: Independent Views on TARP's Effectiveness* (Nov. 19, 2009) (online at cop.senate.gov/documents/testimony-111909-johnson.pdf) (hereinafter "Johnson COP Testimony").

tinue to live with the prospect of imminent foreclosure and the loss of their homes.

i. Credit Risk

Credit spreads measure the differences in yields between different bonds. At the height of the financial crisis in the fall of 2008, spreads between the safest bonds and those that carried greater risk skyrocketed, reflecting instability in the financial markets, as investors panicked and sought refuge in safer investments. Credit spreads have fallen significantly since the creation of the TARP. Treasury cites the improvement as a sign of TARP's success, noting that the largest declines occurred in markets receiving direct government support, such as asset-backed securities and debt by government-supported enterprises such as Fannie Mae and Freddie Mac.[334]

The closely watched LIBOR–OIS spread provides another example of how credit conditions have improved.[335] This spread measures the difference between the London Interbank Offered Rate (LIBOR), which shows quarterly borrowing costs for banks, and the Overnight Indexed Swaps rate (OIS), which measures the cost of extremely short-term borrowing by financial institutions. As the spread increases, market participants have greater fears about whether counterparties will be able to deliver on their obligations. After reaching a record high of 364 basis points, or 3.64 percent, in October 2008, the spread fell to around 100 basis points in early 2009. It stood at 13 basis points on Nov. 17, 2009.[336] The lower spread means that the banking sector now has a significantly lower cost of short-term capital than it did at the height of the crisis.

The TED spread, which is the difference between LIBOR and short-term Treasury bill interest rates, is another indicator of perceived credit risk. A high TED spread shows an unwillingness by investors to hold securities other than Treasury bills. After peaking in late 2008, the TED spread has fallen to pre-crisis levels, as Figure 30 illustrates. A report by the Government Accountability Office (GAO) found that the announcement of the Capital Purchase Program under the TARP had a statistically significant effect on the TED spread, although the decline was not due solely to the TARP.[337] The GAO analysis supports Treasury's claim that the TARP had a positive effect on credit markets.

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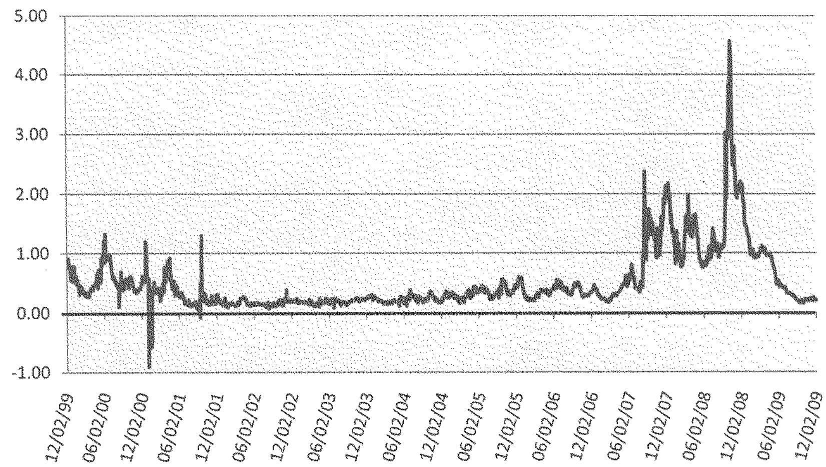
[334] Next Phase of Government Financial Stabilization, *supra* note 70, at 8.
[335] Next Phase of Government Financial Stabilization, *supra* note 70, at 8.
[336] Bloomberg, *Fed to Cut Maximum Maturity of Discount Window Loans* (Nov. 17, 2009) (online at www.bloomberg.com/apps/news?pid=20601068&sid=akC02cF4YHC4).
[337] GAO: TARP One Year, *supra* note 195, at 36.

FIGURE 30: TED SPREAD SINCE DECEMBER 1999 (IN BASIS POINTS)[338]

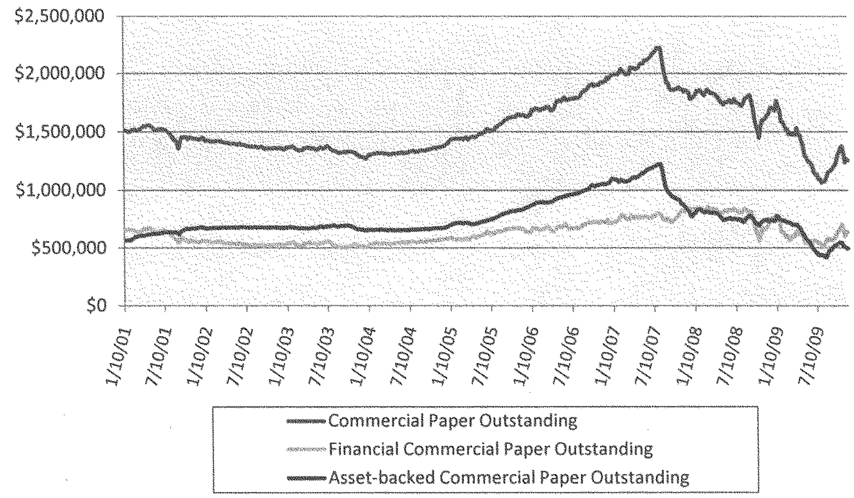


ii. Credit to Businesses

While banks now have a lower short-term cost of capital, putting them in a better position to lend, many borrowers have yet to see a return to pre-crisis levels of credit availability. Commercial paper is a form of debt that companies use to meet various short-term financial obligations, such as meeting their payrolls. Commercial paper outstanding, a rough measure of short-term business debt, is an indicator of the availability of credit for businesses. Since January 2007, total commercial paper outstanding has decreased by almost 37 percent, and it has fallen by more than 20 percent since the enactment of EESA. The value of commercial paper outstanding reached a peak of $2.22 trillion in August 2007, fell to $1.61 trillion by early October 2008, and fell further to $1.24 trillion in November 2009, as Figure 31 indicates. Figure 31 shows that the declines have happened not just in the overall market, but also in its various segments. These declines reflect not only a contraction of available credit to businesses, but also a drop in demand for loans due to poor economic conditions.

[338] SNL Financial, *Historical Yields—Instruments: 3-month LIBOR, 3-month Treasury Bills* (online at www.snl.com/interactivex/dividendyields.aspx?Refreshed=1&YieldViewType=1&Industry=0%2c18%2c3%2c1%2c2%2c8%2c7%2c22%2c10%2c21%2c5%2c4) (accessed Dec. 7, 2009).

FIGURE 31: COMMERCIAL PAPER OUTSTANDING[339]



iii. Housing Sector

The health of the residential real estate market is an important economic indicator, both because of the housing sector's vast size—U.S. households held real estate worth $18.3 trillion in the second quarter of 2009[340]—and because families often have a great deal of their wealth invested in their homes. It is important not to overstate the connection between the TARP and the state of the U.S. housing market. Other government policies aimed at supporting the housing sector, including historically low interest rates, the Federal Reserve's purchases of mortgage-related securities, the enactment of a tax credit for first-time homebuyers, and policies enacted at the Federal Housing Administration and at Fannie Mae and Freddie Mac, which are currently in government conservatorship, have a more direct link to the state of the housing market than the TARP does.

The financial crisis began in the U.S. housing sector, which has seen large nationwide declines in home values. There are two major indices of residential housing prices nationwide: the Federal Housing Finance Agency House Price Index and the S&P/Case-Shiller index. The 2009 data from both indices show signs of housing price stabilization, and prices are currently near their 2004–2005 levels, as Figure 32 shows. However, Treasury recently cautioned that the residential real estate market had not reached a firm bottom.[341]

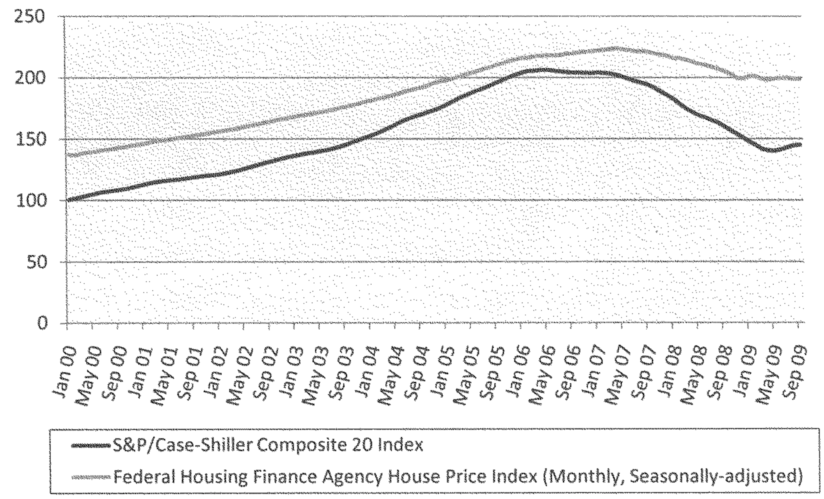
[339] Board of Governors of the Federal Reserve System, *Commercial Paper—Instrument: Commercial Paper, Monthly Outstanding; seasonally adjusted* (online at www.federalreserve.gov/datadownload/Choose.aspx?rel=CP) (accessed Dec. 7, 2009).

[340] *See* Board of Governors of the Federal Reserve System, *B.100 Balance Sheet of Households and Nonprofit Organizations* (Sept. 17, 2009) (online at www.federalreserve.gov/releases/z1/Current/z1r-5.pdf).

[341] Next Phase of Government Financial Stabilization, *supra* note 70, at 12.

To the extent the peak 2006 values were the result of a bubble, a return to those levels is neither desirable nor anticipated. However, the drop in housing prices represents a real loss in wealth to homeowners and investors.

FIGURE 32: CASE SHILLER AND FHFA HOME PRICE INDEXES[342]

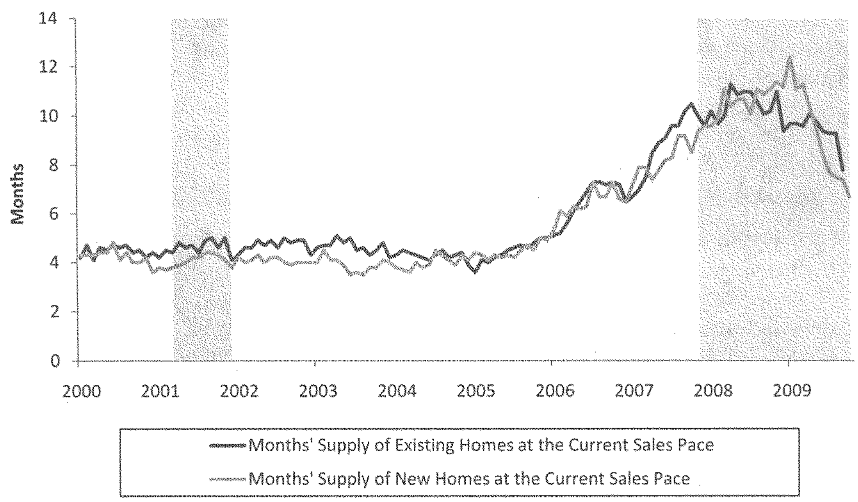


The current inventory of unsold homes offers another indicator of the housing sector's health. Too large an inventory puts downward pressure on prices; a six-month inventory is generally considered healthy. Inventories have been declining in recent months, as Figure 33 shows, the result of declining construction levels and improving sales, although inventory remains well above historic norms. At the end of October 2009, the inventory of unsold homes stood at 3.57 million homes, which constitutes a seven-month supply. This was the first time in more than two years that the inventory of unsold homes fell as low as a seven-month supply.[343]

[342] Standard & Poor's, *S&P/Case-Shiller Home Price Indices—Instrument: Seasonally Adjusted Composite20 Index* (online at www2.standardandpoors.com/spf/pdf/index/SA_CSHomePrice History_102706.xls) (accessed Dec. 7, 2009); Federal Housing Finance Agency, *U.S. and Census Division Monthly Purchase Only Index* (Instrument: USA, Seasonally Adjusted) (online at www.fhfa.gov/Default.aspx?Page=87) (accessed Dec. 7, 2009). Most recent data available for both measures are from September 2009.

[343] National Association of Realtors, *Existing-Home Sales Record Another Big Gain, Inventories Continue to Shrink* (Nov. 23, 2009) (online at http://www.realtor.org/press_room/news_releases/2009 /11/record_big).

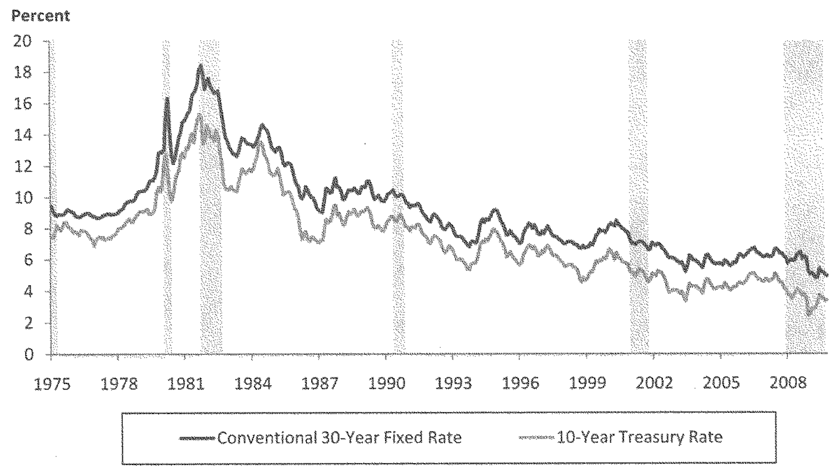
FIGURE 33: HOUSING INVENTORY [344]



Mortgage interest rates are yet another indicator of the housing market's current state. Low rates make home purchases more affordable, and they allow homeowners to refinance their mortgages on favorable terms. Completely apart from the TARP, the federal government has undertaken various efforts aimed at keeping mortgage rates low. These actions include the Federal Reserve's decision to hold large volumes mortgage backed securities on its balance sheet and the government's decision to serve as a backstop for Fannie Mae and Freddie Mac. As Figure 34 shows, rates for 30-year conventional mortgages rose somewhat earlier this year, but are currently back to near historically low levels.

[344] National Association of Realtors, *Housing Inventory Data*. Information provided in response to Panel request. Shaded areas represent periods of recession.

FIGURE 34: MORTGAGE RATES [345]



Finally, as Figure 35 shows, home sales, of both new and existing homes, are beginning to recover, although new home sales remain well below historic averages.

FIGURE 35: NEW AND EXISTING HOME SALES [346]

[345] Board of Governors of the Federal Reserve System, *Selected Interest Rates—Instruments: Contract Rate on 30-Year Fixed Rate Conventional Home Mortgage, Market Yield on U.S. Treasury Securities at 10-Year Constant Maturity* (online at www.federalreserve.gov/datadownload/Choose.aspx?rel=H.15) (accessed Dec. 7, 2009). Shaded areas represent periods of recession.

[346] National Association of Realtors, *New and Existing Home Sales.* Information provided in response to Panel request. Shaded areas represent periods of recession.

While not directly tied to the TARP and its foreclosure mitigation programs, there is a relationship between foreclosures and key housing indicators. Foreclosures, especially on the scale of the 8 to 13 million projected over the next five years, can directly affect home prices and inventory. Foreclosures increase inventory by flooding the market with bank-owned properties and drive down home prices by an average of $7,200 per home.[347]

iv. Commercial Real Estate

The commercial real estate (CRE) sector is also an important indicator of economic health. Unfortunately, like the residential real estate sector, the CRE sector is faring poorly.

The Federal Reserve estimates that approximately $3.5 trillion of CRE debt is currently outstanding, and that nearly $500 billion of CRE loans will mature during each of the next few years.[348] For various reasons, however, commercial property values have declined sharply since 2007 and continue to fall.[349] Meanwhile, banks have become increasingly hesitant to extend new CRE credit or refinance existing debt,[350] while another major source of CRE financing—the market for commercial mortgage-backed securities—has largely shut down since the financial crisis began.[351] Given these trends, as well as high vacancy rates and weak rent growth, Deutsche Bank estimates that banks' aggregate losses on recent-vintage core CRE, construction, and multi-family loans could fall within the $200 billion to $300 billion range, with the biggest losses involving construction loans.[352]

As Figure 36 illustrates, smaller banks are disproportionately exposed to the CRE threat.

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[347] Center for Responsible Lending, *Soaring Spillover: Accelerating Foreclosures to Cost Neighbors $502 Billion in 2009 Alone; 69.5 Million Homes Lose $7,200 on Average* (May 7, 2009) (online at www.responsiblelending.org/mortgage-lending/research-analysis/soaring-spillover-3-09.pdf).

[348] *See* House Oversight and Government Reform, Subcommittee on Domestic Policy, Written Testimony of Jon D. Greenlee, Associate Director of the Division of Banking Supervision and Regulation for the Federal Reserve Board, *Residential and Commercial Real Estate* (Nov. 2, 2009) (online at federalreserve.gov/newsevents/testimony/greenlee20091102a.htm) (hereinafter "Residential and Commercial Real Estate").

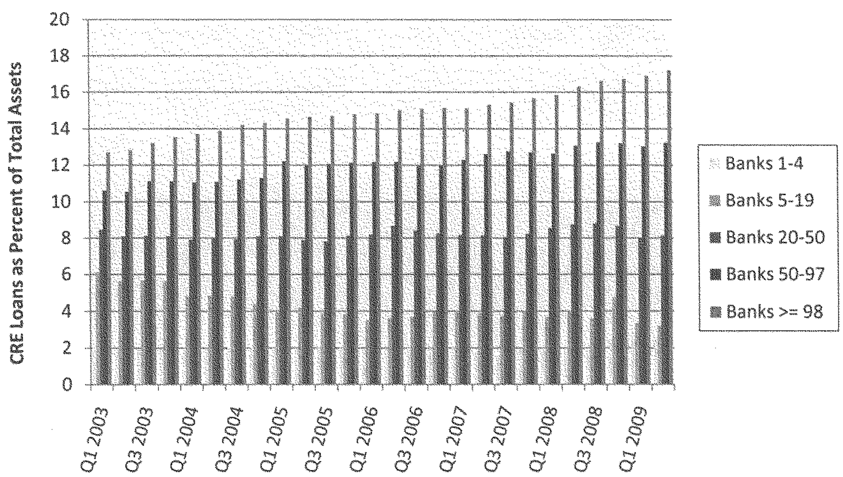
[349] *See* Deutsche Bank, *The Future Refinancing Crisis in Commercial Real Estate,* at 3 (Apr. 23, 2009) (online at cop.senate.gov/documents/report-042309-parkus.pdf) ("Purely as a result of the enormous changes in the available financing terms . . . , we estimate that commercial real estate prices have declined 25–30% from their 2007 peak. On top of this, the impact of the worst economic recession in decades on property cash flows will likely push them down [an] additional 15–20% . . .").

[350] *See* Congressional Oversight Panel, Written Testimony of Jeffrey DeBoer, Chief Executive Officer of the Real Estate Roundtable, *Congressional Oversight Panel Field Hearing in New York City on Corporate and Commercial Real Estate Lending,* at 2 (May 28, 2009) (online at cop.senate.gov/documents/testimony-052809-deboer.pdf).

[351] *See* Residential and Commercial Real Estate, *supra* note 348 ("The current fundamental weakness in CRE markets is exacerbated by the fact that the CMBS market, which previously had financed about 30 percent of originations and completed construction projects, has remained closed since the start of the crisis").

[352] Deutsche Bank, *Q4 2009 CRE Outlook: Searching for a Bottom* (Dec. 1, 2009); *see also* Goldman Sachs, *U.S. Commercial Real Estate Take III: Re-constructing Estimates for Losses, Timing,* at 11–13 (Sept. 29, 2009) (hereinafter "2009 CRE Outlook") (estimating $287 billion in losses from core CRE and construction loans); Congressional Oversight Panel, *August Oversight Report: The Continued Risk of Troubled Assets,* at 56 (Aug. 11, 2009) (noting that "the Panel's model of whole loan losses estimates potential core CRE and construction loan losses through 2010 of $81.1 billion at 701 banks with assets between $600 million and $80 billion").

FIGURE 36: BANK EXPOSURE TO CORE CRE LOANS [353]



D. Expert Commentary on the TARP

To date, only a handful of studies have attempted to evaluate, in a comprehensive way, the effectiveness of the TARP. Thus, in October 2009, the Panel solicited the views of a broad range of economists and other academics. A number responded to the Panel's solicitations. In addition, on November 19, 2009, the Panel held a hearing to solicit expert views on the strengths and weaknesses of the TARP. That hearing—titled "Taking Stock: Independent Views on TARP's Effectiveness"—featured testimony from a distinguished group of economists.[354]

[353] 2009 CRE Outlook, *supra* note 352. The "Banks 1–4" group includes banks with total assets between $1.28 trillion and $2.25 trillion; the "Banks 5–19" group includes banks with total assets between $130 billion and $890 billion; the "Banks 20–50" group includes banks with total assets between $25 billion and $130 billion; the "Banks 50–97" group includes banks with total assets between $10 billion and $25 billion; and the "Banks >=98" group includes banks with total assets less than $10 billion. "Core" CRE does not include construction, multi-family, or farm loans. *See* June Oversight Report, *supra* note 77.

[354] Testifying before the Panel were Dean Baker, Co-Director of the Center for Economic and Policy Research; Charles Calomiris, Henry Kaufman Professor of Financial Institutions at the Columbia Business School; Simon Johnson, Professor of Global Economics and Management at the MIT Sloan School of Management and Senior Fellow at the Peterson Institute for International Economics; Alex Pollock, Resident Fellow at the American Enterprise Institute; and Mark Zandi, Chief Economist and Co-Founder of Moody's Economy.com. Written testimony and a video of the hearing are available on the Panel's website (cop.senate.gov). An official transcript of the hearing will be available online in January 2010.

Several themes run throughout this body of commentary. Most generally, commentators tend to agree that some sort of government intervention was necessary to stabilize the financial system, and that the TARP has contributed materially to that project, at least in the short term.[355] As evidence, these commentators point primarily to the easing of panic in the financial sector, as well as various indicators of financial health—such as credit spreads, CDS spreads for financial firms, and stock prices of financial firms—which have improved demonstrably since the TARP's inception.[356]

In a different but related vein, Professors Pietro Veronesi and Luigi Zingales argue that Treasury's capital injections program—likely the most well-known aspect of the TARP—was both effective and (relatively) efficient.[357] In one of the few in-depth studies on the topic, Professors Veronesi and Zingales examine the combined impact of Treasury's purchase of $125 billion in equity in the ten largest banks and the FDIC's provision of a three-year guarantee of these banks' new debt issuances—*i.e.,* the "first" bailout (or the "Revised Paulson Plan"). After factoring in costs to the taxpayers, they conclude that this action generated $71 to $89 billion in total economic value (accounting for a 30 percent deadweight taxation cost).[358] They further conclude that the Revised Paulson Plan was the most cost effective of the three plans seriously considered by the Bush Administration.[359] Nevertheless, they argue that an even more cost-effective method was never considered: namely, enacting legislation to permit failing firms to enter special, pre-packaged bankruptcies (*i.e.,* with terms set by the government) wherein those firms' long-term debt would be converted into equity and current equity holders would be wiped out unless they chose to exercise a statutory option to purchase existing long-term debt at face value.[360]

Those who acknowledge that TARP was necessary and reasonably effective recognize nevertheless that improvements in key financial and economic indicators cannot be attributed solely to the TARP. Obviously, it remains difficult to disentangle the effects of Treasury's efforts under the TARP from the effects of the govern-

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[355] *See, e.g.,* Congressional Oversight Panel, Written Testimony of Columbia Business school Henry Kaufman Professor of Financial Institutions Charles Calomiris, *Taking Stock: Independent Views on TARP's Effectiveness,* at 4 (Nov. 19, 2009) (online at cop.senate.gov/documents/testimony-111909-calomiris.pdf) (hereinafter "Calomiris COP Testimony") ("In my view, there is no question that the recent crisis qualified as a state of the world in which government assistance to financial institutions was warranted"); Johnson COP Testimony, *supra* note 333, at 1 ("There is no question that passing the TARP was the right thing to do"); Zandi COP Testimony, *supra* note 217, at 1 ("The Troubled Asset Relief Program has contributed significantly to restoring stability to the financial system. In turn, this financial stability has been instrumental to ending the Great Recession"); *see also* COP November Hearing Transcript, *supra* note 218 (Testimony of Simon Johnson) ("[I]f the Congress had not passed TARP, you would have had a much bigger disaster, irrespective of how the money had been used").

These views generally accord with the views of international institutions that have reviewed the TARP. *See* International Monetary Fund, *World Economic Outlook: Sustaining the Recovery,* at 67–71 (Oct. 2009) (online at imf.org/external/pubs/ft/weo/2009/02/pdf/text.pdf); Fabio Panetta et al., *An Assessment of Financial Sector Rescue Programmes,* at 2–3 (July 2009) (online at bis.org/publ/bppdf/bispap48.pdf).

[356] *See, e.g.,* Takeo Hoshi, Letter to Panel Staff, at 1 (Nov. 8, 2009).

[357] *See* Pietro Veronesi & Luigi Zingales, *Paulson's Gift, NBER Working Paper*, at 5 (Oct. 2009) (online at faculty.chicagobooth.edu/brian.barry/igm/P__gift.pdf) (hereinafter "Paulson's Gift"). For a different but related analysis, *see* Dinara Bayazitova & Anil Shivdasani, *Assessing TARP* (University of North Carolina Kenan-Flagler Business School Working Paper) (Aug. 25, 2009) (online at papers.ssrn.com/sol3/papers.cfm?abstract__id=1461884).

[358] *See* Paulson's Gift, *supra* note 357, at 3.

[359] *See* Paulson's Gift, *supra* note 357, at 32–36.

[360] *See* Paulson's Gift, *supra* note 357, at 36.

ment's other financial stability programs, including programs run by the FDIC and the Federal Reserve. It is also difficult to isolate the effects of the TARP—both on the financial sector and on the broader economy—from the effects of increasing public confidence and other macroeconomic factors.[361] In general, however, most commentators seem to accept the proposition that the TARP has played a substantial role in calming and stabilizing the financial system.[362]

Commentators also agree, however, that the TARP has suffered from serious flaws, both in its design and its execution. Though there are as many criticisms of the TARP as there are TARP commentators, these complaints fall into three main categories. First, some commentators argue that the TARP has been implemented in an ad hoc, opaque fashion, and that this lack of consistency and transparency has undermined its effectiveness. Second, most agree that the TARP has failed to address many of the underlying issues plaguing the financial sector, including thin bank capitalization, risky bank activity, and toxic assets on banks' balance sheets. Third, many agree that the TARP has failed to address the so-called "too big to fail" problem and its related moral hazards.

1. Consistency and Transparency

One of the most common criticisms of the TARP is that it has been implemented in an ad hoc fashion that lacks consistency and transparency.[363] Transparency problems plagued the program from the beginning according to November hearing witness Dean Baker, co-director of the Center of Economic and Policy Research. He argues that the TARP was articulated to the public largely as a means to restart the commercial paper markets, stem foreclosures, rein in executive compensation, and stimulate lending to small businesses. Unfortunately, in his view, the TARP has failed to achieve or even seriously pursue any of these goals.[364] Thus, Dr. Baker argues that public confidence in the TARP and the government's other stabilization efforts has been undermined.[365]

A different but related criticism is leveled by November hearing witness Charles Calomiris, Henry Kaufman Professor of Financial Institutions at Columbia Business School. He maintains that Treasury has never clearly and comprehensively articulated goals and principles to guide its TARP activities. Rather, it has employed "*ad hoc* interventions, justified as they go along, which are inconsistent with one another and follow no clear set of discernible principles."[366] As a result, he argues, the implementation of the program has been and will continue to be susceptible to "errors of logic" and behind-the-scenes political dealmaking which tends to

[361] A lack of certainty as to how much credit the TARP deserves for stabilizing the financial system constitutes yet another important theme in the expert commentary. *See, e.g.,* Baker COP Testimony, *supra* note 28, at 1 ("There are many factors that make it difficult to assess the effectiveness of the TARP, [the] most important one being the fact that the TARP was carried through in conjunction with rescue efforts by the [FDIC] and the Federal Reserve Board"); Roy C. Smith, Letter to Panel Staff, at 1 (Oct. 23, 2009).

[362] *See, e.g.,* Martin Neil Baily and Douglas J. Elliott, Letter to Panel Staff, at 2 (Nov. 9, 2009); William Poole, Letter to Panel Staff, at 1 (Oct. 23, 2009).

[363] *See, e.g.,* Lawrence White, Letter to Panel Staff, at 1 (Nov. 20, 2009).

[364] *See* COP November Hearing Transcript, *supra* note 218.

[365] *See* COP November Hearing Transcript, *supra* note 218.

[366] Calomiris COP Testimony, *supra* note 355, at 16.

benefit well-connected but not necessarily deserving entities.[367] November hearing witness Simon Johnson, Professor of Global Economics and Management at MIT Sloan School of Management and senior fellow at the Peterson Institute for International Economics, makes a similar point. He criticizes what he views as the TARP's "prominent place of policy by deal." All too often, he argues, "when a major financial institution [ ] got into trouble, the Treasury Department and the Federal Reserve would engineer a bailout over the weekend and announce that everything was fine on Monday." [368]

November hearing witness Alex Pollock, resident fellow at the American Enterprise Institute, also takes issue with the lack of clarity surrounding the TARP's objectives and priorities, and agrees with Professor Calomiris that the program's lack of transparency has made it unacceptably susceptible to political considerations. In his view, the "principal goal [of TARP managers] should be to run the program in a businesslike manner to return as much of the involuntary investment as possible to its owners, along with a reasonable overall profit." [369] He therefore argues that "TARP should have full, regular, audited financial statements, which depict its financial status and results, exactly as if it were a corporation." [370] According to Mr. Pollock, it would have been far better for transparency and accountability purposes if the TARP had been organized as a separate corporation, rather than within an existing agency.[371]

2. Underlying Issues

Some experts also argue that the TARP, while achieving a measure of short-term stability, has failed to address certain underlying issues that may wreak havoc on the financial sector and the broader economy in the not-too-distant future.

For example, the CPP and the stress tests are commonly credited with reviving private capital sources for capitalizing American banks and making banks better prepared to weather future financial shocks—in other words, with "stabilizing" the financial sector.[372] At the Panel's November hearing, however, it became clear that there is some disagreement as to whether even the largest banks are in fact adequately capitalized and hence sufficiently stable.[373] Much of this disagreement, it seems, stems from (1) com-

[367] Calomiris COP Testimony, *supra* note 355, at 16–17 ("Because assistance programs did not flow from previously articulated guiding principles . . ., the rushed debates over TARP and other policies were undisciplined and prone to errors of logic (like the use of warrants in preferred stock assistance), and political manipulation (like the multiple bailouts of GMAC)").

[368] Johnson COP Testimony, *supra* note 333, at 6. Professor Johnson also takes both the Bush and the Obama administrations to task for providing aid in ways that are difficult for taxpayers to understand. *See id*. at 7 ("As the crisis deepened and financial institutions needed more assistance, the government got more and more creative in figuring out ways to provide subsidies that were too complex for the general public to understand").

[369] *See* Congressional Oversight Panel, Written Testimony of American Enterprise Institute Resident Fellow Alex J. Pollock, *Taking Stock: Independent Views on TARP's Effectiveness*, at 3 (Nov. 19, 2009) (online at aei.org/docLib/Pollock-Testimony–11192009.pdf) (hereinafter "Pollock COP Testimony").

[370] Pollock COP Testimony, *supra* note 369, at 4.

[371] *See* Pollock COP Testimony, *supra* note 369, at 3.

[372] *See, e.g.*, COP November Hearing Transcript, *supra* note 218 (Testimony of Mark Zandi) (arguing that banks generally have enough capital to weather greater-than-projected losses on their portfolios, including the toxic assets they continue to hold).

[373] *See* COP November Hearing Transcript, *supra* note 218 (Testimony of Dean Baker), at 1 ("So, I'd be a little less confident [that the banks are sufficiently capitalized]. And not to say

mentators' differing economic projections, and (2) the difficulty of evaluating precisely banks' capital positions.[374]

Toxic assets are a related point of concern. Commentators agree that Treasury's PPIP, which was designed to leverage private funds to purchase such assets, has not been effective at removing these assets from banks' balance sheets.[375] This is a significant issue that the Panel addressed in its August report and that poses lingering challenges to economic recovery and restoring the banking system to a healthy state.

In addition, some commentators fear that small- and medium-sized banks are particularly susceptible to future shocks, notwithstanding the fact that many have received TARP aid.[376] These banks tend to be disproportionately exposed to commercial real estate loans—loans which are widely expected to suffer heavy losses in the coming years.[377] Indeed, several small- and medium-sized banks have already failed as a result of their commercial real estate exposure, and many more are expected to fail for similar reasons.[378] Such failures threaten to further impede a broad economic recovery.

Commentators have also expressed concerns about whether the TARP has stimulated lending to businesses and consumers—a central justification for using TARP funds for capital infusions. For example, according to Paul Volcker, former chairman of the Board of Governors of the Federal Reserve System, it remains unclear whether the TARP has had a "significant and positive impact" on the provision of credit to businesses and consumers.[379] Joseph Stiglitz argues that "one of the key promised benefits of the TARP—restarting lending—has not materialized," meaning that the "hoped for benefits for the 'real economy' have not materialized."[380] Indeed, some economists argue that TARP-recipient banks have not only withdrawn credit from the marketplace, "but they are doing so at an accelerating rate."[381] Some experts point to TARP-related causes for these phenomena, including Treasury's de-

that they're all going to collapse, but I'm less confident about their soundness, going forward"); COP November Hearing Transcript, *supra* note 218 (Testimony of Simon Johnson) ("So, yes, we have a thinly capitalized banking system, as I said, relative to the—relative to the trajectory of the economy. That's the way I would put it—relative to what I'd see as the real risk scenario"); *see also* James K. Galbraith, Letter to Panel Staff, at 1 (Nov. 8, 2009) (hereinafter "Galbraith Letter to Panel Staff") ("The Treasury has not demonstrated that the purchase of preferred shares in the banking system helped to restore stability. Those purchases were addressed to a question of solvency that they could not, given the vast overhang of toxic assets, have fully resolved").

[374] For a discussion of the difficulties inherent in evaluating banks' capital positions, see August Oversight Report, *supra* note 100, at 18–37, 62.

[375] *See, e.g.*, Zandi COP Testimony, *supra* note 217, at 4–5.

[376] *See, e.g.*, COP November Hearing Transcript, *supra* note 218 (Testimony of Mark Zandi) ("I think that . . . many smaller bank institutions will fail, in large part because of their bad lending—in large part related to the bad . . . commercial real estate lending, which is still being played out").

[377] *See* Goldman Sachs, *U.S. Commercial Real Estate Take III: Re-constructing Estimates for Losses, Timing*, at 11–13 (Sept. 29, 2009).

[378] *See, e.g.*, Office of Inspector General, Federal Deposit Insurance Corporation, *Material Loss Review of Haven Trust Bank, Duluth, Georgia*, at 9 (August 2009) (online at www.fdicoig.gov/reports09/09–017.pdf); *see also* Office of Inspector General, Federal Reserve Board of Governors, *Material Loss Review of County Bank* (September 2009) (online at www.federalreserve.gov/oig/files/County__Bank__MLR__20090909.pdf).

[379] Paul A. Volcker, Letter to Panel Staff, at 1 (Nov. 6, 2009).

[380] *See* Joseph E. Stiglitz, Letter to Panel Staff, at 4 (Nov. 17, 2009); *see also* Richard Christopher Whalen, Letter to Panel Staff, at 1 (Nov. 9, 2009) (arguing that "there has been little positive impact on the real economy as a result of the TARP").

[381] Richard Christopher Whalen, Letter to Panel Staff, at 1 (Nov. 9, 2009).

cision to accept preferred stock rather than common stock or other assets in exchange for TARP funds,[382] Treasury's failure to require banks receiving TARP funds to use those funds for lending,[383] and Treasury's failure to direct a sufficient amount of TARP funds to those parts of the financial sector (e.g., community banks) that are heavily involved in lending to small- and mid-sized businesses.[384] Others identify non-TARP-related factors such as decreased demand for credit and banks' concerns about potential changes to accounting rules.[385] According to November hearing witness Dr. Baker, the current tightening of credit for businesses

> [I]s typical of a recession. The complaints from business owners over being denied credit are not qualitatively different than the complaints that were made in [the] 1990–91 recession. Lenders will also tighten credit to business during a downturn simply because otherwise healthy businesses are much risk[ier] prospects during a recession. There is no reason to believe that the tightening of credit during this downturn is any greater than what should be expected given the severity of the recession.[386]

Finally, the government's efforts to address the foreclosure crisis have drawn little praise. As discussed above, for many reasons those efforts may not help as many homeowners as originally projected. Meanwhile, as James Galbraith has observed, the "underlying financial conditions of the household sector"—including new home sales, new home construction, underwater mortgages and mortgage delinquency rates—"remain very grim" despite Treasury's efforts.[387] Foreclosures have continued at a rate of nearly two million per year since the TARP was passed, and various projections show that this pace is likely to continue through 2011 at least.[388]

3. Moral Hazard

Much has been said about the costs of the TARP. Generally, these discussions focus on a relatively narrow question: whether taxpayers will be paid back for their TARP investments.[389] No

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[382] *See* Linus Wilson & Yan Wendy Wu, *Common (Stock) Sense About Risk-Shifting and Bank Bailouts,* at 2 (Working Paper) (Nov. 30, 2009) (online at papers.ssrn.com/sol3/papers.cfm?abstract_id=1321666) (arguing that "[b]uying up common (preferred) stock is always the most (least) *ex ante-* and *ex post*-efficient type of capital infusion, whether or not the bank volunteers for the recapitalization").

[383] *See* Joseph E. Stiglitz, Letter to Panel Staff, at 3 (Nov. 17, 2009) ("As a major 'owner' of the banks, the government could and should have used its potential control to increase lending, to reduce abusive practices, and to direct lending to those activities most likely to energize the economy.")

[384] *See* Joseph E. Stiglitz, Letter to Panel Staff, at 2 (Nov. 17, 2009).

[385] *See infra* at page 99.

[386] Baker COP Testimony, supra note 28, at 4–5. Dr. Baker also notes that large corporations are having little difficulty issuing commercial paper and long-term bonds, and that homebuyers are not facing any unusual difficulty in securing loans. *See* Baker COP Testimony, *supra* note 28, at 4.

[387] Galbraith Letter to Panel Staff, *supra* note 373, at 1.

[388] *See* Dean Baker, Letter to Panel Staff, at 2 (Nov. 5, 2009).

[389] Few believe that the taxpayers will be paid back in full for all of their TARP investments. For example, November hearing witness Mark Zandi, chief economist and co-founder of Moody's Economy.com, estimates that "the ultimate cost to taxpayers of TARP is expected to be between $100 and $150 billion." Under Dr. Zandi's projections,

> [t]he most[] costly aspect of TARP will be the aid to the motor vehicle industry, which could total up to nearly $50 billion. AIG will cost taxpayers up to $35 billion. Support to the housing market is expected to cost as much as $30 billion. The CPP program is ultimately expected to cost between $15 and $20 billion, while credit losses on the TALF and PPIP programs are expected to reach $10 billion. Some $5 billion will be lost on the small business lending program.

doubt this is an important question. According to some commentators, however, these more quantifiable costs pale in comparison to the so-called "moral hazard" costs of the TARP. These commentators reason as follows. By enacting the TARP, Congress made a conscious decision to intervene in the market. One consequence of this decision was to stabilize the financial sector. Another consequence, however, was to signal to the market that, going forward, the government may step in to provide bailouts to certain systemically significant institutions—such as financial institutions and auto manufacturers—should they face the risk of failure.[390] As a result, the market has been distorted in a way that could, absent responses outside of the TARP, plague the financial sector and the broader economy for the foreseeable future.[391]

E. Accomplishments and Shortcomings: How Well Has the TARP Done in Meeting its Statutory Objectives?

1. TARP's Contribution to Financial Stabilization and Economic Recovery

As noted in the overview, the primary objective of the Congress in passing EESA was to "restore liquidity and stability to the U.S. financial system."[392] EESA further calls for the authority it provides to be used to "promote jobs and economic growth."[393] Similarly, Treasury officials stated that in implementing the TARP they were seeking to "protect the U.S. economy"[394] and "the taxpayer,"[395] "prevent systemic risk,"[396] and "stabilize the financial

Zandi COP Testimony, *supra* note 217, at 3.

[390] *See, e.g.,* James K. Galbraith, Letter to Panel Staff, at 2 (Nov. 8, 2009) ("Having once intervened decisively, the rules of the game are now changed, and participants will expect renewed intervention, as necessary, along similar lines").

[391] *See, e.g.,* Calomiris COP Testimony, *supra* note 355, at 3 ("If financial institutions know that the government is there to share losses, risk-taking becomes a one-sided bet, and so more risk is preferred to less. There is substantial evidence from financial history—including the behavior of troubled financial institutions during the current crisis itself—that this 'moral hazard' problem can give rise to huge loss-making, high-risk investments that are both socially wasteful and an unfair burden on taxpayers"); Johnson COP Testimony, *supra* note 333, at 3 (arguing that the manner in which the TARP was implemented "exacerbated the perception (and the reality) that some financial institutions are 'Too Big to Fail'"—thereby lowering the borrowing costs for such firms, incentivizing them to act in risky ways, and leaving the United States vulnerable to similar financial crises in the future); *see also* Edward Kane, *Safety-Net Subsidies Keep "Toxic" Assets Illiquid,* at 2 (March 10, 2009).

[392] 12 U.S.C. § 5201; 12 U.S.C. § 5223.

[393] 12 U.S.C. § 5201.

[394] *See* U.S. Department of the Treasury, *U.S. Government Actions to Strengthen Market Stability* (Oct. 14, 2008) (online at www.treas.gov/press/releases/hp1209.htm) (stating "Today we are taking decisive actions to protect the U.S. economy . . .").

[395] *See* House Committee on Financial Services, Written Testimony by Treasury Secretary Henry M. Paulson Jr., *Oversight of Implementation of the Emergency Economic Stabilization Act of 2008 and of Government Lending and Insurance Facilities; Impact on Economy and Credit Availability*, 110th Cong., at 30 (Nov. 18. 2008) (online at www.financialstability.gov/latest/hp1279.html) ("It is my responsibility to use the authorities Congress provided to protect and strengthen the financial system, and in so doing, protect the taxpayer"); U.S. Department of the Treasury, *Interim Assistant Secretary for Financial Stability Neel Kashkari Update on the TARP Program* (Dec. 8, 2008) (online at www.treas.gov/press/releases/hp1321.htm) (hereinafter "Assistant Secretary Kashkari Update on TARP") (stating Treasury "acted with the following critical objectives in mind . . . to protect taxpayers").

[396] *See* U.S. Department of the Treasury, *Remarks by Secretary Henry M. Paulson, Jr. on Financial Rescue Package and Economic Update* (Nov. 21, 2008) (online at www.financialstability.gov/latest/hp1265.html) (hereinafter "Remarks by Secretary Paulson on Financial Rescue Package") ("I believe we have taken the necessary steps to prevent a broad systemic event"); *see also* Assistant Secretary Kashkari Update on TARP, *supra* note 395.

system."[397] Treasury also said it would focus on bank lending to restore economic growth.[398]

There is little doubt that—as virtually all of the experts the Panel consulted agree—the TARP played an important role, along with other emergency programs from the Federal Reserve and the FDIC, in stabilizing the financial system. Following the failure of Lehman Brothers and the government's rescue of AIG in September 2008, government officials decided that a crisis of such magnitude could not be contained through the use of monetary policy alone, and that a fiscal response was therefore imperative.[399] The TARP became the government's fiscal response. And the initial TARP programs, which were aimed at shoring up the capital base of financial institutions, did have a positive impact on market confidence. Shortly after the law that established the TARP was enacted, measures of risk in the banking sector began to decline. Between October 10, 2008 and mid-November 2008, interest-rate spreads that reflect the willingness of banks to lend to each other fell by more than 50 percent. These spreads remained highly volatile in late 2008, but on balance they have continued to fall, and are currently back in the low range where they were prior to the financial crisis.[400]

Treasury believes that the capital provided through the CPP has been "essential in stabilizing the financial system, enabling banks to absorb losses from bad assets while continuing to lend to consumers and businesses."[401] In his testimony to the Panel, Assistant Secretary Allison also pointed to capital raising as a sign of stabilization of the financial sector: "banks of all sizes have raised over $80 billion in common equity and $40 billion in non-guaranteed debt."[402] This would appear to reflect renewed confidence in the U.S. banking system and its ultimate solvency and profitability, although there is the lingering question of the degree to which investors now assume that the federal government has become the implicit guarantor of the largest American banks.

The role of the TARP in preventing an even worse economic recession is not as clear. The Federal Reserve relaxed monetary policy very rapidly beginning in September 2007 once the contraction in the housing sector began. From a macroeconomic perspective, the federal government's massive deficit spending—only a portion of which is attributable to the TARP—has undoubtedly played an important role in fostering economic recovery as well. Support for the housing sector through the Federal Housing Administration,

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[397] *See* Remarks by Secretary Paulson on Financial Rescue Package, *supra* note 396 ("We must continue to reinforce the stability of the financial system"); Assistant Secretary Kashkari Update on TARP, *supra* note 395.

[398] *See* Assistant Secretary Kashkari Update on TARP, *supra* note 395 ("Treasury expects banks to increase their lending as a result of [TARP] investments").

[399] *See* James B. Stewart, *Eight Days: The Battle to Save the American Financial System*, New Yorker (Sept. 21, 2009) (available for purchase online at www.newyorker.com/reporting/2009/09/21/090921fa_fact_stewart).

[400] 3 Mo LIBOR-OIS Spread, *supra* note 27; Bloomberg, *TED Spread* (online at www.bloomberg.com/apps/cbuilder?ticker1=.TEDSP%3AIND) (accessed Dec. 7, 2009). It should be noted, however, that there is still a significant lack of liquidity and wide spreads in some markets where the Federal Reserve is the dominant participant.

[401] Congressional Oversight Panel, Written Testimony of Assistant Secretary of the Treasury for Financial Stability Herbert M. Allison, Jr., *Congressional Oversight Panel Hearing with Assistant Treasury Secretary Herbert M. Allison, Jr.* (Oct. 22, 2009) (online at cop.senate.gov/documents/testimony-102209-allison.pdf) (hereinafter "Allison COP Testimony").

[402] Allison COP Testimony, *supra* note 401.

Fannie Mae, and Freddie Mac, as well as the Federal Reserve, also constitute an important element in stabilizing the economy.

Except for the smaller institutions participating in its small business lending initiative, Treasury's bank capitalization efforts are now over. The question going forward is whether banks are currently adequately capitalized and will begin to expand their lending. This, in turn, is partly a function of the condition of bank balance sheets and the lingering issue of the toxic assets whose presence was the justification for creation of the TARP in the first place.

The PPIP, Treasury's main TARP initiative for removing toxic assets from bank balance sheets, remains difficult to assess. This program has only recently become operational. Treasury argues that the mere announcement of the program in March helped to reassure investors, and as a result, prices increased for certain mortgage-related securities.[403] Treasury further argues that because banks are now better positioned to raise private capital, even if they still own toxic assets, the purchase program is less important today than it was when it was announced.[404] However, the Panel is concerned that as long as the value of these securities remains unknown to investors, they will continue to weigh down the banks and be an impediment to economic recovery.

The Panel is also concerned about the health of small banks, which will be helped less by PPIP as it is currently implemented than large banks will, because small banks generally hold whole loans rather than securities.[405] Those concerns are heightened by the deteriorating commercial real estate market, another area where smaller banks are heavily exposed. PPIP's success or failure will rest on whether it creates genuine price discovery that would have been absent otherwise, and whether it provides a return on the public's investment.

As discussed in Part C above, Treasury has recently turned the focus of its capital injection programs to small banks and the promotion of small business lending. Some of this has happened naturally, as larger banks have redeemed their CPP preferred, and Treasury reopened CPP for small banks, thereby "reduc[ing] the size of the Treasury's investments in the banking system . . . shifting the mix of remaining CPP investments significantly toward small and community banks."[406]

However, as noted earlier in the report, there remains disagreement on whether banks have adequate capital, notwithstanding both the TARP capital they still have on their balance sheets and their ability in many cases to acquire new capital from private investors. The stress tests have helped to bring some clarity here and the disclosure of their results appears to have helped restore investors' confidence in those large institutions tested. But the high and rising level of unemployment continues to raise some concern about the adequacy of the stress tests. As we have seen, banks currently enjoy a low interest rate, steep yield curve environment, due to the

[403] Allison COP Testimony, *supra* note 401, at 3–4.
[404] Treasury conversations with Panel staff (Nov. 4, 2009).
[405] *See* August Oversight Report, *supra* note 100, at 4.
[406] Allison COP Testimony, *supra* note 401. The CPP expansion for small banks opened in May 2009. The deadline for applications was November 21, 2009. FAQs on CPP for Small Banks, *supra* note 69.

actions of the Federal Reserve to increase and maintain liquidity in the financial system. Yet there remain questions about the quality of certain assets on bank balance sheets, particularly those related to residential and commercial real estate. Further declines in house prices nationwide, for example, could bring on renewed concerns about the quality of the assets at major TARP assisted banks and raise concerns about the continuing need for the TARP to bolster bank capital positions. Likewise, the low interest rate, steep yield curve environment is bolstering bank profitability in the short run but may not last, bringing renewed concern about capital strengthening.

Treasury has said that it realizes that increasing the availability of credit to small businesses poses a complex challenge, one that is intertwined with the issues of commercial real estate and the economy as a whole. A recent survey found that 14 percent of small business owners found it more difficult to get loans, compared to three months earlier.[407] Availability of credit was not the only factor contributing to this. Although 30 percent of those surveyed found that their borrowing was down, much of this could be due to a decline in the credit quality of borrowers, caused by the recession and declines in real estate values.[408] A significant proportion of small business lending depends on real estate as collateral; therefore, a decline in real estate values will harm borrowers' ability to get credit.[409]

TARP funds have also been used as part of the TALF effort to kick-start the markets for various types of securities, including those based on auto loans, credit card payments, and commercial mortgages, but their impact is difficult to assess. Since this program's inception, issuance of the types of securities that are eligible for the program has risen dramatically, both with and without government backing, but these markets have not returned to their precrisis levels and a number of factors other than TALF may account for much of this recovery.

Continuing problems, and possible upcoming shocks, in the commercial real estate market have also contributed to a contraction in small business lending.[410] Smaller banks, which provide a larger proportion of small business lending, also hold larger proportions of commercial real estate loans.[411] With high levels of commercial real estate assets on their balance sheets, they have less capacity to engage in new and renewed lending. Treasury plans to use its new small business lending program to provide banks that are oth-

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[407] National Federation of Independent Business, *NFIB Small Business Economic Trends,* at 2, 12 (Oct. 2009) (online at www.nfib.com/Portals/0/PDF/sbet/SBET200910.pdf) (hereinafter "NFIB Small Business Economic Trends").

[408] *See* NFIB Small Business Economic Trends, *supra* note 407, at 2 ("In addition, the continued poor earnings and sales performance has weakened the credit worthiness of many potential borrowers"). It should be noted that only slightly more than 300 small and community banks out of roughly 7,400 such institutions have participated in CPP.

[409] Treasury conversations with Panel staff (Nov. 4, 2009).

[410] *See, e.g.,* Federal Reserve Bank of Atlanta, *Speech by Federal Reserve Bank of Atlanta President and Chief Executive Officer Dennis P. Lockhart, to the Urban Land Institute Emerging Trends in Real Estate Conference* (Nov. 10, 2009) (online at www.frbatlanta.org/news/speeches/lockhart_111009.cfm).

[411] *See* Richard Parkus and Jing An, *The Future Refinancing Crisis in Commercial Real Estate, Part II: Extensions and Refinements*, at 23 (July 15, 2009) ("[E]xposure [to commercial real estate loans] increases markedly for smaller banks. For the four largest banks (on the basis of total assets), this exposure is 12.3%, for the 5–30 largest banks, the exposure is 24.5%, while for the 31–100 largest banks, the exposure grows to 38.9%").

erwise viable with capital to increase lending to small businesses. Assistant Secretary Allison explained that the small business lending program can help alleviate small banks' CRE losses: "by providing [small banks with] access to additional capital we can help them to withstand a deterioration of the value of [commercial real estate] assets on their books."[412] Treasury believes that the problems in the commercial real-estate market are material to the economy, but will not be overwhelming, and can be absorbed over time through loan workouts and the bankruptcy process.[413] However, as discussed in Section 1.5.f.iv, the Federal Reserve estimates that almost $500 billion of CRE loans will mature annually for the next several years, which could generate sizeable losses for the banks exposed to this sector.

The Congress also made foreclosure mitigation a priority in EESA, laying out that the authority under the Act was to be used in a manner that "protects home values"[414] and "preserves homeownership."[415] Treasury promised to use its new authorities to stabilize housing and mortgage finance,[416] avoid preventable foreclosures,[417] and keep low cost mortgage financing available."[418] Treasury also promised to "increase foreclosure mitigation efforts"[419] and "enforce stronger oversight of the mortgage origination process."[420]

While more time is needed to evaluate fully Treasury's substantial use of TARP funds to address the foreclosure crisis, it is not too soon to make some preliminary judgments. Treasury met its own goal of beginning 500,000 trial modifications by Nov. 1, but the Panel has serious concerns about whether the program can keep pace with the evolving nature of the foreclosure problem.[421] Since the publication of the Panel's October report, which analyzed Treasury's foreclosure prevention efforts, new data has underscored the Panel's concern that Treasury's mortgage modification program is inadequate to address the foreclosure problem as it has evolved over the last 10 months. In October, the Panel warned that a growing number of people cannot afford their mortgages because they have lost their jobs, and Treasury's existing programs are not designed to help them. Since then, the unemployment rate has passed 10 percent, a level it last reached in 1983. Also in October, the Panel warned that Treasury's existing programs do not address the problem of homeowners who owe more on their loans than their homes are worth, a factor that's correlated with foreclosures. Since

[412] Allison COP Testimony, *supra* note 401, at 57.

[413] Treasury conversations with Panel staff (Nov. 4, 2009).

[414] 12 U.S.C. § 5201.

[415] 12 U.S.C. § 5201.

[416] *See* Remarks by Secretary Paulson on Financial Rescue Package, *supra* note 396 ("market turmoil will not abate until the biggest part of the housing correction is behind us").

[417] *See* Remarks by Secretary Paulson on Financial Rescue Package, *supra* note 396 (stating Treasury "worked aggressively to avoid preventable foreclosures").

[418] *See* Remarks by Secretary Paulson on Financial Rescue Package, *supra* note 396 (Paulson, "worked aggressively to . . . keep mortgage financing available").

[419] *See* Remarks by Secretary Paulson on Financial Rescue Package, *supra* note 396. *See* Assistant Secretary Kashkari Update on TARP, *supra* note 395.

[420] *See* Remarks by Secretary Paulson on Financial Rescue Package, *supra* note 396 (Of course, it is already clear that we must address a number of significant issues, such as . . . oversight of mortgage origination").

[421] *See* Manuel Adelino, Kristopher Gerardi, and Paul S. Willen, *Why Don't Lenders Renegotiate More Home Mortgages? Redefaults, Self-Cures, and Securitization*, Federal Reserve Bank of Boston Working Paper 09–4 (version of July 6, 2009) (online at www.bos.frb.org/economic/ppdp/2009/ppdp0904.htm).

then, new data from the third quarter of 2009 showed that 23 percent of mortgage holders have negative equity in their homes. Lastly in October, the Panel warned that TARP mortgage modifications were not keeping pace with foreclosures. HAMP has led to a total of 10,187 permanent modifications as of the end of October 2009, a fraction of the 89,810 completed foreclosure sales in September alone.

It is too early to evaluate the impact of the TARP investments in General Motors and Chrysler. Treasury notes that its actions helped the two automakers to move unusually fast and efficiently through the bankruptcy process.[422] In addition, TARP assistance to GM and Chrysler likely prevented a much sharper downturn in the manufacturing sector and the broader economy. However, as the Panel stated in its September report, Treasury seems likely to absorb losses on its investments in GM and Chrysler. In the long term these expenditures should be judged based on the viability of GM and Chrysler, as well as their ultimate ability to repay the taxpayers.

One final but very important element of the assessment of Treasury implementation of the statutory goals of EESA concerns the objectives of protecting the U.S. economy and preventing systemic risk over the long term. As stressed by the experts whom the Panel consulted, the major problem is that in executing the TARP, Treasury may have sown the seeds for a future crisis by demonstrating that the government will come to the rescue of institutions that engage in excessive risk taking and are unprepared to deal with the inevitable collapse. Further compounding this problem is the fact that, as a result of the actions taken in the course of stemming this economic crisis, the banking system has perhaps an increased number of "too big to fail" institutions, and they are even bigger in size. This will be an important issue on which policymakers will need to focus in the aftermath of the crisis and the winding down of the TARP.

2. The TARP and the American Taxpayer

While emphasizing the goals of restoring liquidity and stability to the U.S. financial system, Congress also directed that the TARP maximize overall returns and minimize overall costs to U.S. taxpayers[423] and that it ensure the most efficient use of taxpayer funds[424] and minimize the impact on the national debt.[425]

From the perspective of public investors who stepped up at the critical time when private investors had fled, Treasury has now gotten back more than one-quarter of the money it spent on capital injections,[426] and has earned an annual rate of 17 percent on the money invested with those institutions that have now repaid the TARP investments. It is too soon to estimate how much of the over-

[422] *See generally* Allison COP Testimony, *supra* note 401, at 5; Treasury conversations with Panel staff (Nov. 4, 2009).

[423] *See* 12 U.S.C. § 5201; 12 U.S.C. § 5223; 12 U.S.C. § 5224.

[424] *See* 12 U.S.C. § 5213.

[425] *See* 12 U.S.C. § 5213. *See also* 12 U.S.C. 5219 (In coordination with "identify[ing] opportunities for the acquisition of classes of troubled assets that will improve the ability of the Secretary to improve the loan modification and restructuring process and, where permissible, to permit bona fide tenants who are current on their rent to remain in their homes under the terms of the lease").

[426] *See* Allison COP Testimony, *supra* note 401, at 3.

all TARP investment taxpayers will ultimately recover, in part because the banks that have returned the money are the same banks that needed it least. We do know that initial portions of the $80 billion invested in the auto industry are unlikely to be recovered and that no return is expected on the $50 billion TARP mortgage foreclosure program (HAMP). And the banks that have yet to repay their TARP investments are no doubt holding larger amounts of poorer quality assets.

As was the case with the savings and loan rescue in the 1980s and 90s, the ultimate impact of TARP transactions on the national debt will not be known for many years. That financial rescue is now estimated to have cost roughly $150 billion in current dollars, which was lower than earlier feared. Increasingly successful sales of assets acquired early in that episode accounts for a portion of that decline in overall cost to the government.[427]

As explained above, the best current estimates of the cost to the U.S. taxpayer of the current financial crisis are much larger but again perhaps not as large as initially feared. The latest estimates from the budget agencies—OMB and CBO—imply that the ultimate cost of the TARP would be about $341 billion (OMB) and $241 billion (CBO).

As the Panel pointed out in its February report, however, the economic value of the assistance being provided is less easily assessed based upon the information Treasury has been releasing. The Panel therefore contracted with a securities valuation firm and published its findings in its February Report. The firm estimated that of the $184 billion in TARP funds it analyzed, the securities that Treasury received in exchange had a market value of only $122 billion, or 66 percent, at the time Treasury announced its agreement to buy them.[428] Moreover, the action of injecting public funds into the banks that have been assisted may have served to provide these institutions with an implicit public guarantee of their balance sheets, a guarantee for which no fee was charged.

This in turn relates to the larger question of the degree to which Treasury has been forthcoming both in acknowledging the economic value of the assistance that it has been providing to financial institutions and an explanation for the strategy in providing such assistance. As noted in the Zingales and Veronesi working paper, banks with the greatest likelihood of experiencing a run benefited the most from taxpayer assistance.[429] Simply asserting that all recipient institutions were "healthy" is not accurate in this situation. In this respect, Treasury's initial implementation of its authority to purchase bank assets and other financial instruments (e.g., preferred stock) lacked critical transparency and continues to be a source of confusion in understanding the actual condition of the

[427] *See* Timothy Curry and Lynn Shibut, *The Cost of the Savings and Loan Crisis: Truth and Consequences*, Federal Deposit Insurance Corporation Banking Review, at 33 (Dec. 2000) (online at www.fdic.gov/bank/analytical/banking/2000dec/brv13n2__2.pdf) ("As of December 31, 1999, the thrift crisis had cost taxpayers approximately $124 billion and the thrift industry another $29 billion, for an estimated total loss of approximately $153 billion. The losses were higher than those predicted in the late 1980s, when the RTC was established, but below those forecasted during the early to mid-1990s, at the height of the crisis").

[428] *See* February Oversight Report, *supra* note 66, at 4, 27.

[429] *See* Paulson's Gift, *supra* note 357, at 3, 52.

major banks that were the subject of the initial use of TARP resources.

3. Treasury as TARP Steward and Manager

Separate from the issues of how well the American economy is performing after 14 months of the TARP's existence and what has the TARP done for the American taxpayer, there is also the question of how well Treasury, under two administrations, has performed in implementing the sweeping authority EESA provided. EESA calls for "public accountability" in the exercise of the authority it provides.[430] It also requires Treasury to "facilitate market transparency" by making available to the public "a description, amounts, and pricing of assets acquired under this Act." In its initial implementation of EESA, Treasury committed to communicate "actions in an open and transparent manner."[431]

There is no question that Treasury had to implement the TARP in a crisis atmosphere. Through its website at financialstability.gov, the Department has provided voluminous, detailed transactions information, which has allowed the public to monitor closely the funding provided to individual institutions and under what terms, as well as repayments of investments, dividends and interest received, and warrants repurchased. The regular release of online reports has greatly improved the public's access to important information such as the cumulative commitments of TARP resources and the accounting for all of its funding. Publication of TARP accounting statements for federal fiscal year 2009 should provide further, highly useful information on how TARP resources have been utilized and how Treasury has been managing them. Some critics argue, however, that the TARP should meet a higher standard of private sector type accounting statements including issuance on a quarterly rather than just annual basis.[432] Additional disclosures which the Panel believes would be desirable include further information about modifications under HAMP and a more complete picture of PPIP investment structures.

Further, certain transaction details have not been forthcoming, such as the actual number of warrants Treasury holds for each financial institution.

Despite Treasury's disclosures, questions continue to be raised as to "where the money went." The identity of the recipients of CPP funds is well-known, and has been throughout the implementation of the program. A list of recipients and whether their CPP funds have been repaid is available on Treasury's website,[433] and SIGTARP's quarterly reports give the same information.[434] The public thus knows who has the money; what is somewhat less clear is what the recipients did with it. The TARP securities purchase agreements (SPAs) provide that the recipients will expand the flow of credit to U.S. customers and modify mortgage terms but does not

[430] 12 U.S.C. § 5201.

[431] *See* Assistant Secretary Kashkari Update on TARP, *supra* note 395 ("It is essential we communicate our actions in an open and transparent manner to maintain [taxpayers'] trust").

[432] Pollock COP Testimony, *supra* note 369, at 3.

[433] *See* November 25 Transactions Report, *supra* note 71.

[434] *See* Office of the Special Inspector General for the Troubled Asset Relief Program, *Quarterly Report to Congress* (Oct. 21, 2009) (online at www.sigtarp.gov/reports/congress/2009/October2009__Quarterly__Report__to__Congress.pdf).

specify how those objectives should be met, measured, or reported.[435]

Treasury's standard response with respect to the "use of funds" issue is to point out that money is fungible and that it is not possible to correlate receipt of funds with a specific use of those funds.[436] Nevertheless, as the Panel and SIGTARP have noted, Treasury could have conditioned receipt of TARP assistance upon requirements to report the usage of those funds and the overall lending activities of the institutions in question.

Treasury also states that it does not intend to tell banks how to run their businesses.[437] As discussed in Section B above, Treasury does, however, track information on lending levels by the 22 largest CPP recipients.[438] SIGTARP attempted to address the "fungibility of money" issue by asking CPP recipients to identify actions that they would not have been able to take without TARP funding. In July 2009, SIGTARP published a report whose title speaks for itself: "SIGTARP Survey Demonstrates that Banks Can Provide Meaningful Information on Their Use of TARP Funds."[439] SIGTARP sent survey letters to more than 360 CPP recipients, and summarized their responses. While respondents described the use to which they put their CPP funds in general terms, they did not quantify the amount of new lending or the incremental difference

[435] The "recitals" to the form of Securities Purchase Agreement—Standard Terms used for CPP transactions provide:

WHEREAS, the Company agrees to expand the flow of credit to U.S. consumers and businesses on competitive terms to promote the sustained growth and vitality of the U.S. economy;

WHEREAS, the Company agrees to work diligently, under existing programs, to modify the terms of residential mortgages as appropriate to strength the health of the U.S. housing market . . .;

See U.S. Department of the Treasury, *Securities Purchse Agreement for Public Institutions* (online at www.financialstability.gov/docs/CPP/spa.pdf) (accessed Dec. 7, 2009); U.S. Department of the Treasury, *Securities Purchase Agreement for Private Institutions* (online at www.financialstability.gov/docs/CPP/SPA-Private.pdf) (accessed Nov. 30, 2009). While it seems clear that Treasury intended that CPP recipients should be agreeing to increase the flow of credit and the modification of mortgages, the language cited above is too vague to be useful and not in a place where binding obligations are usually set out in a contract. Added to the fact that there are no specific restrictions on use of funds or reequirements with respect to the reporting of such use, the SPAs seem to be a missed opportunity for monitoring the use of taxpayers' funds.

[436] *See* Office of the Special Inspector General for the Troubled Asset Relief Program, *SIGTARP Survey Demonstrates that Banks Can Provide Meaningful Information on Their Use of TARP Funds,* at 38–39 (July 20, 2009) (online at www.sigtarp.gov/reports/audit/2009/SIGTARP__Survey__Demonstrates__That—Banks__Can__Provide__Meaningful__%20Information__On__Their__Use__Of__TARP__Funds.pdf). In its first report, in December 2008, the Panel noted the need for the companies that received TARP funds to explain how they were using those funds. *See* Congressional Oversight Panel, *Questions About the $700 Billion Emergency Economic Stabilization Funds,* at 4 (Dec. 10, 2008) (online at cop.senate.gov/reports/library/ report-121008-cop.cfm).

[437] *See* U.S. Department of the Treasury, *Summary Response to SIGTARP Recommendations in the April 21, 2009 SIGTARP Report,* at 2 (July 2, 2009) (online at www.financialstability.gov/docs/ dividends-interest-reports/Final%20Treasury%20Response %20to%20SIGTARP%20Recommendations %20%2807022009%29.pdf).

[438] In 2008, when Treasury first began issuing its Monthly Lending and Intermediation Snapshot, it only followed the twenty largest CPP recipients. Treasury subsequently added two institutions to the list—American Express and Hartford. *See* U.S. Department of the Treasury, *Treasury Department Monthly Lending and Intermediation Snapshot, Summary Analysis for October–December 2008* (online at www.treas.gov/press/releases/reports/tg30-2-122008.pdf) (accessed Dec. 4, 2009); *see also* U.S. Department of the Treasury, *Treasury Department Monthly Lending and Intermediation Snapshot, Summary Analysis for August 2009* (online at www.financialstability.gov/docs/surveys/Snapshot%20Analysis%20August%202009%20Data%2010%2014% 2009.pdf) (accessed Dec. 4, 2009).

[439] Office of the Special Inspector General for the Troubled Asset Relief Program, *SIGTARP Survey Demonstrates that Banks Can Provide Meaningful Information on Their Use of TARP Funds,* at 5 (July 20, 2009) (online at www.sigtarp.gov/reports/audit/ 2009/SIGTARP__Survey__Demonstrates__That__Banks__Can__Provide__Meaningful__%20Information__On__Their__Use__ Of__TARP__Funds.pdf) (hereinafter "SIGTARP Survey Demonstrates that Banks Can Provide Meaningful Information on Their Use of TARP Funds").

in lending based on use of TARP funds.[440] The Panel notes the limitations inherent in the SIGTARP survey due to the survey's reliance on self-reporting, and the lack of uniform responses or any requirement of quantification. While it is possible to say that 300 banks, more than 80 percent of all respondents, reported increased lending by reason of the TARP,[441] it is not possible to use the survey itself as authority for anything more meaningful.

The Panel staff also reviewed the SEC filings and other public disclosures of a number of banks (this group included the 17 of the 19 stress test banks that report to the SEC and the 10 largest CPP recipients).[442] While, as discussed above, strictly speaking it is not possible to trace particular uses to TARP funds, some institutions have made efforts to show how TARP funds affected their operations. For example, Citigroup, one of the largest TARP recipients,[443] established a Special TARP Committee, which set up guidelines consistent with the objectives and spirit of the program, and internal controls to ensure that TARP funds would only be used for lending and mortgage activities.[444] Citigroup also separately publishes regular reports summarizing its TARP spending initiatives.[445] Similarly, although Associated Banc-Corp did not segregate TARP funds from its regular account, it took measures to ensure that the funds are readily identifiable, thereby allowing its expenditure to be traced.[446]

The SEC filings and other public disclosures, like the responses to the SIGTARP survey, are mixed both in terms of the level of detail provided and the thought that went into designing an approach to answering the question "what did you do with the taxpayers' money?" As Treasury points out, an exact correlation between

[440] CPP recipients' responses to SIGTARP's inquiry included the following:

- More than 80 percent of the respondents cited the use of funds for lending or the avoidance of reduced lending. Many banks reported that lending would have been lower without TARP funds or would have come to a standstill.
- More than 40 percent of the respondents reported that they used some TARP funds to help maintain the capital cushions and reserves required by their banking regulators.
- Nearly a third of the respondents reported that they used some TARP funds to invest in agency-mortgage backed securities.
- A smaller number reported using some TARP funds to repay outstanding loans.
- Several banks reported using some TARP funds to buy other banks.

[441] SIGTARP Survey Demonstrates that Banks Can Provide Meaningful Information on Their Use of TARP Funds, *supra* note 439.

[442] The 19 stress test institutions are: JPMorgan Chase & Co., Citigroup, Bank of America Corp., Wells Fargo & Co., Goldman Sachs Group, Morgan Stanley, MetLife, PNC Financial Services Group, U.S. Bancorp, Bank of New York Mellon Corp., SunTrust Banks, Inc., State Street Corp., Capital One Financial Corp., BB&T Corp., Regions Financial Corp., American Express Co., Fifth Third Bancorp, Keycorp and GMAC LLC. The 10 largest CPP recipients are all stress test banks. These recipients, in order of CPP funds received, are: Citigroup, JPMorgan Chase & Co., Wells Fargo & Co., Bank of America, Goldman Sachs Group, Morgan Stanley, Bank of New York Mellon, State Street Corporation, U.S. Bancorp, and Capital One Financial.

[443] Under CPP, TIP and AGP, Treasury has invested a total of $49 billion in Citibank as of Nov. 17, 2009. *See* November 25 Transactions Report, *supra* note 71.

[444] U.S. Securities and Exchange Commission, *Citigroup's 2008 Annual Report on Form 10–K* (Feb. 27, 2009) (online at www.sec.gov/Archives/edgar/data/831001/000119312509041237/d10k.htm); Citigroup, *TARP Progress Report Third Quarter 2009* (Nov. 12, 2009) (online at www.citigroup.com/citi/corporategovernance/data/tarp/tarp__pr__3q09.pdf?ieNocache=105) (hereinafter "TARP Progress Report Third Quarter 2009").

[445] *See generally* Citigroup, *TARP Progress and Updates* (online at www.citigroup.com/citi/corporategovernance/tarp.htm) (accessed Dec. 4, 2009). "As of the end of the third quarter [2009], Citi has authorized $53.8 billion in initiatives supported by investments it received under the TARP capital programs." TARP Progress Report Third Quarter 2009, *supra* note 444.

[446] Office of the Special Inspector General for the Troubled Asset Relief Program, *Associated Banc-Corp: UST Sequence No. 76* (online at www.sigtarp.gov/reports/audit/UseOfFunds/Associated%20Banc-Corp.pdf) (accessed Dec. 7, 2009).

TARP funds received and loans made is never going to be feasible, and the use of TARP funds for prescribed TARP objectives frees up money received from other sources, lobbying, and other activities that the taxpayers may find objectionable. Within these constraints, however, banks such as Citigroup made meaningful efforts to show their use of TARP funds.[447] Treasury could have asked the SEC to send "Dear CFO" letters to all SEC-reporting TARP recipients, asking them to make the same kind of disclosures. It does not appear that any such effort was made.

The terms of the CPP SPAs include the objective of promoting the flow of credit to U.S. borrowers. The SPAs did not, however, impose any specific geographic restrictions or reporting requirements on use or destination of funds. Additionally, as discussed above, tracing particular uses of funds to a specific source is difficult. As a result, it is difficult to establish, in many cases, whether any TARP funds ended up outside the United States. Of course, use of TARP funds for U.S. activities arguably frees up other funds that those banks can use internationally, and many of the largest CPP recipients had extensive international operations. With respect to Citigroup and AIG, TARP funds permitted the institution to continue functioning and in that respect would logically have benefitted non-U.S. customers, creditors and counterparties. On the other hand, when non-U.S. countries helped their banks with capital infusions and debt guarantees, some of those funds will necessarily flow to U.S. counterparties.

F. Conclusions

The financial crisis that gripped the United States last fall was unprecedented in type and magnitude. There is broad consensus that the TARP was an important part of a broader set of government actions that stabilized the U.S. financial system by renewing the flow of credit and averting a more acute crisis. The financial markets data that are chronicled in this report make a persuasive case that the government's actions, while initially halting, were eventually decisive enough to stop the panic and restore confidence among key financial institutions and actors. However, the TARP's impact on the underlying weaknesses in the financial system that led to last fall's crisis is less clear.

Congress established broad goals for EESA to help address the economic collapse that was gripping the nation at the time of its enactment. It is apparent that after fourteen months the TARP's programs have not been able to solve many of the ongoing problems Congress identified. Credit availability, the lifeblood of the economy, remains low. In light of the weak economy, banks are reluctant to lend, while small businesses and consumers are reluctant to borrow. In addition, questions remain about the capitalization of many banks, and whether they are focusing on repairing their balance sheets at the expense of lending. The FDIC, facing

[447] In order to determine whether a bank had made meaningful efforts to show use of its TARP funds, the Panel staff asked the following questions: Was data easily found in the bank's filings? Did the bank attempt to segregate, identify or otherwise follow the money? Did it set up rules or guidelines? Did it specify acceptable and non-acceptable uses of funds, and by reference to what? How much quantification was there and how granular was the data? Does it report use of funds on special reports?

red ink for the first time in 17 years, must step in to repay depositors at a growing number of failed banks. This problem may well worsen, as deep-seated problems in the commercial real estate sector are poised to inflict further damage on small and mid-sized banks. Large banks have problems of their own. Some of them, waiting for a rebound in asset values that may still be years away, continue to hold the toxic mortgage-related securities that contributed to the crisis. Consequently, the United States continues to face the prospect of banks too big to fail and too weak to play their role adequately in keeping credit flowing throughout the economy. The foreclosure crisis continues to grow. Furthermore, the market stability that has emerged since last fall's crisis has been in part the result of an extraordinary mix of government actions, some of which will likely be scaled back relatively soon, and few of which are likely to continue indefinitely. The removal of this support too quickly could undermine the economy's nascent stability.

What Treasury has done with the nearly $700 billion in TARP funds has not occurred in a vacuum. Since the TARP was enacted in October 2008, the FDIC and the Federal Reserve have undertaken additional major initiatives that are aimed at bolstering financial stability. The Congress enacted a fiscal stimulus measure that is larger than the TARP. The government has also taken numerous smaller actions, such as the enactment of the Cash for Clunkers program, which boosted auto sales. All of these steps are in addition to global market forces that are outside the government's control, yet have a major impact on the U.S. economy. Still, it is clear that the unprecedented government actions taken since last September to bolster the faltering economy have not been enough to stem the rise of unemployment, which (except for October) is currently at its highest level since June 1983.

While strong government action helped prevent a worse crisis, it may have done so at a significant long run cost to the performance of our market economy. Implicit government guarantees pose the most difficult long-term problem to emerge from the crisis. Looking ahead, there is no consensus among experts or policymakers as to how to prevent financial institutions from taking risks that are so large as to threaten the functioning of the nation's economy. Congress is currently grappling with this issue as it considers how to respond legislatively to the financial crisis. It is clear that a failure to address the moral hazard issue will only lead to more severe crises in the future.

Since its inception, the TARP has gone through several different incarnations. It began as a program designed to purchase toxic assets from troubled banks but quickly morphed into a means of bolstering bank capital levels. It was later put to use as a source of funds to restart the securitization markets, rescue domestic automakers, and modify home mortgages. The evolving nature of the TARP, as well as Treasury's relative lack of fixed goals and measures of success for the program, make it hard to provide an overall evaluation. But the Panel remains convinced, as it has been since its inception, that Treasury should make both its decision-making and its actions more transparent. Despite the difficult circumstances under which many decisions have been made, those decisions must be explained to the American people, and the officials who make them must be held accountable for their actions. Transparency and accountability may be painful in the short run, but in the long run they will help restore market functions and earn the confidence of the American people.

SECTION TWO: ADDITIONAL VIEWS

A. Damon Silvers

This separate view does not reflect a disagreement with the Panel report in any respect. Rather I wish to say in a somewhat briefer and perhaps blunter way what I believe the Panel report as a whole says about TARP.

The Emergency Economic Stabilization Act of 2008 and the Troubled Asset Relief Program it created, in my opinion, were significant contributors to stabilizing a full blown financial panic in October 2008. It is clear to me that for that reason, we are better off as a nation for the existence of TARP than if we had done nothing. Of course this proposition is very hard to prove, but I am convinced it is true. Many people deserve credit for doing TARP rather than doing nothing, but three people who in particular deserve credit are Federal Reserve Chairman Ben Bernanke, Treasury Secretary Timothy Geithner, and in particular, former-Treasury Secretary Henry Paulson.

Further, we are better off that, in implementing TARP, then-Secretary Paulson and his colleagues chose to do capital infusions in the form of the Capital Purchase Program rather than the initial plan of asset purchases. The prospect of asset purchases did not calm the markets, the announcement of capital infusions did. Furthermore, asset purchases at the richly subsidized prices the banks had hoped for would have been profoundly unfair to the public. Any other kind of asset purchases would certainly have had little impact on the panic and could have worsened it.

The reason, however, for the success of the CPP infusions into the nine largest banks was, I believe, not that those infusions by themselves made those institutions adequately capitalized or resolved the toxic asset problem. It worked because it was a credible signal, together with other guarantees issued by Treasury and the FDIC, that the United States government was guaranteeing the solvency of the large banks.

The question then was, what price the Treasury would ask on behalf of the public for guaranteeing the large banks? Our February report showed that in purchasing preferred stock from the large banks the Treasury accepted significantly less in exchange for its investment than private commercial parties were demanding at the time.[448] This mispricing was substantially driven by the decision to price the preferred stock purchased from the large banks as if each bank was equally healthy, a decision later criticized by the Special Inspector General for TARP as based on a manifestly false premise.[449]

This initial mispricing was followed by then-Secretary Paulson's decision to rescue first Citigroup and then Bank of America from imminent bankruptcy without subjecting their shareholders to the same levels of dilution that had been forced on AIG. This placed

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[448] Congressional Oversight Panel, *February Oversight Report: Valuing Treasury's Acquisitions* (Feb. 6, 2009) (online at cop.senate.gov/documents/cop-020609-report.pdf).

[449] SIGTARP, *Emergency Capital Injections Provided to Support the Viability of Bank of America, Other Major Banks, and the U.S. Financial System,* at 17 (Oct. 5, 2009) (online at sigtarp.gov/reports/audit/2009/Emergency__Capital__Injections__Provided__To__Support__the__Viability__of__Bank__of__America...__100509.pdf).

the public in the position of rescuing the stockholders of banks. For the previous seventy-five years, it had been a fundamental premise of bank regulation that while a stable system required deposit insurance, and we might bail out other short term creditors and even bondholders in a crisis, no public purpose was served by rescuing stockholders. In fact the moral hazard issues created by such a wealth transfer were profoundly dangerous.

After an initial period of deliberation, the Obama Administration settled on an approach of trying to limit further capital infusions into the banks while effectively pursuing a time-buying strategy. This strategy led to improved transparency in some respects, such as the release of the stress test results and the recognition that some banks were stronger than others, opacity continued in other areas. For example, in our August report we found it was not possible to determine the value of toxic assets on the books of the large banks.[450] It appeared in general that where transparency led to the conclusion that the banks were strong, the approach was transparency. Where transparency might have led to a different conclusion, opacity continued. This is of course completely consistent with a time-buying strategy. The time-buying strategy so far has worked in that so far there have been no further direct capital infusions into the major banks since President Obama took office.

However, though the consequences of the time-buying strategy appear to be that while we have had no further capital infusions into the large banks, it is unclear whether the large banks are actually healthy. Citigroup, Wells Fargo, and Bank of America were not allowed to return their TARP money after the stress tests. Those banks constitute approximately 40 percent of the nation's bank assets. Recently Bank of America announced its intention to return TARP money after completing a public offering, though questions have been raised by informed commentators like Andrew Ross Sorkin as to whether Bank of America is really strong enough to be allowed to return its TARP capital, and point to the lack of lending on the part of Bank of America.[451] Meanwhile, small banks that do not benefit from either implicit or explicit guarantees are failing at an alarming rate.

As a result of the continuing underlying weakness in the banking system, banks appear reluctant to lend, particularly to small- and medium-sized businesses. This dynamic has been cited by Federal Reserve Chairman Bernanke as a key contributor to the high rate of unemployment.[452] In a parallel development, Treasury's foreclosure relief programs seem to be designed with the first principle of avoiding writedowns. This is again consistent with a goal of buying time for banks, but not consistent with a goal of stabilizing the housing market or keeping American families in their homes. These dynamics appear to have some resemblance to the forces that led in different circumstances to Japan in the 1990s having a

[450] August Oversight Report, *supra* note 100.

[451] Andrew Ross Sorkin, *Bailout Refund Is All About Pay, Pay, Pay,* New York Times (Dec. 7, 2009) (online at www.nytimes.com/2009/12/08/business/08sorkin.html).

[452] Ben S. Bernanke, *Speech at the Economic Club of New York* (Nov. 16, 2009) (online at www.federalreserve.gov/newsevents/speech/bernanke20091116a.htm).

decade long problem with bank weakness that contributed to prolonged economic weakness.

So the verdict on TARP is that it was a success at stabilizing a serious financial crisis but that it has been characterized by a willingness to give public money to the banks at less than fair terms to the public, and by a refusal to resolve fundamental problems with the financial institutions it has rescued. These weaknesses in TARP were not necessary. In some cases these weaknesses have been addressed over time. Where these problems remain, and I believe they remain central to the nature of TARP today, they could still be addressed.

B. Richard Neiman

I voted for and support this month's Report and my Additional Views are related more to important matters of emphasis than to specific conclusions. It is critical to remember in our analysis that EESA was enacted and first implemented in the depths of a major crisis, and the TARP was charged with multiple, complex, and enormous responsibilities.

1. TARP Has Significantly Improved the Stability of the Financial System

In my opinion the Report could be stronger in giving credit to TARP for having achieved the primary statutory objective of restoring general financial stability and liquidity in the financial system, including the restoration of functioning credit markets. There are legitimate debates about specific causation (TARP was part of a coordinated set of responses) and about particular transactions (methods of rescue or seizure of one institution or another). However, in comparison to the situation in October 2008, I give Congress, the Administration, and TARP a large share of credit for the achievement of the primary objective under EESA.

The Panel has issued a series of reports that have closely examined TARP programs and transactions and we have been critical of many aspects of implementation, including transparency and accountability. Yet, in this year-end review we should take a step back and be clear and emphatic that a dominant success and objective was in fact achieved.

In hindsight it is difficult to remember how close the system was to imploding and even more difficult to imagine what the consequences to the "real economy" might have been had the global financial system collapsed. It is not possible to adequately construct that scenario. But for all the criticism Treasury has received for assisting in the rescue of Bear Stearns and allowing the failure of Lehman Brothers, I shudder to imagine what might have happened if AIG had been allowed to fail and been followed quickly by a series of major American banks and investment banks during those weeks in early October 2008. They would not have simply "failed" in the traditional sense—the entire global financial system would have seized and ground to a halt. The specter of the United States government not acting in the face of such a crisis would have been devastating to the world economy. The impacts on trade, on the movement of goods, possibly on hunger and dislocation, and certainly on the American people's confidence, can only be imagined.

Therefore I think this is a moment to give some appropriate credit to the Congress, the Treasury, and the Federal Reserve for acting decisively in the face of a potential disaster and to TARP for playing a central role in averting that outcome.

2. Formidable Problems Remain in the General Economy, Particularly With Respect to Mounting Foreclosures

In restoring liquidity and financial stability to the financial system, Treasury was charged with ensuring that TARP funds and its authority under EESA "are used in a manner that . . . preserves homeownership and promotes jobs and economic growth."[453] These are very serious issues for the Treasury and for Congress and the country. In some cases TARP results have been better; in other cases worse.

I do not attribute primary responsibility for solving the problems of general economic recovery to TARP programs, but I do think that some TARP programs could have done, and still can do, much better in promoting those goals.

On the positive side, the TARP capital support programs, including the SCAP, have generally been successful in promoting financial condition transparency, bringing private capital investment back to the banking sector, and protecting taxpayer funds. The disagreement among our expert panel of witnesses about the current adequacy of overall banking capital levels is, I believe, more related to their differing views of the future economy and its impact on bank capital than it is to their assessment of TARP's effectiveness.

As for the asset-related programs, the TALF program has performed reasonably well in reviving functioning asset-backed securities markets for certain consumer credit asset classes. The PPIP program was late in launching but can now be expected to play an important role in creating a liquid market for troubled assets.

The auto companies' rescue was generally well executed, albeit at a cost, and at this point it has helped to mitigate the degree of job dislocation in the general economy.

On the other hand, as the Report rightly points out in detail, TARP has struggled to help homeowners and small businesses. HAMP has made only limited progress for nine months now, and the residential foreclosure crisis continues to mount. Moreover, credit is not sufficiently available for small businesses and we are entering a period of severe stress on commercial real estate loans. Much more needs to be done.

Looking ahead, TARP needs to close the book on large institution support and focus all of its energies on addressing the problems of foreclosures, small business credit, and commercial real estate.

One proposal I have long called for is for Treasury to expand its foreclosure prevention program to assist borrowers who risk foreclosure due to job loss or other temporary hardship. As the recession lingers, prime borrowers with mortgages that are otherwise affordable are increasingly falling into this category. I therefore have been urging the use of TARP funds to support state emergency mortgage assistance programs to help borrowers while they get back on their feet. Innovative programs at the state level have demonstrated that this idea can work.

3. The Risk of Moral Hazard Goes Well Beyond the Implementation of TARP

Moral hazard, which is discussed in the Report, is a far ranging effect that occurs anywhere the government interfaces with any of the financial sector (e.g., bank debt support), private contracts (e.g., mortgages), and the general industrial economy (e.g., auto rescue). TARP's very enactment was a massive instance of government intervention; presumably Congress reached the conclusion that the

[453] § *EESA* 2.

risks of not acting outweighed the risks of moral hazard that implementing TARP required.

Therefore, while moral hazard is a very real issue I do not believe it is appropriate to assign the lion's share of responsibility for moral hazard risk to the implementation of TARP programs. The statute itself was an emergency act of moral hazard-inducing intervention. So it is not surprising to find moral hazard associated with TARP—it was there from the beginning.

Extraordinary government efforts necessary to avoid system-wide financial collapse last fall in some cases made institutions bigger and more complex and interconnected. This was not a desirable matter of policy but an unfortunate matter of exigency. In a crisis, a larger company may be required to absorb the business of another large company quickly, consolidate management and operations, and provide uninterrupted service to customers and business partners.

The important lesson of moral hazard is that we need to address "too big to fail" not by criticizing or second guessing TARP, but by renewing our efforts to create a systemic regulator and resolution authority. This is the greatest legislative imperative for financial reform and where our energies must be directed.

4. Going Forward—Reform of Financial Institutions Must Be Considered

These outcomes of the crisis have only heightened the need to address systemic risk legislatively and to create an authority to unwind such institutions in an orderly fashion in event of failure.

They also highlight the debate about whether large financial institutions should be allowed to grow so large and complex in the first place. Our national dialogue must include the debate over the social responsibility and utility of banks subject to the federal safety net, and whether in addition to stronger capital requirements we should consider restricting the level of risky activities that these institutions are permitted to conduct (such as proprietary trading and sponsorship of hedge funds). Proposals such as those made by former Federal Reserve Chairman Paul Volcker warrant full consideration and discussion.

5. Conclusion

TARP was instrumental in avoiding a global financial meltdown—a far worse scenario than we experience today—at a much lower cost than was originally expected. Systemic stability and functioning credit markets were a necessary pre-condition to be in a position to tackle the problems relating to foreclosures, credit availability, and economic growth. Going forward these are the most important issues. TARP funds and programs must now focus on them.

C. Representative Jeb Hensarling

Although I commend the Panel and its staff for their efforts in producing the December report, I do not concur with all of the analysis and conclusions presented and, thus, dissent. I would like, however, to thank the Panel for incorporating several of the suggestions I offered during the drafting process.

Executive Summary

The Panel's December report focuses on whether Treasury has properly discharged its Congressional mandate under the Emergency Economic Stabilization Act of 2008—the enabling statute for the Troubled Asset Relief Program. In my view, it is not possible to assess the overall effectiveness of the TARP without acknowledging and thoughtfully analyzing the intended and unintended consequences of the program and the manner in which it was implemented by Treasury. In making these determinations I analyzed a series of specifically tailored metrics and inquired whether the TARP (i) stabilized the U.S. financial system, (ii) promoted lending, (iii) was implemented in a manner so as to protect the taxpayers, (iv) enhanced systemic, implicit guarantee and moral hazard risks, (v) enhanced political risk, (vi) promoted transparency and accountability, and (vii) was used for economic stimulus instead of financial stability.

Based upon this analysis I conclude that the TARP is failing its mandate and offer the following summary of my findings.

- In order to end the abuses of the TARP as evidenced by the Chrysler, General Motors (GM) and GMAC bailouts, misguided foreclosure mitigation programs and the re-animation of reckless behavior and moral hazard risks, Secretary Geithner should not extend the TARP but permit it to end on December 31, 2009.
- As of today, Treasury has approximately $297.2 billion of TARP authority available to fund existing commitments and new programs. As the EESA statute requires, all recouped and remaining TARP funds should go back into the Treasury general fund for debt reduction. All revenues and proceeds from TARP investments that have generated a positive return should also go for debt reduction.
- If the Secretary extends the TARP to October 31, 2010, I fear the Administration will continue to employ taxpayer resources as a revolving bailout fund to promote its politically favored projects as was clearly evident in the Chrysler, GM and GMAC bailouts.
- While the programs offered by Treasury, the Federal Reserve and the FDIC may very well have *jointly* assisted with the stabilization of the financial system over the past year, it seems quite unlikely that the TARP—unassisted by the Federal Reserve and the FDIC—would have stabilized the U.S. financial system.
- Although some criticize the TARP for its failure to jump start new lending activity and for the creation of dysfunctional financial institutions (zombie banks), others note that lending-for-the-sake-of-lending may sow the seeds of the next asset bubble and lead to another round of non-performing loans and toxic securitized debt instruments. Nevertheless, if the TARP is judged on the basis of whether it successfully restarted the lending market for large and

small business credit, it appears that it has again failed to meet such expectation.

- It is difficult to conclude that Treasury has diligently discharged its taxpayer protection obligation given the TARP funds that will most likely be lost with respect to AIG, the auto related bailouts and the various foreclosure mitigation efforts.
- Instead of lessening systemic risk the TARP has exacerbated the "too big to fail" problem by making the federal government the implicit guarantor of the largest American financial institutions as well as an undefined select group of business enterprises the failure of which might impede the Administration's economic, social and political agenda.
- By evidencing its willingness to rescue businesses that engage in excessive risk taking and poor business judgment Treasury has created needless implicit guarantee and moral hazard risks and laid the foundation for another economic crisis. If the Administration provides a safety net from risky behavior no one should be surprised if the intended recipients accept the offer and engage in such behavior. If the participants win their high risk bets they will reap all of the benefits but if they lose the taxpayers will bear the burden of picking up the pieces. It is possible that the TARP not only increased the number of "too big to fail" institutions but the size of such institutions as well.
- I remain troubled that the implementation of the TARP has caused the private sector to incorporate the concept of "political risk" into its analysis before engaging in any direct or indirect transaction with the United States government. The realm of political risk is generally reserved for business transactions undertaken in developing countries and not interactions between private sector participants and the United States government. Following the Chrysler and GM decisions it is possible that private sector participants may begin to view interactions with the United States government through the same jaundiced eye they are accustomed to directing toward third-world governments.
- Treasury has often been less than forthcoming regarding matters of transparency and accountability. Treasury should provide detailed financial statements to the taxpayers and operate its TARP investments in a businesslike manner.
- The TARP was promoted as a way to provide "financial stability," and the American Reinvestment and Recovery Act was promoted as a way to provide "economic stimulus." Regrettably, the TARP has evolved from a program aimed at financial stability during a time of crisis to one that increasingly resembles another attempt by the Administration to promote its economic, political and social agenda through fiscal stimulus.
- The bankruptcy restructurings of Chrysler and GM and the recapitalization of GMAC were financed with TARP proceeds. These cases serve as the poster child of why the TARP should end on December 31, 2009. The restructurings failed each of the standards noted above by exacerbating implicit guarantee and moral hazard risks, incorporating a heavy dose of political risk into private-public sector interactions, offering little in the way of taxpayer protection, transparency and accountability, and using funds dedicated to financial stability for economic stimulus.

• Much like the auto industry interventions, HAMP and the Administration's other foreclosure mitigation efforts to date have been a failure. The Administration's opaque foreclosure mitigation efforts have assisted only a small number of homeowners while drawing billions of involuntary taxpayer dollars into a black hole.

• The best foreclosure mitigation program is a job, and the best assurance of job security is economic growth and the adoption of public policy that encourages and rewards capital formation and entrepreneurial success. Without a robust macroeconomic recovery the housing market will continue to languish and any policy that forestalls such recovery will by necessity lead to more foreclosures.

A. Overview

The Panel's December report focuses on whether Treasury has properly discharged its Congressional mandate under the Emergency Economic Stabilization Act of 2008 (EESA)—the enabling statute for the Troubled Asset Relief Program (TARP).[454] In assessing the overall effectiveness of the TARP I will analyze the program against each of the following metrics:

- stabilization of the U.S. financial system;
- increased lending activity;
- taxpayer protection;
- systemic, implicit guarantee and moral hazard risks;
- political risk;
- transparency and accountability; and
- financial stability v. economic stimulus.

I will also describe what I believe was the primary cause of the financial crisis that the TARP was created to remedy. In addition I will retrace my analyses of the Chrysler and General Motors (GM) restructurings—the TARP's lowest point—and the misguided TARP funded foreclosure mitigation efforts.

Based upon this analysis I conclude that the TARP is failing its mandate and recommend that Secretary Geithner not extend the TARP but allow the program to terminate on December 31, 2009.[455]

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[454] The EESA statute requires COP to accomplish the following, through regular reports:
• Oversee Treasury's TARP-related actions and use of authority;
• Assess the impact to stabilization of financial markets and institutions of TARP spending;
• Evaluate the extent to which TARP information released adds to transparency; and
• Ensure effective foreclosure mitigation efforts in light of minimizing long-term taxpayer costs and maximizing taxpayer benefits.
12 U.S.C. 5223.

[455] *See generally, Geithner Expects Bailout Program to End Soon,* The Associated Press (Dec. 2, 2009) (online at www.nytimes.com/2009/12/03/business/economy/03derivatives.html) ("Treasury Secretary Timothy F. Geithner affirmed Wednesday the administration's intent to end the $700 billion financial bailout program soon. Although Mr. Geithner did not provide details, he said the government was close to the point at which 'we can wind down this program' and end it. 'Nothing would make me happier,' he told the Senate Agriculture Committee"); Jackie Calmes, *Repaid Bailout Money May Go to Jobless Benefits,* New York Times (Dec. 3, 2009) (online at www.nytimes.com/2009/12/03/us/politics/03jobs.html) ("Treasury Secretary Timothy F. Geithner, testifying on Wednesday before the Senate Agriculture Committee, warned against shuttering the program just yet, given the continued weakness in the banking, housing and real estate markets. But Mr. Geithner said much of the $700 billion would not be needed, an indication of how far the financial industry has improved since Mr. Obama took office and prepared to ask for up to $500 billion more. On Wednesday, Bank of America announced that it would repay all of its $45 billion in bailout money before the end of the year"); Michael Crittendon and Sarah Lynch, *Geithner Says TARP Is Winding Down, but Date Not Set,* Wall Street Journal (Dec. 3, 2009) (online at online.wsj.com/article/SB125976850821372893.html) ("The Obama administration will outline its plan to end the government's $700 billion financial rescue program in the next few weeks, a top official said, though that doesn't mean it will expire as scheduled

Before beginning my analysis of the TARP I thought it would be helpful to provide some perspective regarding the magnitude of the taxpayer resources that have been dedicated to financial stability and economic stimulus over the past year. *The Wall Street Journal* recently reported that Treasury is considering the investment of up to an *additional* $5.6 billion in GMAC.[456] To date Treasury has invested $12.5 billion in GMAC. I am not aware of any serious claim that the survival of GMAC is necessary for the financial stability of our country. Remarkably, the up to $18 billion that ultimately may be invested in GMAC represents a small drop in a large bucket relative to the trillions of dollars of taxpayer sourced funds presently committed to financial stability and economic stimulus. By comparison, for fiscal year 2010 the National Institutes of Health has requested just over $6 billion for cancer research.[457] Although the Panel is not charged with debating the allocation of limited public resources, as taxpayers we may nevertheless question if GMAC merits the equivalent of three years of taxpayer funded cancer research.

B. Primary Cause of the Financial Crisis

Just as a history of bad management decisions did not preclude Chrysler and GM from receiving TARP funds, the same is true of Fannie Mae and Freddie Mac. It should be noted that their financial insolvency materialized after years of mismanagement—and after years of enjoying the gold seal of the government's implicit guarantee. Fannie and Freddie exploited their congressionally granted charters to borrow money at discounted rates. They dominated the entire secondary mortgage market and wildly inflated their balance sheets. Because market participants long understood that this government created duopoly was implicitly (and, now, explicitly) backed by the federal government, investors and underwriters chose to believe that if Fannie or Freddie touched something, it was safe, sound, secure, and most importantly "sanctioned" by the government. The results of those misperceptions have had a devastating impact on our entire economy. Given Fannie and Freddie's market dominance, it should come as little surprise that once they dipped into the subprime and Alt-A markets, lenders quickly followed suit. In 1995, HUD authorized Fannie and Freddie to purchase subprime securities that included loans to low-income borrowers and allowed the government sponsored enterprises (GSEs) to receive credit for those loans toward their mandatory affordable housing goals. Fannie and Freddie readily complied, and as a result, subprime and near-prime loans

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by year end. 'We are close to the point where we can wind down this program and stop making new commitments,' Treasury Secretary Timothy Geithner told a U.S. Senate panel Wednesday").

[456] Dan Fitzpatrick and Damian Paletta, *GMAC Asks for Fresh Lifeline,* Wall Street Journal (Oct. 29, 2009) (online at online.wsj.com/article/SB125668489932511683.html?mod=djemalertNEWS) ("The U.S. government is likely to inject $2.8 billion to $5.6 billion of capital into the Detroit company, on top of the $12.5 billion that GMAC has received since December 2008, these people said. The latest infusion would come in the form of preferred stock. The government's 35.4% stake in the company could increase if existing shares eventually are converted into common equity").

[457] Senate Committee on Appropriations, Subcommittee on Labor, Health and Human Services, Education, and Related Agencies, Written Testimony of National Cancer Institute Director John E. Niederhuber, *Budget Request for FY 2010* (May 21, 2009) (online at legislative.cancer.gov/files/appropriations-2009-05-21.pdf).

jumped from 9 percent of securitized mortgages in 2001 to 40 percent in 2006. In 2004 alone, Fannie and Freddie purchased $175 billion in subprime mortgage securities, which accounted for 44 percent of the market that year. Then, from 2005 through 2007, the two GSEs purchased approximately $1 trillion in subprime and Alt-A loans, and Fannie's acquisitions of mortgages with less than 10-percent down payments almost tripled. As a result, the market share of conventional mortgages dropped from 78.8 percent in 2003 to 50.1 percent by 2007 with a corresponding increase in subprime and Alt-A loans from 10.1 percent to 32.7 percent over the same period. These non-traditional loan products, on which Fannie and Freddie so heavily gambled as their Congressional supporters encouraged them to "roll the dice a little bit more," now constitute many of the same non-performing loans which have contributed to our current foreclosure troubles.[458] Private sector lenders and securitizers of mortgage backed securities lowered their diligence and underwriting standards in order to compete with the heavily subsidized duopoly resulting in unprecedented levels of mortgage defaults and the near shut-down of our credit markets. Without the reckless behavior of Freddie and Fannie it seems most unlikely that a financial crisis of the magnitude we have experienced over the past year would have developed.[459]

GAO noted in a September 2009 report:

> While housing finance may have derived some benefits from the enterprises' activities over the years, GAO, federal regulators, researchers, and others long have argued that the enterprises had financial incentives to engage in risky business practices to strengthen their profitability partly because of the financial benefits derived from the implied federal guarantee on their financial obligations.[460]

In September 2008, Treasury put Fannie Mae and Freddie Mac into conservatorship under the Federal Housing Finance Agency (FHFA), effectively making taxpayers liable for their portfolios which now total about $5.46 trillion (including mortgage-backed securities and other guarantees, as well as gross mortgage portfolios).[461]

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[458] Representative Jeb Hensarling, *Additional Views to Congressional Oversight Panel, March Oversight Report: Foreclosure Crisis: Working Towards a Solution* (Mar. 6, 2009) (online at cop.senate.gov/documents/cop–030609–report-view-hensarling.pdf).

[459] In addition, for well over twenty years, federal policy has promoted lending and borrowing to expand home ownership, through incentives such as the home mortgage interest tax exclusion, the FHA, discretionary HUD spending programs, and the Community Reinvestment Act (CRA). CRA is an example of a program with the best of intentions having adverse, unintended consequences on exactly the population it hopes to serve. It was initially authorized to prevent "redlining," a term that refers to the practice of denying loans to neighborhoods considered to be higher economic risks, by mandating banks lend to the communities where they take deposits. Since its passage into law in 1977, however, CRA has advanced at least two undesirable outcomes: (1) some financial institutions completely avoided doing business in neighborhoods and restricted even low-risk forms of credit, and (2) many institutions went the other way and relaxed underwriting standards to meet CRA guidelines, thus opening the door to the development of certain risky products that have contributed to the problem of foreclosures. These lax underwriting standards spread to Fannie and Freddie and ultimately to the private sector as the role of the GSEs morphed from that of a liquidity provider to a promoter of home ownership.

[460] Government Accountability Office, *Analysis of Options for Revising the Housing Enterprises' Long-term Structures* (September 2009) (online at www.gao.gov/new.items/d09782.pdf).

[461] Fannie Mae, *Monthly Summary* (July 2009) (online at www.fanniemae.com/ir/pdf/monthly/2009/073109.pdf); Freddie Mac, *Monthly Volume Summary* (July 2009) (online at www.freddiemac.com/investors/volsum/pdf/0709mvs.pdf).

C. Analysis of the TARP

In my view, it is not possible to assess the overall effectiveness of the TARP without acknowledging and thoughtfully analyzing the intended and unintended consequences of the program and the manner in which it was implemented by Treasury. Any analysis that does not thoroughly consider the issues of implicit guarantee, moral hazard, political risk, transparency and accountability, and financial stability v. economic stimulus is myopic and of limited benefit.

1. Stabilization of U.S. Financial System

Any role that the TARP may have played over the past year in stabilizing the financial system cannot be analyzed to the exclusion of the programs adopted by the Federal Reserve and the FDIC. Although Treasury's maximum exposure under the TARP totals $698.7 billion, the Federal Reserve and the FDIC have maximum exposures of $1.732 trillion and $666.7 billion, respectively.[462]

Any such analysis becomes more challenging when you consider the broad array of programs adopted by Treasury, the Federal Reserve and the FDIC. Treasury—under TARP authority—rolled out a dizzying group of programs including, among others:

- the Capital Purchase Program (CPP—the purchase of preferred stock in approximately 700 financial institutions);
- the Targeted Investment Program (TIP—exceptional assistance to Citigroup and Bank of America);
- the Systemically Significant Failing Institutions Program (SSFI—exceptional assistance to AIG);
- the Asset Guarantee Program (AGP—the guarantee of certain assets of Citigroup);
- the Public-Private Investment Program (PPIP—purchase of toxic assets from financial institutions);
- the Term-Asset Back Securities Loan Facility Program (TALF—restart the securitization market);
- various small business programs;
- the Making Home Affordable Program (MHA—foreclosure mitigation, including the Home Affordable Modification Program (HAMP) and the Home Affordable Refinancing Program (HARP);
- the Automotive Industry Financing Program (AIFP—bailout of Chrysler, GM and GMAC); and
- the Auto Supplier Support Program (bailout of certain auto suppliers).

The Federal Reserve has extended credit to AIG, advanced loans under the TALF program, provided asset guarantees to Citigroup and extended over $1 trillion in credit under, among others, its Term Auction Facility, discount window program, Primary Dealer Credit Facility, commercial paper facility programs, and GSE debt securities and mortgage backed securities programs. The FDIC introduced the Temporary Liquidity Guarantee Program (TLGP-guarantee of debt issued by certain financial institutions), structured a PPIP for whole loans, guaranteed assets of Citigroup and

[462] See Figure 27 on pp. 79–80 of the Panel's December Report.

increased outlays to its deposit insurance fund.[463] The Panel's current and prior reports analyze many of these programs in detail.

While the programs offered by Treasury, the Federal Reserve and the FDIC may very well have *jointly* assisted with the stabilization of the financial system over the past year, it seems quite unlikely that the TARP—unassisted by the Federal Reserve and the FDIC—would have stabilized the U.S. financial system.[464]

Interestingly, some who attribute relative success to certain aspects of the TARP offer only faint praise. Dr. Dean Baker, Co-Director, Center for Economic and Policy Research, provided the following testimony to the Panel:

> There are many factors that make it difficult to assess the effectiveness of the TARP, most important one being the fact that the TARP was carried through in conjunction with rescue efforts by the Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve Board. The money made available to the financial system through these alternative mechanisms was considerably larger than the amount made available through the TARP. Furthermore, there is no publicly available information on the terms or the beneficiaries of the loans issued through the Fed's special lending facilities.
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> For this reason, there is no easy way to determine the importance of TARP funds in stabilizing the financial system. Clearly, the TARP did play a role in stopping the panic that was driving financial markets last year. Together with the other structures put in place, the TARP did succeed in restoring stability to the financial system.
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> However, keeping the financial system operating is a rather low bar. There is little doubt that the Federal Reserve Board, with its virtual unlimited ability to print money, can prevent a financial collapse. The relevant question is whether the TARP, along with the other programs put in place, restored stability in a way that best served the real economy and also can be viewed as fair by the American people. By these criteria, the TARP does not score very well.[465]

Roy Smith, Professor of Finance, New York University Stern School of Business, states in his written submission to the Panel that the role of the TARP was relatively small compared to that of the Federal Reserve. In his view, the greatest contribution of the program was its announcement, which signaled that the government intended to act, while the actual accomplishments of the program are "relatively few and unimportant." Professor Smith states

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[463] See pp. 74–81 of the Panel's December Report.

[464] Because it has served as a barrier to private-sector investment and capital formation, TARP has likely done much more to impede job creation and organic economic growth than it has done to promote them. U.S. unemployment recently surpassed 10 percent for the first time in 26 years and the broader definition of unemployment—including those who are underemployed and have stopped looking for work—recently jumped to 17.5 percent. Although the two metrics have fallen to 10 percent and 17.2 percent, respectfully, such improvements, while encouraging, hardly signal a return to a robust employment market.

[465] Congressional Oversight Panel, *Written Testimony of Center for Economic and Policy Research Co-Director Dean Baker, Taking Stock: Independent Views on TARP's Effectiveness,* at 1 (Nov. 19, 2009) (online at cop.senate.gov/documents/testimonyµ09111909-baker.pdf).

that Treasury's highest priority should be to recover the TARP's investment.[466]

William Isaac, chairman of the FDIC, 1981–1985, argues in his written submission to the Panel that the TARP legislation did more harm than good, and that the Federal Reserve, the FDIC and the SEC had the tools necessary to alleviate the financial crisis without taxpayer outlays. In Chairman Isaac's view, Treasury lacked the expertise and personnel to run the capital infusion program, and as a result Treasury should have turned the program over to the FDIC. Isaac criticizes Treasury for (i) forcing banks to participate in the TARP, (ii) publicly announcing the stress tests, and (iii) taking the position that the TARP is a revolving fund.[467]

2. Lending

Dr. Baker offered the following written testimony to the Panel regarding the lending activity of TARP recipients:

> The one sector that clearly is having difficulty securing credit is the small business sector. While this is an impediment to recovery, this sort of credit tightening is typical of a recession. The complaints from business owners over being denied credit are not qualitatively different than the complaints that were made in 1990–91 recession. Lenders will also tighten credit to business during a downturn simply because otherwise healthy businesses are much risk[ier] prospects during a recession. There is no reason to believe that the tightening of credit during this downturn is any greater than what should be expected given the severity of the recession. To press banks to make more loans in this context would be to insist that they make loans on which they expect to lose money. This would be questionable economic policy.[468]

Although some criticize the TARP for its failure to jump start new lending activity and for the creation of dysfunctional financial institutions (zombie banks), Dr. Baker notes that lending-for-the-sake-of-lending may sow the seeds of the next asset bubble and lead to another round of non-performing loans and toxic securitized debt instruments. Nevertheless, if the TARP is judged on the basis of whether it successfully restarted the lending market for large and small business credit, it appears that it has again failed to meet such expectation.

3. Taxpayer Protection

Roughly $71 billion of TARP funds have been paid back, mostly from large financial institutions who received equity injections as part of the CPP. In addition, Bank of America recently announced that it will repay the full $45 billion with interest it has accessed from the TARP. As Treasury unwinds several TARP programs where the taxpayers have recouped their investments with interest, the Panel should focus its attention on the new or existing pro-

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[466] Roy Smith, Letter to Panel Staff (Oct. 23, 2009).
[467] William Isaac, Letter to Panel Staff (Nov. 6, 2009).
[468] Congressional Oversight Panel, *Written Testimony of Center for Economic and Policy Research Co-Director Dean Baker, Taking Stock: Independent Views on TARP's Effectiveness,* at 4, 5 (Nov. 19, 2009) (online at cop.senate.gov/documents/testimony-111909-baker.pdf).

grams that are likely more enduring and costly to the taxpayers. The opportunity cost of not providing rigorous oversight in these areas is high. These programs include taxpayer funds directed to AIG, Chrysler, GM, GMAC, foreclosure mitigation, preferred and common share purchases in Citigroup, Bank of America and hundreds of additional large and small financial institutions and other initiatives. The Panel should undertake to analyze these programs to determine if the investment of taxpayer funds is appropriate, authorized under EESA and adequately protected. This undertaking is particularly important with respect to the TARP funded foreclosure mitigation programs since EESA requires the Panel to "ensure effective foreclosure mitigation efforts in light of minimizing long-term taxpayer costs and maximizing taxpayer benefits." It is difficult to conclude that Treasury has diligently discharged its taxpayer protection obligation given the TARP funds that will most likely be lost with respect to AIG, the auto related bailouts and the various foreclosure mitigation efforts.

4. Systemic, Implicit Guarantee and Moral Hazard Risks

Instead of reducing systemic risk the TARP has exacerbated the "too big to fail" problem by making the federal government the implicit guarantor of the largest American financial institutions as well as an undefined select group of business enterprises the failure of which might impede the Administration's economic, social and political agenda.[469] By evidencing its willingness to rescue businesses that engage in excessive risk taking and poor business judgment Treasury has created needless implicit guarantee and moral hazard risks and laid the foundation for another economic crisis. If the Administration provides a safety net from risky behav-

[469] The *Financial Times* reports that thirty institutions have made the latest "too big to fail list":

The list, which is not public, contains many of the multinational bank names that would be widely expected: Goldman Sachs, JPMorgan Chase, Morgan Stanley, Bank of America Merrill Lynch and Citigroup of the US; Royal Bank of Canada; UK groups HSBC, Barclays, Royal Bank of Scotland and Standard Chartered; UBS and Credit Suisse of Switzerland; France's Société Générale and BNP Paribas; Santander and BBVA from Spain; Japan's Mizuho, Sumitomo Mitsui, Nomura, Mitsubishi UFJ; Italy's UniCredit and Banca Intesa; Germany's Deutsche Bank; and Dutch group ING.

The exercise follows the establishment of the FSB in the summer and is principally designed to address the issue of systemically important cross-border financial institutions through the setting up of supervisory colleges. These colleges will comprise regulators from the main countries in which a bank or insurer operates and will have the job of better coordinating the supervision of cross-border financial groups.

As a spin-off from that process, the groups on the list will also be asked to start drawing up so-called living wills—documents outlining how each bank could be wound up in the event of a crisis.

Regulators are keen to see living wills prepared for all systemically important financial groups, but the concept has split the banking world, with the more complex groups arguing that such documents will be almost impossible to draft without knowing the cause of any future crisis.

Patrick Jenkins and Paul J. Davies, *Thirty Financial Groups on Systemic Risk List,* Financial Times (Nov. 30, 2009) (online at www.ft.com/cms/s/0/c680e0da-dd4e-11de-ad60–00144feabdc0.html).

The Wall Street Journal recently reported regarding Treasury's AIG exit strategy:

The bailout of AIG, owned 80% by taxpayers, is one of the most controversial of the government's unpopular bailouts. Yet with so much taxpayer money at stake, the government is asserting its ownership.

AIG is the best example of why the government should never get itself in the position of even having to make these tradeoffs, said Anil Kashyap, an economics professor at the University of Chicago Booth School of Business. "It's why you don't want the government involved in the private sector in the first place."

Deborah Solomon, *AIG's Rescue Bedevils U.S.,* Wall Street Journal (Nov. 23, 2009) (online at online.wsj.com/article/SB10001424052748703819904574554241356640428.html).

ior no one should be surprised if the intended recipients accept the offer and engage in such behavior. If the participants win their high risk bets they will reap all of the benefits but if they lose the taxpayers will bear the burden of picking up the pieces. It is possible that the TARP not only increased the number of "too big to fail" institutions but the size of such institutions as well.

Charles Calomiris, the Henry Kaufman Professor of Financial Institutions, Columbia Business School, stated in written testimony before the Panel:

> In my judgment, TARP and other interventions were not designed properly, and consequently assistance programs have resulted in less benefit to the economy than they should have (in particular, have resulted in insufficient mitigation of the credit crunch) and they have cost more than they should have (in the form of excessive taxpayer bearing of current losses, and unnecessary moral-hazard incentive costs going forward).
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> Government loans, guarantees and investments in troubled financial institutions (which even include potential capital infusions into the GSEs), not to mention government purchases of assets (as originally contemplated under the TARP plan, and as executed under the TALF plan) have resulted in huge losses to taxpayers (Fannie and Freddie and FHA subprime lending will account for the lion's share of these losses, as *they alone will approach half a trillion dollars)* and remaining risks of future loss. They also have changed the risk-taking behavior of financial institutions going forward. If financial institutions know that the government is there to share losses, risk-taking becomes a one-sided bet, and so more risk is preferred to less. There is substantial evidence from financial history—including the behavior of troubled financial institutions during the current crisis itself—that this "moral-hazard" problem can give rise to hugely loss-making, high-risk investments that are both socially wasteful and an unfair burden on taxpayers. [470] (emphasis in original.)

In order to avoid the creation of moral hazard risks, Professor Calomiris advises that any government sponsored intervention incorporate the following concepts:

> (1) Assistance should be offered only under *rare* circumstances. The purpose of assistance is not to prevent the failure of one or a few institutions, per se; assistance is only warranted when asymmetric information about the incidence of losses in the financial system leads to a general breakdown in financial market buying and selling, resulting in a liquidity crisis, which makes it impossible or excessively difficult for otherwise solvent borrowers to roll

[470] Congressional Oversight Panel, Written Testimony of Charles Calomiris, Henry Kaufman Professor of Financial Institutions, Columbia Business School, *Taking Stock: Independent Views on TARP's Effectiveness,* at 1, 3 (Nov. 19, 2009) (online at cop.senate.gov/documents/testimony-111909-calomiris.pdf).

over their debts, or for banks to prove their solvency to the market in order to access needed capital to shore up their positions.

(2) The design of assistance is crucial to maximizing its effectiveness and minimizing its social costs; particularly the allocation of the risk of loss between the private sector and the government is crucial to the successful design of assistance. Assistance should be *selective,* targeted toward institutions worth saving, not basket cases. Government should take a *senior* position in loss sharing; in discount window lending that is ensured through collateralization of loans; in preferred stock purchases, seniority is ensured through the adequacy of common equity; in other assistance programs, it is achieved through the structure of guarantees (e.g., their out-of-the-moneyness).

(3) The assistance toolkit must be *diverse.* The proper structure of assistance depends on the severity of the systemic crisis being addressed; discount window lending may be sufficient for dealing with liquidity crises that are not very severe, bank preferred stock purchases by the government may make sense for more severe shocks, and other mechanisms (organized rescues of failed institutions, or guarantees attached to liabilities or assets) may be the only effective tools to employ when the crisis is even more severe. No matter which of the tools is employed, the other principles (*rarity, selectivity,* and *seniority*) can and should be adhered to." [471] (emphasis in original).

Dr. Baker submitted the following testimony to the Panel regarding systemic risk:

> The crisis itself led to further concentration in the financial sector, with the largest banks all having been encouraged to buy up bankrupt competitors. As a result, the largest banks now enjoy fairly explicit "too big to fail" protection. There also has been almost nothing done to restrain the speculative practices of the major banks. Goldman Sachs, in particular, stands out by virtue of the fact that it is still acting as an investment bank (arguably, it can better be described as a hedge fund), even though it is now operating under the protective umbrella of the Federal Reserve Board and the FDIC. There does not appear to be any effort to restrain its speculative activity.

Simon Johnson, the Ronald Kurtz Professor of Entrepreneurship, MIT Sloan School of Management, stated in written testimony before the Panel:

> If any country pursues (a) unlimited government financial support, while not implementing (b) orderly resolution for troubled large institutions, and refusing to take on (c) serious governance reform, it would be castigated by the

[471] Congressional Oversight Panel, Written Testimony of Charles Calomiris, Henry Kaufman Professor of Financial Institutions, Columbia Business School, *Taking Stock: Independent Views on TARP's Effectiveness,* at 6, 7 (Nov. 19, 2009) (online at cop.senate.gov/documents/testimony-111909-calomiris.pdf).

> United States and come under pressure from the IMF. At the heart of every crisis is a political problem—powerful people, and the firms they control, have gotten out of hand. Unless this is dealt with as part of the stabilization program, all the government has done is provide an unconditional bailout. That may be consistent with a short-term recovery, but it creates major problems for the sustainability of the recovery and for the medium-term. Serious countries do not do this. Seen in this context, TARP has been badly mismanaged.
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> The implementation of TARP exacerbated the perception (and the reality) that some financial institutions are "Too Big to Fail." This lowers their funding costs, enabling them to borrow more and to take more risk.
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> The administration as much as said that the major banks will all pass the stress tests, making it appear that the results were foreordained. Essentially, this was used to signal that the government stood behind the 19 banks in the stress test and would not allow any of them to fail. Effectively, the government signaled which banks were Too Big To Fail.[472]

Viral Acharya and Matthew Richardson, Professors of Finance, New York University Stern School of Business, argue in their written submission to the Panel that the CPP did not include "sufficient strings attached," and as a result created the expectation of "unconditional government support" in the future. Moving forward, Professors Acharya and Richardson highlight the risks of moral hazard, noting "it is not just about fighting the last war, but also about the next one."[473]

Paul Volcker, former Chairman of the Federal Reserve, 1979–1987, and member of the Economic Recovery Advisory Board, states in his written submission to the Panel that Treasury "appears to have done a good job in structuring their capital investments," but questions the extent to which the program is currently having a positive impact on the flow of credit. Chairman Volcker also notes the problems associated with moral hazard, concluding that reform is necessary.[474]

William Poole, Senior Fellow, the Cato Institute, argues in his written submission to the Panel that the core issue in the financial system today is the subsidy to large banks created by the implicit federal guarantee of bank liability. Citing a recent paper by Dean Baker and Travis McArthur, Mr. Poole notes that the implicit subsidy may be as large as $34 billion per year. In addition to this subsidy, the funding advantage enjoyed by large banks permits them to grow larger, increasing the risks posed by banks that are

[472] Congressional Oversight Panel, Written Testimony of Professor Simon Johnson, Ronald Kurtz Professor of Entrepreneurship, MIT Sloan School of Management, *Taking Stock: Independent Views on TARP's Effectiveness,* at 2, 3, 7 (Nov. 19, 2009) (online at cop.senate.gov/documents/testimony–111909–johnson.pdf).

[473] Viral Acharya and Matthew Richardson, Letter to Panel Staff (received Nov. 6, 2009).

[474] Paul A. Volcker, Letter to Panel Staff (Nov. 6, 2009).

too big to fail. Poole also notes that efforts to control executive compensation are "unwise and will ultimately be ineffective."[475]

In a recent report, SIGTARP addressed the problem of moral hazard, stating that "TARP runs the risk of merely re-animating markets that had collapsed under the weight of reckless behavior."[476] I am concerned that the TARP is again inflating the problem of moral hazard by providing government funded capital to institutions that contributed to the crisis, modifications to homeowners who may have taken on too much risk, and lower-cost loans to spur the purchase of what may be volatile, high-priced asset backed securities.

The SIGTARP report also discussed the cost of the TARP to the government's credibility. It claims, "Unfortunately, several decisions by Treasury—including Treasury's refusal to require TARP recipients to report on their use of TARP funds, its less-than accurate statements concerning TARP's first investments in nine large financial institutions, and its initial defense of those inaccurate statements—have served only to damage the Government's credibility and thus the long-term effectiveness of TARP."[477] I do not see how Treasury will be able to regain the public's trust so long as it continues to employ taxpayer sourced funds to make investments based upon the Administration's economic, political and social agenda where there is diminished promise that such funds will be fully recouped.[478]

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[475] William Poole, Letter to Panel Staff (Oct. 23, 2009).

[476] SIGTARP, *Quarterly Report to Congress,* at 4 (Oct. 21, 2009) (online at sigtarp.gov/reports/congress/2009/October2009__Quarterly__Report__to__Congress.pdf).

[477] *Id.*

[478] There are three recent examples of the problems that may arise with respect to government financed investments in the private sector.

(i) A recent GAO report on the Chrysler and GM bailouts states:

> As long as Treasury maintains ownership interests in Chrysler and GM, it will likely be pressured to influence the companies' business decisions.
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> * * * * *
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> Treasury officials stated that they established such up-front conditions not solely to protect Treasury's financial interests as a creditor and equity owner but also to reflect the Administration's views on responsibly utilizing taxpayer resources for these companies. While Treasury has stated it does not plan to manage its stake in Chrysler or GM to achieve social policy goals, these requirements and covenants to which the companies are subject indicate the challenges Treasury has faced and likely will face in balancing its roles.

Government Accountability Office, *Troubled Asset Relief Program: Continued Stewardship Needed as Treasury Develops Strategies for Monitoring and Divesting Financial Interests in Chrysler and GM* (Nov. 2, 2009) (online at www.gao.gov/new.items/d10151.pdf).

(ii) Thomas E. Lauria, the Global Practice Head of the Financial Restructuring and Insolvency Group at White & Case LLP, represented a group of senior secured creditors, including the Perella Weinberg Xerion Fund ("Perella Weinberg"), during the Chrysler bankruptcy proceedings. On May 3, the *New York Times* reported:

> In an interview with a Detroit radio host, Frank Beckmann, Mr. Lauria said that Perella Weinberg 'was directly threatened by the White House and in essence compelled to withdraw its opposition to the deal under threat that the full force of the White House press corps would destroy its reputation if it continued to fight.'
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> In a follow-up interview with ABC News's Jake Tapper, he identified Mr. [Steven] Rattner, the head of the auto task force, as having told a Perella Weinberg official that the White House 'would embarrass the firm.'

Michael J. de la Merced, *White House Denies Claims of Threat to Chrysler Creditor,* New York Times (May 3, 2009) (online at dealbook.blogs.nytimes.com/2009/05/03white-house-perella-weinberg-deny-claims-of-threat-to-firm/). *See also* News/Talk WJR 760 am, *Frank Talks With Tom Lauria, Who Represents a Group of Lenders That Object to the Chrysler Sale* (May 1, 2009) (online at www.760wjr.com/article.asp?id=1301727&spid=6525).

For a further discussion of the interactions between Mr. Rattner and Perella Weinberg see William D. Cohan, *The Final Days of Merrill Lynch,* The Atlantic (Sept. 2009) (online at www.theatlantic.com/doc/200909/bank-of-america) and Steve Fishman, *Exit the Czar*, New York Magazine (Aug. 2, 2009) (online at nymag.com/news/features/58193/).

In my view and as supported by the above cited economists, the TARP has created substantial and needless implicit guarantee and moral hazard risks. In order to articulate these risks I offer the following analysis from the Panel's November report on the government sponsored guarantee programs which also applies to the broader TARP:

> A larger issue arises when one considers the implicit guarantees, those that are paid for by neither party, but whose cost is borne by the taxpayer. The [government sponsored guarantee programs] carry fees paid for by the financial institutions. But their existence, and the existence of the other elements of the bailout of the financial system, could imply that there is a permanent, and "free," insurance provided by the government, especially for those institutions deemed "too big to fail," or "too connected to fail." There is an implication that, in the case of another major economic collapse, the government will again step in to prop up the financial system, especially the "too big to fail" institutions. This moral hazard creates a real risk to the system.
>
> This "free" insurance causes a number of distortions in the marketplace. On the financial institution side, it might promote risky behavior. On the investor and shareholder side, it will provide less incentive to hold management to a high standard with regard to risk-taking. By creating a class of "too big to fail" institutions, it has provided these institutions with an advantage with respect to the pricing of credit:
>
> Creditors who believe that an institution will be regarded by the government as too big to fail may not price into their extensions of credit the full risk assumed by the institution. That, of course, is the very definition of moral hazard. Thus the institution has funds available to it at a price that does not fully internalize the social costs associated with its operations. The consequences are a diminu-

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I requested Secretary Geithner to investigate the allegation and, to my disappointment, he declined. Specifically, I submitted the following question for the record to the Secretary: "Will you agree to conduct a prompt and thorough investigation of this matter by contacting Mr. Rattner, Mr. Lauria and representatives of Weinberg Perella and submit your findings to the Panel?"

The Secretary responded: "SIGTARP will determine the appropriate actions with regards to this issue. But as noted above, I would reiterate that Mr. Rattner categorically denies Mr. Lauria's allegations."

Again, I ask the Secretary to investigate this matter and report his findings to the Panel.

See my dissent from the September report on the auto bailouts. Representatives Jeb Hensarling, *Additional Views to Congressional Oversight Panel, September Oversight Report: The Use of TARP Funds in the Support and Reorganization of the Domestic Automotive Industry* (Sept. 9, 2009) (online at cop.senate.gov/documents/cop-090909-report-additionalviews.pdf).

(iii) *The Wall Street Journal* recently reported:

> Federal support for companies such as GM, Chrysler Group LLC and Bank of America Corp. has come with baggage: Companies in hock to Washington now have the equivalent of 535 new board members—100 U.S. senators and 435 House members.
>
> Since the financial crisis broke, Congress has been acting like the board of USA Inc., invoking the infusion of taxpayer money to get banks to modify loans to constituents and to give more help to those in danger of foreclosure. Members have berated CEOs for their business practices and pushed for caps on executive pay. They have also pushed GM and Chrysler to reverse core decisions designed to cut costs, such as closing facilities and shuttering dealerships.

Neil King, Jr., *Politiciand Butt In at Bailed-Out GM,* Wall Street Journal (Oct. 29, 2009) (online at online.wsj.com/article/SB125677552001414699.html#mod=todays—us—page—one).

tion of market discipline, inefficient allocation of capital, the socialization of losses from supposedly market-based activities, and a competitive advantage for the large institution compared to smaller banks.[479]

The implied guarantee of "too big to fail" institutions might also result in a concentration of risk in this group, resulting in greater danger to the taxpayer if and when the government must step in again.

5. Political Risk

In addition to the implicit guarantee and moral hazard issues discussed above, I am troubled that the implementation of the TARP has caused the private sector to incorporate the concept of "political risk" into its analysis before engaging in any direct or indirect transaction with the United States government. While private sector participants are accustomed to operating within a complex legal and regulatory environment, many are unfamiliar with the emerging trend of public sector participants to bend or restructure rules and regulations so as to promote their economic, social and political agenda as was clearly evident in the Chrysler and GM bankruptcies (described in more detail below). The realm of political risk is generally reserved for business transactions undertaken in developing countries and not interactions between private sector participants and the United States government. Following the Chrysler and GM decisions it is possible that private sector participants may begin to view interactions with the United States government through the same jaundiced eye they are accustomed to directing toward third-world governments. It's disingenuous for the Administration to champion transparency and accountability for the private sector but neglect such standards when conducting its own affairs. How is it possible for directors and managers of private sector enterprises to discharge their fiduciary duties and responsibilities when policy makers legislate and regulate without respect for precedent and without thoughtfully vetting the unintended consequences of their actions?

6. Transparency and Accountability

Although improvements have been made, Treasury has often been less than forthcoming regarding matters of transparency and accountability. I agree with Alex Pollock, a Resident Fellow with the American Enterprise Institute, that Treasury should provide detailed financial statements to the taxpayers and operate its TARP investments in a businesslike manner. Mr. Pollock provided the following testimony to the Panel:

> The principal goal should be to run [TARP] in a businesslike manner to return as much of the involuntary investment as possible to its owners, along with a reasonable overall profit. The predominant discipline should be that of investment management, not politics.

* * * * *

[479] Board of Governors of the Federal Reserve System, Speech: Federal Reserve Board Governor Daniel K. Tarullo at the Exchequer Club, Washington D.C., *Confronting Too Big to Fail* (Oct. 21, 2009) (online at www.federalreserve.gov/newsevents/speech/tarullo20091021a.htm).

In my view, TARP should have full, regular, audited financial statements, which depict its financial status and results, exactly as if it were a corporation. There should be a balance sheet, with all assets, liabilities, accumulated profits or losses, and contingencies. There should be a profit and loss statement and a statement of cash flows. The expenses should include the interest cost of the Treasury debt required to fund its disbursements, and like every financial operation, TARP management should be estimating probable losses on investments and reserving accordingly.

Had TARP been organized as a corporation, it would have facilitated this accountability. But even with its status as a "program", we should insist on appropriate and regular accounting. Everybody must agree with this basic requirement for financial responsibility.

Moreover, TARP's financial statements should include line of business reporting. Logical separate profit and loss reporting units would include: the Capital Purchase Program; automotive program; Citigroup; AIG; mortgage modification (of course a total loss from the TARP point of view); and small business and consumer programs.[480]

7. Financial Stability v. Economic Stimulus

The TARP was promoted as a way to provide "financial stability," and the American Reinvestment and Recovery Act (ARRA) was promoted as a way to provide "economic stimulus." In testimony on the still-nascent TARP, former Treasury Secretary Henry Paulson reminded Congress, "[t]he rescue package was not intended to be an economic stimulus or an economic recovery package; it was intended to shore up the foundation of our economy by stabilizing the financial system. . ."[481] Regrettably, the TARP has evolved from a program aimed at financial stability during a time of crisis to one that increasingly resembles another attempt by the Administration to promote its economic, political and social agenda through fiscal stimulus. If the TARP is not being used for "economic stimulus," then how else is it possible to explain the $81 billion bankruptcy restructuring of Chrysler and GM, neither of which qualifies as a "financial institution" as required under EESA? In addition, the United States government has agreed to transfer to Fiat part of the equity it received in Chrysler if Fiat assists Chrysler in building a car that produces 40 miles per gallon. What does this transfer of United States government owned Chrysler stock to Fiat have to do with "financial stability"? No transparent end-game is in sight for the TARP's commitment to support Chrysler, GM and GMAC.

[480] Congressional Oversight Panel, Written Testimony of American Enterprise Institute resident fellow Alex J. Pollock, *Taking Stock: Independent Views on TARP's Effectiveness* (Nov. 19, 2009) (online at aei.org/docLib/Pollock-Testimonyµ-11192009.pdf).

[481] U.S. Department of the Treasury, *Testimony of Treasury Secretary Paulson before the House Financial Services Committee* (Nov. 18, 2008) (online at www.treasury.gov/press/releases/hp1279.htm).

D. Chrysler and GM Bankruptcies [482]

The bankruptcy restructurings of Chrysler and GM and the recapitalization of GMAC were financed with TARP proceeds. These cases serve as the poster child of why the TARP should end on December 31, 2009. If the TARP is extended to October 31, 2010, I fear the Administration will continue to employ taxpayer resources as a revolving bailout fund to promote its economic, social and political agenda as was clearly evident in the Chrysler, GM and GMAC bankruptcy restructurings. These restructurings failed each of the standards noted above by exacerbating implicit guarantee and moral hazard risks, incorporating a heavy dose of political risk into private-public sector interactions, offering little in the way of taxpayer protection, transparency and accountability, and using funds dedicated to financial stability for economic stimulus.[483]

1. Policy Issues and Fundamental Questions Arising from the Use of TARP Proceeds in the Chrysler and GM Bankruptcies

Over the past year taxpayers have involuntarily "invested" over $81 billion [484] in Chrysler, GM, GMAC and the other auto programs. According to a recent estimate from the CBO, the investment of TARP funds in the auto industry is expected to add $40 billion more to the deficit than CBO calculated just five months earlier in March 2009.[485] A reasonable interpretation of such an estimate provides that the American taxpayers may suffer a loss of over 50 percent of the TARP funds invested in Chrysler, GM and the other auto programs.[486]

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[482] In this section I borrow extensively from my dissent to the Panel's September report on the auto bailouts. Representative Jeb Hensarling, Additional Views to Congressional Oversight Panel, September Oversight Report: The Use of TARP Funds in the Support and Reorganization of the Domestic Automotive Industry (Sept. 9, 2009) (online at cop.senate.gov/documents/cop-090909-report-additionalviews.pdf).

[483] Edward Niedermeyer, *Taking Taxpayers for a Ride,* New York Times (Nov. 22, 2009) at www.nytimes.com/2009/11/23/opinion/23niedermayer.html?__r=1&sq=taking taxpayers for a ride niedermeyer november22&st=cse&adxnnl=1&scp=1&adxnnlx=1259856084-RhEqA9+sraJEUegFNAcvew).

[484] According to the Panel's December report, $2.2 billion of the funds advanced under the Auto Industry Financing Program have been repaid. See Figure 25 of this Report, supra.

[485] Congressional Budget Office, *The Budget and Economic Outlook: An Update August 2009,* at 55–56 (online at www.cbo.gov/ftpdocs/105xx/doc10521/08–25-BudgetUpdate.pdf) (accessed Dec. 8, 2009). The report provides in part:

> *The improvement in market conditions results in a reduction in the subsidy rate associated with the Capital Purchase Program (CPP)*—a major initiative through which the government purchases preferred stock and warrants (for the future purchase of common stock) from banks. CBO has dropped the projected subsidy for the remaining investments in that program from 35 percent in the March baseline to 13 percent. The decrease in the estimated CPP subsidy cost also reflects banks' repurchase of $70 billion of preferred stock through June. Similarly, the estimated subsidy cost for other investments in preferred stock (for example, that of American International Group) has also been reduced. *Partially offsetting those reductions in projected costs is the expansion of assistance to the automotive industry; CBO has raised its estimate of the costs of that assistance by nearly $40 billion relative to the March baseline.* (emphasis added).

In addition, our country faces a staggering deficit of $1.6 trillion in 2009, and a debt that more-than-triples in ten years.

[486] How is it possible that with the economic challenges facing our nation the Administration chose to allocate such a significant share of the TARP to such questionable investments? How much additional funding will be provided by the Administration for Chrysler and GM? What is the strategy and timeline for recouping taxpayer dollars? See Keith Bradsher, *G.M. is Said to Agree to Sell Stakes to China Partner,* New York Times (Dec. 3, 2009) (online at www.nytimes.com/2009/12/04/business/global/04gm.html?hp). What are the metrics for determining whether or not Chrysler and GM are "successful," and will the Administration continue to provide assistance until this is attained?

By making such an unprecedented investment in Chrysler and GM[487] the Administration by definition chose not to assist other Americans who are in need. With the economic suffering the American taxpayers have endured during the past two years one wonders why Chrysler and GM merited such generosity to the exclusion of other taxpayers. Why, indeed, did the United States government choose to reward two companies that have been arguably mismanaged for many years at the expense of other hard working taxpayers? More poetically, *The New York Times* on July 25 asked: "Why, after all, should the automakers receive the equivalent of a Technicolor dreamcoat, giving them favorite-son status, when other industries, like airlines and retailers, also have suffered from the national recession?" More bluntly, the September 2009 issue of *The Atlantic* simply cut to the bottom line: "Essentially, the government was engineering a transfer of wealth from TARP bank shareholders to auto workers, and pressuring other creditors to go along."[488] The Chrysler and GM reorganizations represent a sad day for the rule of law, the sanctity of commercial law principles and contractual rights, long term economic growth, and the ideal that the United States government should not pick winners and losers.

Given the unorthodox reordering of the rights of the Chrysler and GM creditors, a fundamental question arises as to whether the Administration directed that TARP funds be used to advance its economic, social and political objectives rather than to stabilize the American economy as required by EESA. It has long been my view that the United States government should not engage in the business of picking winners and losers and certainly should not allocate its limited resources to favor one group of taxpayers over another. Following the Chrysler and GM bankruptcies one has to question what's next in the Administration's playbook—a bailout of the airline industry and its unionized workforce? What about Starbucks?

2. Transfer of TARP Proceeds and Retirement Saving of Indiana School Teachers and Police Officers to the UAW and the VEBAs

On a "before" v. "after" basis the Chrysler and GM bankruptcy cases make little legal or economic sense.[489] How is it possible that

[487] In the bankruptcy proceedings for Chrysler and GM, (i) "Old Chrysler" sold substantially all of its assets to "New Chrysler" and (ii) "Old GM" sold substantially all of its assets to "New GM," each pursuant to Section 363 of the United States Bankruptcy Code. For purposes of simplicity, I generally refer to these entities as "Chrysler" or "GM," but occasionally employ other terms as appropriate.

[488] William D. Cohan, *The Final Days of Merrill Lynch,* The Atlantic (Sept. 2009) (online at www.theatlantic.com/doc/200909/bank-of-america).

[489] The Chrysler and GM bankruptcy rearranged the rights of the creditors and equity holders as follows: *Chrysler.* Pursuant to the Chrysler bankruptcy, the equity of New Chrysler was allocated as follows:

(i) United States government (9.846 percent initially, but may decrease to 8 percent),
(ii) Canadian government (2.462 percent initially, but may decrease to 2 percent),
(ii) Fiat (20 percent initially, but may increase to 35 percent), and
(iii) UAW (comprising current employee contracts and a VEBA for retired employees) (67.692 percent, but may decrease to 55 percent).

The adjustments noted above permit Fiat to increase its ownership interest from 20 percent to 35 percent by achieving specific performance goals relating to technology, ecology and distribution designed to promote improved fuel efficiency, revenue growth from foreign sales and US based production.

Some, but not all, of the claims of the senior secured creditors were of a higher bankruptcy priority than the claims of the UAW/VEBA.

Continued

the Chrysler and GM VEBAs[490]—unsecured creditors—received a greater allocation of proceeds than the Chrysler senior secured creditors or the GM bondholders? In other words, why did the United States government spend tens of billions of dollars of taxpayer money to bailout employees and retirees of the UAW to the detriment of other non-UAW employees and retirees—such as retired school teachers and police officers from the State of Indiana[491]—whose pension funds invested in Chrysler and GM indebtedness?[492]

What message do the Chrysler and GM holdings send to non-UAW employees whose pension funds invested in Chrysler and GM indebtedness—you lose part of your retirement savings because your pension fund does not have the special political relationships of the UAW? What message do the Chrysler and GM bankruptcies send to the financial markets—contractual rights of investors may be ignored when dealing with the United States government?

In written testimony submitted to the Panel, Barry E. Adler, professor of law and business at New York University, noted:

> There are at least two negative consequences from the disregard of creditor rights. First, at the time of the deviation from contractual entitlement, there is an inequitable

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The Chrysler senior secured creditors received 29 cents on the dollar ($2 billion cash for $6.9 billion of indebtedness).

The UAW/VEBA, an unsecured creditor, received (x) 43 cents on the dollar ($4.5 billion note from New Chrysler for $10.5 billion of claims) and (y) a 67.692 percent (which may decrease to 55 percent) equity ownership interest in New Chrysler.

GM. Pursuant to the GM bankruptcy, the equity of New GM was allocated as follows:

(i) United States government (60.8 percent),
(ii) Canadian government (11.7 percent),
(iii) UAW (comprising current employee contracts and a VEBA for retired employees) (17.5 percent), and
(iv) GM bondholders (10 percent).

The bankruptcy claims of the UAW/VEBA and the GM bondholders were of the same bankruptcy priority.

The equity interest of the UAW/VEBA and the GM bondholders in New GM may increase (with an offsetting reduction in each government's equity share) to up to 20 percent and 25 percent, respectively, upon the satisfaction of specific conditions. It is important to note, however, the warrants received by the UAW/VEBA and the GM bondholders are out of the money and it's possible they will not be exercised. As such, it seems likely that the UAW/VEBA and the GM bondholders will hold 17.5 percent and 10 percent, respectively, of the equity of New GM.

The GM bondholders exchanged $27 billion in unsecured indebtedness for a 10 percent (which may increase to 25 percent) common equity interest in New GM, while the UAW/VEBA exchanged $20 billion in claims for a 17.5 percent (which may increase to 20 percent) common equity interest in New GM and $9 billion in preferred stock and notes in New GM.

[490] The Chrysler and GM VEBAs (voluntary employee benefit associations) administer and fund the health and retirement plans of Chrysler and GM retirees.

[491] The Chrysler senior secured debt and the GM bonds were held by pension funds (for the benefit of retirees such as the Indiana school teachers and police officers), individuals (including the retirees who have contacted my office to ask why they lost their savings but UAW employees benefited) as well as different types of business entities.

[492] If you trace the funds, TARP money was employed by New Chrysler and New GM to purchase assets of the old auto makers, yet a substantial portion of the equity in the new entities was transferred to the VEBAs and, thus, not retained for the benefit of the American taxpayers (who funded the TARP) or shared with other creditors of Old Chrysler and Old GM. Accordingly, it's hardly a stretch to conclude that TARP funds were transferred to the UAW and the VEBAs after being funneled through New Chrysler and New GM. In addition, New Chrysler and New GM entered into promissory notes and other contractual arrangements for the benefit of the VEBAs, but not for the benefit of the other creditors of Old Chrysler and Old GM. Why did the United States government—the controlling shareholder of New Chrysler and New GM—direct New Chrysler and New GM to make an exclusive gift of taxpayer funds to the VEBAs? Why didn't New Chrysler and New GM transfer more of their equity interests to the creditors of Old Chrysler and Old GM? Why were Indiana school teachers and police officers and other investors in the Chrysler senior secured indebtedness and the GM bonds in effect forced by the Administration to transfer a portion of their claims against Chrysler and GM, respectively, to the UAW and the VEBAs? That is, why did the Administration orchestrate two bankruptcy plans whereby one group of employees and retirees was preferred to another?

distribution of assets. Take the Chrysler case itself, where the approved transaction well-treated the retirement funds of the UAW. If such treatment deprived the secured creditors of their due, one might well wonder why the UAW funds should be favored over other retirement funds, those that invested in Chrysler secured bonds. Second, and at least as importantly, when the bankruptcy process deprives a creditor of its promised return, the prospect of a debtor's failure looms larger in the eyes of future lenders to future firms. As a result, given the holding in Chrysler, and the essentially identical holding in the General Motors case, discussed next, one might expect future firms to face a higher cost of capital, thus dampening economic development at a time when the country can least well afford impediments to growth.[493]

In an article analyzing the Chrysler and GM bankruptcies, Mark J. Roe and David A. Skeel, professors of law at Harvard University and the University of Pennsylvania, respectively, noted:

> Warren Buffett worried in the midst of the reorganization that there would be "a whole lot of consequences" if the government's Chrysler plan emerged as planned, which it did. If priorities are tossed aside, as he implied they were, "that's going to disrupt lending practices in the future." "If we want to encourage lending in this country," Buffett added, "we don't want to say to somebody who lends and gets a secured position that the secured position doesn't mean anything."[494]

In an op-ed in *The Wall Street Journal,* Todd J. Zywicki, professor of law at George Mason University, noted:

> By stepping over the bright line between the rule of law and the arbitrary behavior of men, President Obama may have created a thousand new failing businesses. That is, businesses that might have received financing before but that now will not, since lenders face the potential of future government confiscation. In other words, Mr. Obama may have helped save the jobs of thousands of union workers whose dues, in part, engineered his election. But what about the untold number of job losses in the future caused by trampling the sanctity of contracts today?[495]

In the September 2009 issue of *The Atlantic,* William D. Cohan notes:

> "The rules as to how the government will act are not what we learned," explained Gary Parr, the deputy chairman of Lazard and one of the leading mergers-and-acquisitions advisers to financial institutions. "In the last 12 months, new precedents have been set weekly. The old

[493] Congressional Oversight Panel, Written Testimony of Barry E. Adler, *Field Hearing on the Auto Industry* (July 27, 2009) (online at cop.senate.gov/documents/testimony-072709-adler.pdf).
[494] Mark Roe and David Skeel, *Assessing the Chrysler Bankruptcy* (Aug. 12, 2009) (online atssrn.com/abstract=1426530).
[495] Todd Zywicki, *Chrysler and the Rule of Law,* Wall Street Journal (May 13, 2009) (online at online.wsj.com/article/SB124217356836613091.html).

> rules often don't apply as much anymore." He said the recent examples of the government's aggression are "a really big deal," but adds, "I am not sure it is going to last a long time. I sure hope not. I can't imagine the markets will function properly if you are always wondering if the government is going to step in and change the game."[496]

Richard A. Epstein, the James Parker Hall Distinguished Service Professor of Law, The University of Chicago, the Peter and Kirsten Bedford Senior Fellow, The Hoover Institution, and a visiting law professor at New York University Law School, offered the following analysis in the May 12, 2009 issue of Forbes:

> The proposed bankruptcy of the now defunct Chrysler Corp. is the culmination of serious policy missteps by the Bush and Obama administrations. To be sure, the long overdue Chrysler bankruptcy is a welcomed turn of events. But the heavy-handed meddling of the Obama administration that forced secured creditors to the brink is not.
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> A sound bankruptcy proceeding should do two things: productively redeploy the assets of the bankrupt firm and correctly prioritize various claims against the bankrupt entity. The Chrysler bankruptcy fails on both counts.
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> * * * * *
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> In a just world, that ignominious fate would await the flawed Chrysler reorganization, which violates these well-established norms, given the nonstop political interference of the Obama administration, which put its muscle behind the beleaguered United Auto Workers. Its onerous collective bargaining agreements are off-limits to the reorganization provisions, thereby preserving the current labor rigidities in a down market.
>
> Equally bad, the established priorities of creditor claims outside bankruptcy have been cast aside in this bankruptcy case as the unsecured claims of the union health pension plan have received a better deal than the secured claims of various bond holders, some of which may represent pension plans of their own.
>
> President Obama—no bankruptcy lawyer—twisted the arms of the banks that have received TARP money to waive their priority, which is yet another reason why a government ownership position in banks is incompatible with its regulatory role. Yet the president brands the non-TARP lenders that have banded together to fight this bogus reorganization as "holdouts" and "speculators."
>
> Both charges are misinformed at best. A holdout situation arises when one party seeks to get a disproportionate return on the sale of an asset for which it has little value in use. Thus the owner of a small plot of land could hold out for a fortune if his land is the last piece needed to assemble a large parcel of land. But the entire structure of bankruptcy eliminates the holdout position of all creditors,

[496] William D. Cohan, *The Final Days of Merrill Lynch,* The Atlantic (Sept. 2009) (online at www.theatlantic.com/doc/200909/bank-of-america).

> secured and unsecured alike, by allowing the court to "cram" the reorganization down their throats so long as it preserves the appropriate priorities among creditors and offers the secured creditors a stake in the reorganized business equal to the value of their claims. Ironically, Obama's Orwellian interventions have allowed unsecured union creditors to hold out for more than they are entitled to.
>
> His charge of "speculation" is every bit as fatuous. Speculators (who often perform a useful economic function) buy high-risk assets at low prices in the hope that the market will turn in their favor. By injecting unneeded uncertainty into the picture, Obama has created the need for a secondary market in which nervous secured creditors, facing demotion, sell out to speculators who are better able to handle that newly created sovereign risk. He calls on citizens to buy Chrysler products, but patriotic Americans will choose to go to Ford, whose own self-help efforts have been hurt by the Chrysler and GM bailouts.
>
> Sadly, long ago Chrysler and GM should have been allowed to bleed to death under ordinary bankruptcy rules, without government subsidy or penalty. Libertarians have often remarked on these twin dangers in isolation. The Chrysler fiasco confirms their deadly synergistic effect.[497]

In his testimony before the Judiciary Committee of the United States House of Representatives, Andrew M. Grossman, senior legal policy analyst, The Heritage Foundation, stated:

> Also detrimental to General Motors and Chrysler is the difficulty that they will have accessing capital and debt markets. Lenders know how to deal with bankruptcy—it's a well understood risk of doing business. But the tough measures employed by the Obama Administration to cram down debt on behalf of the automakers were unprecedented and will naturally make lenders reluctant to do business with these companies, for fear they could suffer the same fate. Even secured and senior creditors, those who forgo higher interest rates to protect themselves against risks, suffered large, unexpected losses. So nothing that either company can offer, no special status or security measure, can fully assuage lenders' fears that, in an economic downturn, they could be forced to accept far less than the true value of their holdings. At best, if General Motors and Chrysler have access to debt markets at all, they will have to pay dearly for the privilege. At worst, even high rates and tough covenants will not be enough to attract interest.
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> The Obama Administration's transparent favoritism toward its political supporters in the United Auto Workers

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[497] Richard Epstein, *The Deadly Sins Of The Chrysler Bankruptcy,* Forbes (May 12, 2009) (online at www.forbes.com/2009/05/11/chrysler-bankruptcy-mortgage-opinions-columnists-epstein.html).

Union may lead other unions to demand the same: hefty payouts and ownership stakes in exchange for halfhearted concessions. Lenders know now that the Administration is unable to resist such entreaties. As one hedge fund manager observed, "The obvious [lesson] is: Don't lend to a company with big legacy liabilities, or demand a much higher rate of interest because you may be leapfrogged in bankruptcy."

Perhaps the most affected will be faltering corporations and those undergoing reorganization—that is, the enterprises with the greatest need for capital. Lending money to a nearly insolvent company is risky enough, but that risk is magnified when bankruptcy ceases to recognize priorities or recognize valid liens. With private capital unavailable, larger corporations in dire straits will turn to the government for aid—more bailouts—or collapse due to undercapitalization, at an enormous cost to the economy.

* * * * *

Financial institutions—enterprises that the federal government has already spent billions to strengthen—will also be affected. Many hold debt in domestic corporations that could be subject to government rescue, rendering their obligations uncertain. It is that uncertainty which transforms loans into impossible-to-value toxic assets and blows holes in balance sheets across the economy.

Finally, there are the investors, from pension funds and school endowments to families building nest eggs for their future. General Motors bonds, like the debt of other long-lived corporations, has been long regarded as a refuge from the turmoil of equity markets. The once-safe investment held directly by millions of individuals and indirectly, through funds and pensions, by far more, are now at risk, which will be reflected in those assets' values.[498]

3. The Use of TARP Funds in the Chrysler and GM Bankruptcies

Section 101(a)(1) of the EESA states that:

> The Secretary [of the Treasury] is authorized to . . . purchase, and to make and fund commitments to purchase, troubled assets from any *financial institution,* on such terms and conditions as are determined by the Secretary, and in accordance with this Act and the policies and procedures development and published by the Secretary. (emphasis added).

A plain reading of the statute would necessarily preclude the employment of TARP funds for the benefit of the auto industry because, among other reasons, neither Chrysler nor GM qualifies as a "financial institution." If Chrysler and GM are somehow deemed to qualify as "financial institutions," then what business enterprise

[498] Andrew M. Grossman, *Bailouts, Abusive Bankruptcies, And the Rule of Law, Testimony before the Judiciary Committee of the United States House of Representatives* (May 21, 2009) (online at www.heritage.org/Research/Economy/tst052209a.cfm).

will fail to so qualify? If Congress had intended for the TARP to cover all business enterprises it would not have incorporated such a restrictive term as "financial institution" into EESA.

Further, a funding bill specifically aimed at assisting the auto industry was not approved by Congress. Nevertheless, the Bush Administration extended credit to Chrysler and GM and the Obama Administration orchestrated the Chrysler and GM bankruptcies which resulted in an investment of over $81 billion in the auto industry.

Since the authority for such an investment remains unclear, I requested that the Administration provide the Panel with a formal written legal opinion justifying:[499]

(i) the use of TARP funds to support Chrysler and GM prior to their bankruptcies;

(ii) the use of TARP funds in the Chrysler and GM bankruptcies;

(iii) the transfer of equity interests in New Chrysler and New GM to the UAW/VEBAs; and

(iv) the delivery of notes and other credit support by New Chrysler and New GM for the benefit of the UAW/VEBAs.[500]

Such opinions have not been delivered.

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[499] In a written response to the Panel the Administration stated:

The Treasury described the authority to use TARP funds to finance the old Chrysler and GM in bankruptcy court filings made on its behalf by the Department of Justice, specifically in the Statement of the United States of America Upon The Commencement of General Motors Corporation's Chapter 11 Case filed June 10, 2009, a copy of which has been provided to the Congressional Oversight Panel. In Judge Gerber's final sale order in the GM bankruptcy case dated July 5, 2009, also provided to the Congressional Oversight Panel, he wrote:

The U.S. Treasury and Export Development Canada ("EDC"), on behalf of the Governments of Canada and Ontario, have extended credit to, and acquired a security interest in, the assets of the Debtors as set forth in the DIP Facility and as authorized by the interim and final orders approving the DIP Facility (Docket Nos. 292 and 2529, respectively). Before entering into the DIP Facility and the Loan and Security Agreement, dated as of December 31, 2008 (the "Existing UST Loan Agreement"), the Secretary of the Treasury, in consultation with the Chairman of the Board of Governors of the Federal Reserve System and as communicated to the appropriate committees of Congress, found that the extension of credit to the Debtors is "necessary to promote financial market stability," and is a valid use of funds pursuant to the statutory authority granted to the Secretary of the Treasury under the Emergency Economic Stabilization Act of 2008, 12 U.S.C. §§5201 et seq. ("EESA"). The U.S. Treasury's extension of credit to, and resulting security interest in, the Debtors, as set forth in the DIP Facility and the Existing UST Loan Agreement and as authorized in the interim and final orders approving the DIP Facility, is a valid use of funds pursuant to EESA.

The rationale and determination of the ability to use TARP funds applies equally to the financing provided to the new Chrysler. There was no new financing provided to New GM. Instead, cash flowed from old GM to new GM as part of the asset sale, and new GM assumed a portion of the loan that Treasury had made to old GM.

The interests received by other stakeholders of Chrysler and GM including the UAW/VEBAs were a result of negotiations between all stakeholders as described in detail by myself and Harry Wilson in our depositions in the bankruptcy cases, transcripts of which have been provided to the Congressional Oversight Panel.

I find the response unhelpful and ask the Administration to provide a formal written legal opinion supporting its position. Since Congress specifically rejected the bailout of Chrysler and GM, under what theory and precedent did the Executive unilaterally invest $81 billion in these non-financial institutions?

[500] The promissory notes issued to the UAW/VEBAs are senior to the equity issued to the United States government. Since the government controlled New Chrysler and New GM at the time the notes were issued, it's apparent that the government agreed to subordinate the TARP claims held by the American taxpayers to the claims held by the UAW/VEBAs. What was the purpose of the subordination except perhaps to prefer the claims of a favored class over the claims of the taxpayers who funded the TARP?

4. Analysis of the Chrysler and GM Cases by Bankruptcy Scholars and Pressure on TARP Recipients

A number of bankruptcy academics at top-tier law schools have questioned the holdings in the Chrysler and GM bankruptcies. In the Chrysler and GM proceedings, Section 363 of the United States bankruptcy code was used by the Administration to upset well established commercial law principles and the contractual expectations of the parties. As Professors Adler, Roe and Skeel note, the Chrysler and GM bankruptcy courts required each Section 363 bidder to assume certain obligations of the UAW/VEBAs as part of its bid. This means that potential purchasers could not simply acquire the assets free and clear of the liabilities of the seller, but, instead, were also required to assume certain of those liabilities. This requirement most likely chilled the bidding process and precluded the determination of the true fair market value of the assets held by Chrysler and GM. By disrupting the bidding process it's entirely possible that TARP proceeds were misallocated away from the Chrysler senior secured creditors and the GM bondholders to the UAW/VEBAs.[501] Although I do not concur that EESA authorized the use of TARP proceeds in the Chrysler and GM bailouts, it's nevertheless important to follow the TARP funds once they were committed.

The technical bankruptcy laws issues are exacerbated because the winning purchaser in the Chrysler and GM cases—entities directly or indirectly controlled by the United States government—had virtually unlimited resources, which is certainly not the case in typical private equity transactions. The matter becomes particularly muddled when you consider that a majority in interest of the

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[501] A summary of the analysis of Professors Adler, Roe and Skeel as well as a set of examples are included in Appendix A to my Dissenting Views to the Panel's September Auto Report. Representative Jeb Hensarling, *Additional Views to Congressional Oversight Panel, September Oversight Report: The Use of TARP Funds in the Support and Reorganization of the Domestic Automotive Industry* (Sept. 9, 2009) (online at cop.senate.gov/documents/cop-090909-report-additionalviews.pdf).

The following example illustrates how the Administration used Section 363 of the bankruptcy code to achieve its economic, social and political objectives at the expense of the American taxpayers and the Chrysler senior secured creditors and GM bondholders.

Assume Oldco (i.e., Old Chrysler or Old GM) has (i) assets with a fair market value (FMV) of $70, (ii) secured debt (with liens on $40 FMV of assets) in an outstanding principal amount of $90 held by Creditor 1, and (iii) unsecured debt in an outstanding principal amount of $50 held by Creditor 2. Creditor 1 in effect holds two claims, a $40 secured claim (equal to the FMV of the assets securing Creditor 1's claim) and a $50 unsecured claim (which together equal Creditor 1's total claim of $90); and Creditor 2 holds a $50 unsecured claim. Any distribution on the unsecured claims should be shared 50/50 percent (because each creditor holds a $50 unsecured claim) under the "no unfair discrimination" rule of Chapter 11.

If, in a Section 363 sale, Newco (i.e., New Chrysler or New GM) purchased the Oldco assets (with no assumption of Oldco liabilities) for $70 FMV, then the $70 cash proceeds would be distributed as follows: Creditor 1 would receive $55 ($40 secured position, plus $15 unsecured position), and Creditor 2 would receive $15.

Conversely, if in the Section 363 sale the bankruptcy court required Newco to assume Creditor 2's debt of $50, then Newco would only pay $20 cash for the Oldco assets ($70 FMV of assets, less $50 required assumption of Creditor 2's debt). In such event, Creditor 1 would only receive $20 (representing 100 percent of the cash sales proceeds from the Section 363 sale, but leaving a shortfall of $70 ($90, less $20)). Creditor 2 would receive no proceeds *from the Section 363 sale, but would quite possibly receive $50 in the future from Newco* (the amount of Creditor 2's debt assumed by Newco).

Thus, without the required assumption of the $50 claim by Newco, Creditor 1 (the senior creditor) would receive $55 and Creditor 2 (the junior creditor) would receive $15. This result is consistent with commercial law principles and the contractual expectations of the parties. With the required assumption, however, Creditor 1 would only receive $20 and Creditor 2 would receive $50. The required assumption results in a shift of $35 from Creditor 1 to Creditor 2, a result that is not consistent with commercial law principles, the contractual expectations of the parties and the Chapter 11 reorganization rules.

Chrysler senior secured debt was held by TARP recipients at a time when there was much talk in the press about "nationalizing" some or all of these institutions. It is not difficult to imagine that these recipients felt direct pressure to "get with the program" and support the Administration's proposal.[502]

Based upon the analysis of Professors Adler, Roe and Skeel, the bankruptcy courts should have called a time-out and changed the bidding procedure (i.e., no assumption of liabilities required), extended the time to submit a bid[503] and applied the protections af-

[502] TARP recipients who were also Chrysler senior secured creditors included Citigroup, JPMorgan Chase, Morgan Stanley and Goldman Sachs.

Michael J. de la Merced, Dissident Chrysler Group to Disband, New York Times (May 8, 2009) (online at dealbook.blogs.nytimes.com/2009/05/08/oppenheimer-withdraws-from-dissident-chrysler-group/?scp=1&sq=TARP%20lender%20Chrysler%20pressure&st=cse). The article provides:

"After a great deal of soul-searching and quite frankly agony, Chrysler's non-TARP lenders concluded they just don't have the critical mass to withstand the enormous pressure and machinery of the US government," Thomas E. Lauria, a partner of Mr. Kurtz's and the lead lawyer for the group. "As a result, they have collectively withdrawn their participation in the court case."

With the group's disbanding, a little over a week since it made itself public, a vocal obstacle to Chrysler's reorganization has subsided. The committee's membership has shrunken by the day as it faced public criticism from President Obama and others. That continued withdrawal of firms led Oppenheimer and Stairway to conclude that they could not succeed in opposing the Chrysler reorganization plan in court, the two firms said in separate statements.

In its first public statement last week, the ad hoc committee said that it consisted of about 20 firms holding $1 billion in secured debt. But hours after Mr. Obama criticized the firms as "speculators," the group lost its first major member, Perella Weinberg Partners, which changed its mind and signed onto the Chrysler plan.

In the September 2009 issue, The Atlantic reported:

As the crisis has receded this year, the government has remained aggressive, seeking business outcomes it finds desirable with some apparent indifference to contractual rights. In Chrysler's bankruptcy negotiations in April, for example, Treasury's plan offered the automaker's senior-debt holders 29 cents on the dollar. Some debt holders, including the hedge fund Xerion Capital Partners, believed they were contractually entitled to a much better deal as senior creditors holding secured debt. But four TARP banks—JPMorgan Chase, Citigroup, Morgan Stanley, and Goldman Sachs—which owned about 70 percent of the Chrysler senior debt at par (100 cents on the dollar), had agreed to the 29-cent deal. By getting these banks and the other senior-debt holders to accept the 29-cent deal and give up their rights to push for the higher potential payout they were entitled to, the government could give Chrysler's workers, whose contracts were general unsecured claims—and therefore junior to the banks'—a payout far more generous than would otherwise have been possible or likely. Essentially, the government was engineering a transfer of wealth from TARP bank shareholders to auto workers, and pressuring other creditors to go along.

* * * * *

A somewhat similar story played out during GM's bankruptcy—the government again put together a deal that looked to many like a gift to the United Auto Workers at the expense of bondholders, who were pressed hard to quickly take a deal that would leave them with 10 percent of the equity of the reorganized company (plus some out-of-the-money warrants) when they likely would have been able to negotiate for more in a less well-orchestrated bankruptcy proceeding." (emphasis added.)

William D. Cohan, *The Final Days of Merrill Lynch,* The Atlantic (Sept. 2009) (online at www.theatlantic.com/doc/200909/bank-of-america).

In the Panel's September Report I requested that SIGTARP investigate this matter.

[503] Mr. Richard E. Mourdock, the Indiana State Treasurer, whose pension funds invested in Chrysler senior secured indebtedness, provided the following testimony to the Panel:

The principal restriction was imposed by the time requirement that mandated the bankruptcy be completed by June 15, 2009. Throughout the bankruptcy process, the government maintained if the deal was not completed by that date that Fiat would walk away from its "purchase" of 20% of the Chrysler assets. From the beginning, the June 15 date was a myth generated by the federal government. Fiat was being given the assets at no cost at a minimum value of $400,000,000. Why would Fiat establish or negotiate such a date when they were to receive such a bonanza? On the very day that the Chrysler assets were transferred to Fiat, the company's chairman stated to the media that the June 15th date never originated from them. The artificial date drove the process in preventing creditors from having any opportunity to establish true values, prepare adequate cases, and therefore failed to protect their rights to the fullest provisions of the law. The artificial date also forced the courts to act with less than complete information.

The U.S. [Second Circuit] Court of Appeals in its written opinion of August 9, 2009, denied our pensioners standing pursuant to the argument that we could not prove, under any other bankruptcy plan, we could have received more than the $0.29 we were offered. We believe this was an error because the court used a liquidation value for the company rather than an 'on-

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forded under the Chapter 11 reorganization rules. With those changes the judicial holdings would have most likely appeared fair and reasonable and could have served as a model for high-pressure bankruptcies that followed. Without such changes, however, the process was inherently flawed because we will never know if another bidder would have paid more for the gross assets (without the assumption of any liabilities) of Chrysler or GM.[504] As intentionally structured by the Administration, the bidding procedures ultimately adopted for the Section 363 sales necessarily precluded the determination of the true fair market value of the assets held by Chrysler and GM. Without such determination, the appropriateness of the price paid for the assets of Old Chrysler and Old GM as well as the appropriateness of the distribution made by Old Chrysler and Old GM to the Chrysler senior secured creditors and GM bondholders will remain in doubt.

E. TARP and Foreclosure Mitigation[505]

Much like the auto industry interventions, HAMP and the Administration's other foreclosure mitigation efforts to date have been a failure.[506] The Administration's opaque foreclosure mitigation efforts have assisted only a small number of homeowners while drawing billions of involuntary taxpayer dollars into a black hole.[507]

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going concern' basis. We received written notice from the U.S. Bankruptcy Court of New York by certified letter of our rights to file a claim on Monday, May 18, 2009, at 10:00 a.m. We were advised in the letter that any evidence we wished to submit to make a claim against the submitted plan (in part, the $0.29), would have to include trade tickets, depositions, affidavits, documents of evidence to substantiate claims, and etc. and would have to be filed with the bankruptcy court on Tuesday, May 19, 2009, by 4:00 p.m. The bankruptcy of Chrysler was frequently referred to as "the most complex bankruptcy in American history," and yet we were given thirty hours to respond. We feel this was clearly an error in the process that helped to reduce the wealth of our beneficiaries.

Congressional Oversight Panel, *Field Hearing on the Auto Industry,* at 154 (July 27, 2009) (online at cop.senate.gov/documents/transcript-072709-detroithearing.pdf).

[504] It is also important to note that for these purposes it's irrelevant if certain Chrysler or GM creditors happened to have purchased their securities at a cheap price. The substantive legal issue concerns whether their contractual rights were honored. Courts should not abrogate well established commercial law principles and contractual expectations simply because an investor has earned a "reasonable return" on its investment. That's not the rule of law, but the law of political expediency.

[505] In this section I borrow extensively from my dissent to the Panel's October report on foreclosure mitigation. Representative Jeb Hensarling, *Congressional Oversight Panel, October Oversight Report: An Assessment of Foreclosure Mitigation Efforts After Six Months* (Oct. 9, 2009) (online at cop.senate.gov/documents/cop-100909-report-hensarling.pdf).

[506] Taxpayer protection is a guiding principle of EESA interwoven throughout the legislation, including for foreclosure mitigation efforts. EESA gives the Panel a clear duty to provide information on foreclosure mitigation programs, but with the following caveat. Reports must include:

The effectiveness of foreclosure mitigation efforts and the effectiveness of the program from the standpoint of minimizing long-term costs to the taxpayers and maximizing the benefits for taxpayers.

12 U.S.C. 5223(b)(1)(A)(iv).

[507] Housing GSEs—Government Sponsored Enterprises—Fannie Mae and Freddie Mac play key roles in the Administration's new housing policies. Funds from the Preferred Share Purchase Agreements, which allow the GSEs to draw up to $400 billion from Treasury, are being deployed for foreclosure mitigation and refinancing efforts. Since Fannie Mae and Freddie Mac are now under the conservatorship of the Federal Housing Finance Agency (FHFA), their concerns are now officially the taxpayer's concerns—any losses they experience through MHA should be a carefully considered part of a cost-benefit analysis.

Fannie Mae and Freddie Mac should be more forthcoming with respect to their foreclosure mitigation efforts and use of taxpayer funds.

1. 100 Percent Loss to the Taxpayers from the Administration's Foreclosure Mitigation Efforts

While the CBO estimates that taxpayers will lose 100 percent of the $50 billion in TARP funds committed to the Administration's foreclosure relief programs, the Administration appears inclined to commit additional taxpayer funds in hopes of helping distressed homeowners—both deserving and undeserving—with a taxpayer subsidized rescue.[508]

While there may be some positive signals in our economy, recovery remains in a precarious position. The unemployment rate hovers around 10 percent and the broader definition of unemployment exceeds 17 percent. This is unfortunate because the best foreclosure mitigation program is a job, and the best assurance of job security is economic growth and the adoption of public policy that encourages and rewards capital formation and entrepreneurial success. Without a robust macroeconomic recovery the housing market will continue to languish and any policy that forestalls such recovery will by necessity lead to more foreclosures.

To date, despite the commitment of some $27 billion,[509] only a modest number of underwater homeowners have received a permanent modification of their mortgage.[510] If the Administration's goal of subsidizing up to 9 million home mortgage refinancings and modifications is met, the cost to the taxpayers will possibly exceed the $75 billion already allocated to the MHA—Making Home Affordable—program,[511] and it is likely that most (if not all) of it will be not be recovered.

2. Mortgage Holders Profit from Private Sector Foreclosure Mitigation Efforts

Professor Alan M. White, an expert retained by the Panel, notes in a paper attached to the Panel's October Report the effectiveness of non-subsidized voluntary foreclosure mitigation when he states:

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[508] Dealbook, *Treasury Pushes Mortgage Firms for Loan relief*, New York Times (Nov. 30, 2009) (online at dealbook.blogs.nytimes.com/2009/11/30/treasury-presses-banks-for-mortgage-relief/?scp=1&sq=Treasury%20Goodman%20November%2030&st=cse):

The Obama administration said Monday that it would increase the pressure on banks to help troubled homeowners permanently lower mortgage payments. . .

* * * * *

Monday's push was the latest evidence that a $75 billion taxpayer-financed effort aimed at stemming foreclosures was struggling. Even as lenders have accelerated the pace at which they are reducing mortgage payments for borrowers, most loans modified remain in a trial stage lasting up to five months, and only a fraction have been made permanent.

In its statement on Monday, the Treasury Department said that more than 650,000 borrowers have received trial modifications under the program, called Making Home Affordable, and that about 375,000 borrowers were scheduled to convert to permanent modifications by the end of the year.

That would represent a sharp turnaround—last month, an oversight panel created by Congress reported that fewer than 2,000 of the 500,000 loan modifications then in progress had become permanent.

Jim Kuhnhenn, *Strong Banks, Weak Credit: Treasury Rethinks TARP,* ABC News (Nov. 24, 2009) (online at abcnews.go.com/Business/wireStory?id=9161503). Determination of costs is especially important if, as Treasury Secretary Geithner has stated, TARP is interpreted to be a "revolving facility." Given the likelihood that he will extend TARP to October 31, 2010, it's possible that a substantial portion of the $700 billion TARP facility could be directed to foreclosure mitigation efforts.

[509] Number as defined by the current "Total Cap" for the Home Affordable Modification Program, $27,382,460,000. U.S. Department of the Treasury, *Transactions Report* (Nov. 30, 2009) (online at www.financialstability.gov/docs/transaction-reports/11-30-09%20Transactions%20Report%20as%20of%2011-25-09.pdf).

[510] See Section One, C.3. of the Panel's December report.

[511] The Making Home Affordable program presently consists of the HAMP—Home Affordable Modification Program—and the HARP—Home Affordable Refinancing Program.

> Nevertheless, there is convincing evidence that successful modifications avoided substantial losses, while requiring only very modest curtailment of investor income. In fact, the typical voluntary modification in the 2007–2008 period involved no cancellation of principal debt, or of past-due interest, but instead consisted of combining a capitalization of past-due interest with a temporary (three to five year) reduction in the current interest rate. Foreclosures, on the other hand, are resulting in losses of 50% or more, i.e. upwards of $124,000 on the mean $212,000 mortgage in default.[512]

Significantly, he also quantifies the overall benefit of voluntary foreclosure mitigation to investors by concluding:

> The bottom line to the investor is that any time a homeowner can afford the reduced payment, with a 60% or better chance of succeeding, the investor's net gain from the modification could average $80,000 per loan or more. Two million modifications with a 60% success rate could produce $160 billion in avoided losses, an amount that would go directly to the value of the toxic mortgage-backed securities that have frozen credit markets and destabilized banks.[513]

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[512] Since these numbers apparently include up to $9,000 of incentive payments, it appears that the total cost to the taxpayers of all interest rate and principal adjustments is approximately $10,000 per modification, or approximately $2,000 per year ($167 per month) for the full five-year HAMP modification period. Perhaps this is correct, but I question whether mortgage loans may be successfully modified at such a relatively modest cost to the taxpayers under the HAMP. It appears that Professor White did not independently calculate these amounts, but, instead, generally relied upon estimates provided by Treasury. It is unclear what methodology Treasury employed except, perhaps, to divided the $50 billion of TARP funds initially allocated to HAMP by 2.5 million modifications, or $20,000 per mortgage modification. Treasury's approach, although employed by Professor White, should be augmented by the application of a more comprehensive methodology. See generally Alan M. White, *Annex B to Congressional Oversight Panel, October Oversight Report: An Assessment of Foreclosure Mitigation Efforts After Six Months Potential Costs and Benefits of the Home Affordable Modification Program,* at 118 (Oct. 9, 2009) (online at cop.senate.gov/documents/cop-100909-report.pdf).

[513] If this is indeed the case, then why is it not in the best interest of each mortgage holder to modify the mortgage loans in its portfolio? Why would a mortgage holder risk breaching its fiduciary duties to its investor group by foreclosing on mortgaged property instead of restructuring the underlying loans? Why should the taxpayers subsidize the restructuring of mortgage loans—whether through the HAMP or otherwise—if the mortgage holders may independent of such subsidy, realize a net gain of approximately $80,000 per loan by voluntarily restructuring their distressed mortgage loans?

Professor White seems to imply that without taxpayer funded subsidies the mortgage servicers would be economically disinclined to modify distressed mortgage loans because of unfavorable terms included in typical pooling and servicing agreements—the contracts pursuant to which servicers discharge their duties to mortgage holders. Professor White writes:

> While modification can often result in a better investor return than foreclosure, modification requires "high-touch" individualized account work by servicers for which they are not normally paid under existing securitization contracts (pooling and servicing agreements or "PSAs".) Servicer payment levels were established by contracts that last the life of the mortgage pools. Servicers of subprime mortgages agreed to compensation of 50 basis points, or 0.5% from interest payments, plus late fees and other servicing fees collected from borrowers, based on conditions that existed prior to the crisis, when defaulted mortgages constituted a small percentage of a typical portfolio. At present, many subprime and alt-A pools have delinquencies and defaults in excess of 50% of the pool. The incentive payments under HAMP can be thought of as a way to correct this past *contracting failure.*
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> * * * * *
>
> Because mortgage servicers are essentially contractors working for investors who now include the GSE's, the Federal Reserve and the Treasury, we can think of the incentive payments under HAMP as *extra-contractual compensation* for additional work that was not anticipated by the parties to the PSAs at the time of the contract. (emphasis added).

Is the purpose of the HAMP to bail out servicers from their "contracting failure" through the payment of "extra-contractual compensation"? The taxpayers should not be charged with such

Notwithstanding the complexity injected into the foreclosure mitigation debate by the Administration, a solution appears relatively straightforward. If, as Professor White suggests, mortgage holders stand to realize a net gain of approximately $80,000 from restructuring each mortgage loan instead of foreclosing on the underlying property, the mortgage holders themselves should undertake to subsidize the "contracting failure" of their servicers out of such gains. I appreciate that mortgage holders may not wish to remit additional fees to their servicers, but, between mortgage holders and the taxpayers, why should the taxpayers—through TARP or otherwise—bear such burden? Taxpayers should not be required to subsidize mortgage holders or servicers when foreclosure mitigation efforts appear to be in their own economic best interests.

The Administration, by enticing mortgage holders and servicers with the $75 billion HAMP and HARP programs (with a reasonable expectation that additional funds may be forthcoming) has arguably caused them to abandon their market oriented response to the atypical rate of mortgage defaults in favor of seeking hand-outs from the government.[514] All of the false starts with HAMP and the other government programs may have in effect exacerbated the foreclosure mitigation process by keeping private sector servicers and mortgage holders on the sidelines waiting on a better deal from the government. By creating a perceived safety net, the foreclosure mitigation efforts advocated by the Administration may encourage economically inefficient speculation in the residential real estate market with its adverse bubble generating consequences.

3. Taxpayer Protection and Shared Appreciation Rights

It is my understanding that the foreclosure mitigation programs announced by Treasury do not provide Treasury or the mortgage lenders with the ability to participate in any subsequent appreciation in the fair market value of the properties that serve as collateral for the modified or refinanced mortgage loans. Since one of Treasury's fundamental mandates is taxpayer protection, the incorporation of a shared appreciation right or equity kicker feature would appear appropriate. Homeowners should not receive a windfall at the expense of the taxpayers and mortgage lenders who suffered the economic loss from restructuring their distressed mortgage loans.

For example, a $100,000, 6 percent home mortgage loan may be modified by reducing the principal to $90,000 and the interest rate to 5 percent. If the house securing the mortgage loan subsequently appreciates by, say, $25,000, the taxpayers and the mortgage lender who shared the cost of the mortgage modification will not benefit from any such increase in value. Such result seems inappropriate and particularly unfair to the taxpayers. By modifying the mortgage loan and avoiding foreclosure, the taxpayers and the mortgage lender have provided a distinct and valuable financial benefit to the distressed homeowner that should be recouped to the extent of

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a responsibility and I am disappointed that the Administration and Professor White would advocate such an approach.

[514] It is difficult to fault mortgage holders and servicers for their rational behavior in accepting bailout funds that may enhance the overall return to their investors.

any subsequent appreciation in the value of the house securing the modified mortgage. A simple filing in the local real estate records should make the shared appreciation feature self-effectuating upon the sale or exchange of the applicable residence. In order to ensure the integrity of the shared appreciation right, limitations should apply regarding the ability of homeowners to obtain home equity loans except when the proceeds of the loans are used to repay the taxpayers for the costs incurred with respect to the mortgage modifications.

In addition, as I noted in my dissent to the Panel's October report on foreclosure mitigation,[515] it would also seem productive if modified home mortgage loans were treated as recourse loans to the homeowners instead of as in effect non-recourse loans under the "anti-deficiency" laws of many jurisdictions.[516]

4. Equity and Moral Hazard

Regardless of whether one believes foreclosure mitigation can truly work, taxpayers who are struggling to pay their own mortgage should not be forced to bail out their neighbors through such an inefficient and transparency-deficient program. The Administration appears to prioritize good intentions and wishful thinking over taxpayer protection.

Any foreclosure mitigation effort must appear fair and reasonable to the American taxpayers. It is important to remember that the number of individuals in mortgage distress reaches beyond individuals who have experienced an adverse "life event" or been the victims of fraud. This complicates moral hazard issues associated with large-scale modification programs. Distinct from a moral hazard question there is an inherent question of fairness as those who are not facing mortgage trouble are asked to subsidize those who are facing trouble.

In light of current statistics regarding the overall foreclosure rate, an essential public policy question that must be asked regarding the effectiveness of any taxpayer-subsidized foreclosure mitigation program is: "Is it fair to expect approximately 19 out of every 20 people to pay more in taxes to help the 20th person maintain their current residence?" Although that question is subject to individual interpretation, there is an ever-increasing body of popular sentiment that such a trade-off is indeed not fair.[517]

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[515] Representative Jeb Hensarling, *Congressional Oversight Panel, October Oversight Report: An Assessment of Foreclosure Mitigation Efforts After Six Months,* at 158–61 (Oct. 9, 2009) (online at cop.senate.gov/documents/cop-100909-report-hensarling.pdf).

[516] Edward Pinto, *Saving More Homes for the Same Money,* Wall Street Journal (Dec. 6, 2009) (online at online.wsj.com/article/SB10001424052748704342404574577853961145272.html).

[517] State anti-deficiency laws also create significant moral hazard risks that will be exacerbated if Congress passes a cramdown amendment to the bankruptcy code. With these laws in effect, the risk-reward mix underlying each mortgage and home equity loan will be bifurcated with lenders assuming substantially all of the risks regarding the underlying value of the mortgaged property and homeowners receiving substantially all of the rewards. These laws may have the unintended consequence of encouraging homeowners to reject their contractual responsibilities and service their mortgage obligations only when it's in their economic self-interest. Since option contracts are inherently more risky to lenders than traditional mortgage contracts, lenders may have little choice but to incorporate such risks into the interest rates and fees charged on mortgage loans. The Administration should refrain from suggesting that Congress enact legislation that encourages individuals and families to invest in the housing market for speculative purposes while permitting them to avoid their contractual obligations upon the occurrence of adverse market conditions.

It is worth noting that the decision of individuals and families to speculate in the housing market, while perhaps unwise, is not entirely irrational. While some may contend that the aver-

Since there is no uniform solution for the problem of foreclosures, a sensible approach should encourage multiple private sector mitigation programs that do not amplify taxpayer risk or require government mandates. Subsidized loan refinancing and modification programs may provide relief for a select group of homeowners, but they work against the majority who shoulder the tax burden and make mortgage payments on time. Based upon the analysis of Professor White, little reason exists for government sponsored programs since it is in the best economic interest of the mortgage holders to restructure troubled loans rather than to pursue a foreclosure remedy.

F. Secretary Geithner Should Not Extend the TARP but Permit it to End on December 31, 2009

In order to end the abuses of EESA as evidenced by the Chrysler and GM bankruptcies, misguided foreclosure mitigation programs and the re-animation of reckless behavior and moral hazard risks, Secretary Geithner should not extend the TARP but permit it to end on December 31, 2009. As of today, Treasury has approximately $297.2 billion of TARP authority available to fund existing commitments and new programs.[518] As the EESA statute requires, all recouped and remaining TARP funds should go back into the Treasury general fund for debt reduction. All revenues and proceeds from TARP investments that have generated a positive return should also go to the general fund. Neither the letter nor the spirit of the law allow for TARP funds to be used as offsets for future spending programs, such as those currently being considered by the Administration and Majority leadership.

Further, the TARP should be terminated due to:

- the desire of the taxpayers for TARP recipients to repay all TARP-related investments sooner rather than later;
- the troublesome corporate governance and regulatory conflict of interest issues raised by Treasury's ownership of equity and debt interests in the TARP recipients;
- enhanced implicit guarantee and moral hazard risks;
- an increase in the number and size of "too big to fail" financial institutions;
- the absence of appropriate standards of transparency and accountability in TARP-related disclosure by Treasury;
- the stigma associated with continued participation in the TARP by the recipients;[519] and
- the use of the TARP (i) for economic stimulus instead of EESA mandated financial stability and (ii) to promote the Ad-

age consumer is too unskilled to comprehend seemingly sophisticated financial products, I would argue to the contrary. With anti-deficiency, single-action and, perhaps, bankruptcy cramdown laws in effect, borrowers will receive the bulk of any equity appreciation while lenders will bear substantially all of the risk of loss arising from home mortgage loans. Most consumers are rational and react favorably to incentives that reward particular behavior. Providing economic and legal incentives that encourage inappropriate speculation in the housing market is unwise and fraught with adverse unintended consequences. That a bankruptcy cramdown law could help reinflate a housing bubble by encouraging reckless speculation and cause lenders to raise mortgage interest rates and fees justifies its rejection.

[518] See Section One, C.5.b.i. of the Panel's December report.

[519] Dealbook, *Bank of America's TARP Move Helps Shed Stigma,* New York Times (Dec. 3, 2009) (online at dealbook.blogs.nytimes.com/2009/12/03/move-to-repay-aid-helps-bank-of-america-shed-stigma/?scp=2&sq=stigma%20bank%20of%20america&st=cse).

ministration's economic, social and political agenda as evidenced by, among others, the Chrysler and GM bankruptcies.

Some of the adverse consequences that have arisen for TARP recipients include, without limitation:

- the private sector must now incorporate the concept of "political risk" into its due diligence analysis before engaging in any transaction with the United States government;
- corporate governance and conflict of interest issues; and
- the distinct possibility that TARP recipients—including those who have repaid all CPP advances but have warrants outstanding to Treasury—and other private sector entities may be subjected to future adverse rules and regulations.

A recent report issued by SIGTARP provides an insightful analysis of the actual cost of the TARP.[520]

- Assuming that most financing for the TARP comes from short-term Treasury bills, Treasury estimates the interest cost for TARP funds spent to be about $2.3 billion, although SIGTARP says a blended cost would double this amount and an "all-in" estimate would triple or quadruple it.[521]
- Were the TARP to reach its $699 billion potential, it would mean a $5,000 expenditure for each taxpayer.[522] The TARP represents five percent of 2008 GDP.
- Other costs identified by SIGTARP include (i) higher borrowing costs in the future as a result of increased Treasury borrowing levels, (ii) a potential "crowding out effect" on prospective private sector borrowers, potentially driving private sector borrowers out of the market, (iii) moral hazard, or unnecessary risk-taking in the private sector due to the bailout, and (iv) costs incurred by the other financial-rescue-related federal agencies that have not yet been quantified.

I introduced legislation—H.R. 2745—to end the TARP on December 31, 2009. In addition, the legislation:

- requires Treasury to accept TARP repayment requests from well capitalized banks;
- requires Treasury to divest its warrants in each TARP recipient following the redemption of all outstanding TARP-related preferred shares issued by such recipient and the payment of all accrued dividends on such preferred shares;
- provides incentives for private banks to repurchase their warrant preferred shares from Treasury; and
- reduces spending authority under the TARP for each dollar repaid.

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[520] SIGTARP, *Quarterly Report to Congress* (Oct. 21, 2009) (online at sigtarp.gov/reports/congress/2009/October2009_Quarterly_Report_to_Congress.pdf).

[521] A blended cost combines short- and medium-term Treasury securities, while an "all-in" cost balances those with longer-term Treasury securities. If TARP is a medium- to longer-term program, either approach would seem more sensible than Treasury's current short-term interest estimate.

[522] The $5,000 "cost" per taxpayer assumes 138.4 million taxpayers are covering the full $699 billion.

D. Paul S. Atkins

Although I concur with the report issued by the Panel today, some aspects of the report should be elucidated. The report is careful to come to no outright conclusion regarding the TARP. The program is still in operation and distributing money (although at a much diminished rate), and we are still much too close to the events of last year to be able to obtain good data in order to render a dispassionate analysis.

The basic question of this month's report is: Has TARP been a success? The response must be that we do not know. Not that the program, together with larger government programs instituted by the Federal Reserve and FDIC that dwarfed TARP in terms of taxpayer dollars put at risk, did not show some results. Indeed, the Panel report on page 77, points out that the federal government had almost $8 trillion of exposure through various programs to try to cure the ills of the banking and finance industry, including TARP's $700 billion. With the injection of all of this money into the system, something had to happen. The fact that these programs had some effect does not answer the question of whether the resources were used wisely.

More time is needed to judge the short- and long-term ramifications of TARP and the other programs. The benefits that some ascribe to TARP only manifested themselves long after the program was implemented. Looking at the equity markets, the banks hit bottom in March 2009, months after the implementation of TARP. The credit markets also took a while to recover. Does this length of time between the implementation of TARP and the manifestation of supposed benefits indicate that exogenous factors might have come into play?

A major cause of the turmoil in the financial markets last year was the lack of transparency and the resulting lack of confidence that investors had in bank balance sheets. The TARP infusions, other than demonstrating that the government was willing to put taxpayer money on the line and stood ready to bail banks out, did not solve the transparency issue. In fact, the issue persists and affects valuation of financial firms. It did not help that the government at first claimed that TARP money would only be given to "healthy" banks. This claim proved to be manifestly false as even some of the original recipients appear not to have been healthy.

One cannot view government programs only in the short term; one must take into account the longer term. Otherwise, the analysis inevitably will be superficial because the full ramifications of decisions are given little weight. With TARP, dangerous precedents have been made and expectations established in the marketplace. These include the unfortunate embrace of the principle of "too big to fail" and the implicit guarantees that go with that doctrine. I am pleased that the Panel will consider these issues in next month's report.

Under normal circumstances, TARP would be in the liquidating phase because institutions are repaying the money they received. Unfortunately, the Treasury seems to be trying to maximize its power by improperly considering TARP to be like a revolving line of credit, contrary to the intent of Congress and section 106(d) of

EESA, which states: “Revenues of, and proceeds from the sale of troubled assets purchased under this Act, or from the sale, exercise, or surrender of warrants or senior debt instruments acquired in section 113 shall be paid into the general fund of the Treasury for reduction of the public debt.” Moreover, the program may yet be extended by the Treasury Secretary until October 2010, and it may transform itself into something entirely different during that time, given the nature of the hastily drafted statute that established TARP and the extreme flexibility with which the Treasury apparently interprets its mandate and powers thereunder.

Already, $80 billion of TARP funds have been used to intervene in General Motors, Chrysler, and GMAC, hardly major components of the banking and finance system. The Treasury has announced that it intends to dump billions more into GMAC, but the underlying problems of the automotive industry, including excessive labor costs, inflexible work rules, and a poor product mix have yet to be addressed. As the financial markets have stabilized, a continuation of TARP raises the prospect that Treasury will put funds into other companies with only a tenuous connection to the financial markets, contrary to Congress’s intent. Thus, TARP should not be extended. If more funds are needed in the future, Treasury should go back to the current Congress and make its case.

During our hearing featuring five economists on November 19, 2009, I posed a question to Dr. Dean Baker as to whether things would look different today in the financial industry if TARP had never been established. He responded by saying that “I am not convinced that we’d be in a hugely different world.” Presumably, the Treasury and the Federal Reserve would have found ways to muddle through, much as they had done during and after the collapse of Bear Stearns. Dr. Baker further argued that “the biggest flaw of TARP” was that “we rushed in with something that wasn’t well thought out.” Indeed, some economists argue that the confusing roll out of TARP in 2008 only made matters worse. Ultimately, however, had there been no TARP, we would not be facing all of the unfortunate collateral consequences of TARP and a poorly thought-out EESA.

As we move into 2010, perhaps into the final few months of this Panel’s existence, we should be insisting that Treasury stick to the intent of EESA and to a strict reading of the statute. In addition, we should follow the advice of Mr. Alex Pollock, who appeared before the Panel on November 19, to insist that Treasury run TARP as a business. Transparency, audited financial statements, and adherence to Congressional intent will foster accountability and taxpayer confidence.

SECTION THREE: CORRESPONDENCE WITH TREASURY UPDATE

On behalf of the panel, Chair Elizabeth Warren sent a letter on November 25, 2009,[523] to Secretary of the Treasury Timothy Geithner, to follow up on a letter sent on September 15, 2009,[524] and to request that the Secretary provide a timely response to the questions contained therein regarding inputs, formulae, and other information for the stress tests. The Panel has not yet received a response from Secretary Geithner.

On behalf of the panel, Chair Elizabeth Warren sent a letter on November 25, 2009,[525] to Secretary of the Treasury Timothy Geithner, to obtain information on Treasury's assistance to CIT Group, Inc. (CIT). Specifically, the letter inquires about the effects of CIT's recent bankruptcy on the taxpayers' investment in the company via the Capital Purchase Program (CPP), and whether Treasury expects failures of more financial institutions participating in the CPP. The Panel has not yet received a response from Secretary Geithner.

On behalf of the panel, Chair Elizabeth Warren sent a letter on November 25, 2009,[526] to Assistant Secretary of the Treasury for Financial Stability Herbert M. Allison, Jr. The letter notes that Assistant Secretary Allison had yet to respond to a series of questions for the record following his appearance before the Congressional Oversight Panel on October 22, 2009, despite an initial request to receive a response by November 18, 2009. The Panel received a response from Assistant Secretary Allison on December 1, 2009.[527]

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[523] See Appendix III of this report, *infra*.

[524] See Appendix I of the Congressional Oversight Panel's October Oversight Report. October Oversight Report, *supra* note 220, at 207.

[525] See Appendix IV of this report, *infra*.

[526] See Appendix II of this report, *infra*.

[527] Questions for the Record for Assistant Secretary Allison, *supra* note 253.

SECTION FOUR: TARP UPDATES SINCE LAST REPORT

A. TARP Repayment

Since the Panel's prior report, additional banks have repaid their TARP investments under CPP. A total of 50 banks have repaid in full their preferred stock TARP investments provided under the CPP to date. Of these banks, 30 have repurchased their warrants as well. Additionally, during the month of October, CPP participating banks paid $481.6 million in dividends and $125.8 million in interest on Treasury investments.

Bank of America has been given leave by its regulator to repay $45 billion in TARP funds. News reports stated that Bank of America would sell common equity to raise the funds for the repayment. As of December 2, 2009, Bank of America reported that it had raised $19.3 billion, and that it would be holding a shareholder meeting to approve the issuance of additional shares to be sold for this purpose.

B. CPP Monthly Lending Report

Treasury releases a monthly lending report showing loans outstanding at the top 22 CPP recipient banks. The most recent report, issued on November 16, 2009, includes data through the end of September 2009, and shows that CPP recipients had $4.18 trillion in loans outstanding as of September 2009. This represents a one percent decline in loans outstanding between the end of August and the end of September.

C. Term Asset-Backed Securities Loan Facility (TALF)

At the November 17, 2009 facility, there were $1.4 billion in loans requested for legacy CMBS, and $72.2 million for new CMBS. By way of comparison, there were $2.1 billion in loans for legacy CMBS requested at the October facility, and $1.4 billion at the September facility. This month was the first facility in which there was a request for TALF loans for new CMBS.

At the December 3, 2009 facility, there were $3 billion in loans requested to support the issuance of ABS collateralized by loans in the credit card, equipment, floorplan, small business, servicing advances, and student loan sectors. No loans in the auto and premium financing sectors were requested. By way of comparison, there were $1.1 billion in loans requested at the November 3, 2009 facility to support the issuance of ABS collateralized by loans in the auto, credit card, equipment, floorplan, small business, and student loan sectors.

D. Public-Private Investment Funds

Treasury announced the initial closing of three more of the nine funds pre-qualified as Fund Managers as part of the Public-Private Investment Program. Treasury expects the final fund to close shortly. As of November 30, 2009, Public-Private Investment Funds have closed on $5.07 billion of private sector equity. This investment has been matched by Treasury for a total of $10.13 billion in equity capital. Treasury has also provided $10.13 billion of debt capital.

E. Capital Assistance Program Closing

On November 9, 2009, Treasury announced that it would close the CAP without making any investments through the program. CAP was established to provide additional assistance to institutions subject to the stress tests. The only institution that was determined to need additional capital was GMAC. Treasury has announced that GMAC will receive the needed assistance through the Automotive Industry Financing Program instead of through CAP.

F. Auctions to Sell Capital Purchase Program Warrants

Treasury announced on November 19, 2009, that it would sell several warrant positions received under the Capital Purchase Program. The sales would take place over the month following the announcement and would include Treasury's warrant positions in JPMorgan Chase & Co., Capital One Financial Corporation, and TCF Financial Corporation. Each of these banks has already repurchased Treasury's full preferred stock investment. The sales will be conducted through registered public offerings using a Dutch auction method. The auction for Capital One began on December 1, 2009 and closed on December 3, 2009. This auction included 12,657,960 warrants to purchase common stock of Capital One and the net proceeds from the sale, which should close on or around December 9, are expected to be $146.5 million.

SECTION FIVE: OVERSIGHT ACTIVITIES

The Congressional Oversight Panel was established as part of EESA and formed on November 26, 2008. Since then, the Panel has produced twelve oversight reports, as well as a special report on regulatory reform, issued on January 29, 2009, and a special report on farm credit, issued on July 21, 2009. Since the release of the Panel's November oversight report assessing guarantees and contingent payments, the following developments pertaining to the Panel's oversight of the Troubled Asset Relief Program (TARP) took place:

- The Panel held a hearing in Washington, DC with several prominent economists to discuss the effectiveness of the TARP. The views of these experts informed this report.

Upcoming Reports and Hearings

The Panel will release its next oversight report in January. The report will assess Treasury's strategy for exiting the TARP.

The Panel is planning its third hearing with Secretary Geithner on December 10, 2009. The Secretary has agreed to testify before the Panel once per quarter. His most recent hearing was on September 10, 2009.

SECTION SIX: ABOUT THE CONGRESSIONAL OVERSIGHT PANEL

In response to the escalating crisis, on October 3, 2008, Congress provided Treasury with the authority to spend $700 billion to stabilize the U.S. economy, preserve home ownership, and promote economic growth. Congress created the Office of Financial Stability (OFS) within Treasury to implement a Troubled Asset Relief Program. At the same time, Congress created the Congressional Oversight Panel to "review the current state of financial markets and the regulatory system." The Panel is empowered to hold hearings, review official data, and write reports on actions taken by Treasury and financial institutions and their effect on the economy. Through regular reports, the Panel must oversee Treasury's actions, assess the impact of spending to stabilize the economy, evaluate market transparency, ensure effective foreclosure mitigation efforts, and guarantee that Treasury's actions are in the best interests of the American people. In addition, Congress instructed the Panel to produce a special report on regulatory reform that analyzes "the current state of the regulatory system and its effectiveness at overseeing the participants in the financial system and protecting consumers." The Panel issued this report in January 2009. Congress subsequently expanded the Panel's mandate by directing it to produce a special report on the availability of credit in the agricultural sector. The report was issued on July 21, 2009.

On November 14, 2008, Senate Majority Leader Harry Reid and the Speaker of the House Nancy Pelosi appointed Richard H. Neiman, Superintendent of Banks for the State of New York, Damon Silvers, Director of Policy and Special Counsel of the American Federation of Labor and Congress of Industrial Organizations (AFL–CIO), and Elizabeth Warren, Leo Gottlieb Professor of Law at Harvard Law School to the Panel. With the appointment on November 19, 2008, of Congressman Jeb Hensarling to the Panel by House Minority Leader John Boehner, the Panel had a quorum and met for the first time on November 26, 2008, electing Professor Warren as its chair. On December 16, 2008, Senate Minority Leader Mitch McConnell named Senator John E. Sununu to the Panel. Effective August 10, 2009, Senator Sununu resigned from the Panel, and on August 20, 2009, Senator McConnell announced the appointment of Paul Atkins, former Commissioner of the U.S. Securities and Exchange Commission, to fill the vacant seat.

APPENDIX I: UNPAID DIVIDEND PAYMENTS UNDER CPP AS OF OCTOBER 31, 2009

UNPAID DIVIDEND PAYMENTS UNDER CPP AS OF OCTOBER 31, 2009 [528]

Institution	Value of unpaid dividends
CIT Group Inc	$29,125,000
Popular, Inc	11,687,500
First BanCorp	5,000,000
Pacific Capital Bancorp	4,515,850
First Banks, Inc	4,024,825
Sterling Financial Corporation/Sterling Savings Bank	3,787,500
UCBH Holdings, Inc	3,734,213
Anchor BanCorp Wisconsin, Inc	2,979,167
Midwest Banc Holdings, Inc	2,119,600
Dickinson Financial Corporation II	1,989,980
Central Pacific Financial Corp	1,687,500
Seacoast Banking Corporation of Florida/Seacoast National Bank	1,250,000
Blue Valley Ban Corp	543,750
Centrue Financial Corporation	408,350
Royal Bancshares of Pennsylvania, Inc	380,088
One United Bank	301,575
United American Bank	230,490
Pacific City Financial Corporation/Pacific City Bank	220,725
Commonwealth Business Bank	209,850
The Connecticut Bank and Trust Company	178,573
Peninsula Bank Holding Co	162,500
Commerce National Bank	150,000
Citizens Bancorp	141,700
Pacific Coast National Bancorp	112,270
Premier Service Bank	105,972
Idaho Bancorp	94,013
Lone Star Bank	87,917
Pacific International Bancorp Inc	81,250
One Georgia Bank	80,766
Georgia Primary Bank	70,850
Saigon National Bank	54,378
Patterson Bancshares, Inc	50,288
Grand Mountain Bancshares, Inc	35,395
Fresno First Bank	33,357
Citizens Bank & Trust Company	32,700
Pacific Commerce Bank	31,961
Community Bank of the Bay	28,874
Community First Bank	11,199
Total	$75,739,924

[528] U.S. Department of the Treasury, *Dividends and Interest Reports,* May, 2009–October, 2009 (online at www.financialstability.gov/latest/reportsanddocs.html); SIGTARP, *Quarterly Report to Congress*, at 58 (Oct. 21, 2009) (online at www.sigtarp.gov/reports/congress/2009/October2009__Quarterly__Report__to__ Congress.pdf).

APPENDIX II: LETTER FROM CHAIR ELIZABETH WARREN TO ASSISTANT SECRETARY HERB ALLISON, RE: WRITTEN RESPONSES FOR HEARING RECORD, DATED NOVEMBER 25, 2009

ELIZABETH WARREN, CHAIR
REP. JEB HENSARLING
PAUL S. ATKINS
RICHARD H. NEIMAN
DAMON SILVERS

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

Congress of the United States

CONGRESSIONAL OVERSIGHT PANEL

November 25, 2009

The Honorable Herbert M. Allison, Jr.
Assistant Secretary for Financial Stability
United States Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Mr. Assistant Secretary:

Following your testimony before the Congressional Oversight Panel on October 22, 2009, the Panel sent you a series of questions for the hearing record and requested that you respond to them in writing by November 18, 2009. As of the date of this letter, the Panel has yet to receive your responses. We ask that you provide these responses to the Panel as soon as possible, and no later than Tuesday, December 1, to allow us sufficient time to review and incorporate them into our forthcoming December oversight report.

If, for some reason, you are unable to provide these responses in a timely fashion, please have a member of your staff contact the Panel's Executive Director, Naomi Baum, at [redacted] to explain why and when they can be expected. Thank you for your cooperation.

Sincerely,

Elizabeth Warren
Chair
Congressional Oversight Panel

APPENDIX III: LETTER FROM CHAIR ELIZABETH WARREN TO SECRETARY TIMOTHY GEITHNER, RE: STRESS TESTS, DATED NOVEMBER 25, 2009

ELIZABETH WARREN, CHAIR
REP. JEB HENSARLING
PAUL S. ATKINS
RICHARD H. NEIMAN
DAMON SILVERS

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

Congress of the United States

CONGRESSIONAL OVERSIGHT PANEL

November 25, 2009

The Honorable Timothy F. Geithner
Secretary of the Treasury
United States Department of the Treasury
Room 3330
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220

Dear Mr. Secretary:

During and after your testimony before the Congressional Oversight Panel on September 10, you said that you would be willing to provide the Panel with the inputs and formulae for the stress tests, including the loss rates you referred to in your testimony. I followed up with a letter to you on September 15 to request that information as soon as possible. A copy of my original letter is enclosed.

Although I sent my letter in advance of the Panel's questions for the record, emphasizing the urgency of my request, I have not yet received any reply. By contrast, Treasury has already sent the Panel the formal responses to the questions for the record.

Effective oversight depends on timely response from the Department of Treasury to the Panel's requests for information. This is especially true of the stress tests, which have been a critical part of your strategy to assure bank stability. I would appreciate receiving the information I requested more than two months ago so that our Panel can continue its work.

Sincerely,

EWarren

Elizabeth Warren
Chair
Congressional Oversight Panel

Enclosure

Cc:
Mr. Paul Atkins
Rep. Jeb Hensarling
Mr. Richard H. Neiman
Mr. Damon A. Silvers

APPENDIX IV: LETTER FROM CHAIR ELIZABETH WARREN TO SECRETARY TIMOTHY GEITHNER, RE: CIT GROUP, INC., DATED NOVEMBER 25, 2009

ELIZABETH WARREN, CHAIR
REP. JEB HENSARLING
PAUL S. ATKINS
RICHARD H. NEIMAN
DAMON SILVERS

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

Congress of the United States

CONGRESSIONAL OVERSIGHT PANEL

November 25, 2009

The Honorable Timothy F. Geithner
Secretary of the Treasury
United States Department of the Treasury
Room 3330
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Dear Mr. Secretary:

On behalf of the Congressional Oversight Panel (Panel), I am writing to obtain information on Treasury's assistance to CIT Group, Inc. (CIT) in conjunction with the Panel's oversight of the Capital Purchase Program (CPP). The Panel was created pursuant to section 125 of the Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343 (EESA), which requires the Panel to report to Congress on Treasury's use of authority under EESA and on the impact of EESA-authorized purchases on financial institutions.

On December 29, 2008, taxpayers made a $2.3 billion CPP investment in CIT, and obtained warrants for 88,705,584 shares of CIT stock as part of that investment. On November 1, 2009, CIT filed for bankruptcy protection. Under the terms of its bankruptcy plan, preferred and common equity holders – including the U.S. government – will receive only a minimal return.

CIT's failure is the largest to date by a CPP-recipient financial institution, and it raises several significant oversight questions:

1. How much does the U.S. taxpayer stand to lose due to CIT's bankruptcy, including, separately, the value of all preferred stock, warrants, and projected dividends?

2. How much, separated into the same categories, has the taxpayer lost due to the failures of other CPP-recipient financial institutions?

3. Treasury has stated that "participation [in CPP] is reserved for healthy, viable institutions," noting that "[h]ealthy banks, not weak banks, lend to their communities, and the CPP is a program for healthy banks." Did Treasury consider CIT to be a healthy bank at the time when CPP assistance was first provided? If so, on what basis did Treasury make this determination? If not, for what reasons did Treasury consider CIT to be eligible for CPP funding? Please provide any due diligence memoranda or other documentation explaining Treasury's decision.

4. Treasury has explicitly stated that CPP is not a bailout and that it was "designed to generate a positive return over time to the taxpayer." In the case of CIT, however, it

appears clear that taxpayers will face significant losses. Regulators have closed United Commercial Bank and Pacific Coast National Bank as well, which also received CPP assistance. Did Treasury's expectation of "a positive return over time" incorporate the possibility of the failure of these or other financial institutions? If so, how has Treasury accounted for these loss projections in estimating the long-term cost or benefit to taxpayers of CPP?

5. How many more failures does Treasury expect among CPP-recipient financial institutions, and what is the estimated cost to taxpayers of these failures? Please provide any memoranda projecting such losses. How is Treasury acting to protect the taxpayers' investments in those institutions?

6. In particular, how many institutions in the CPP program are now on the list of problem banks maintained by the Federal Deposit Insurance Corporation? What steps is Treasury taking to protect the taxpayers' investment in those institutions?

7. What is Treasury's projection of the final benefit or cost to taxpayers of the overall CPP program?

8. Treasury has provided exceptional assistance outside of CPP to several firms that it considers "systemically significant," including Bank of America, Citigroup, and AIG. Did Treasury consider whether CIT's significance to the financial system warranted similar assistance? If Treasury determined that CIT was not systemically significant, on what basis was this determination made? Please provide any memoranda regarding this determination.

The information sought by this letter is necessary for the Congressional Oversight Panel to carry out section 125 of EESA. This information request is made pursuant to section 125(e)(3) of that Act.

I would be happy to answer any questions about this letter that you may have. If you would prefer, a member of your staff can contact the Panel's Executive Director, Naomi Baum, to discuss any such questions. Ms. Baum's telephone number is [redacted]

Sincerely,

Elizabeth Warren
Chair
Congressional Oversight Panel

Cc:
Mr. Paul Atkins
Rep. Jeb Hensarling
Mr. Richard H. Neiman
Mr. Damon A. Silvers

APPENDIX V: ENDNOTES TO FIGURE 27: FEDERAL GOVERNMENT'S FINANCIAL STABILIZATION PROGRAMS (AS OF NOVEMBER 25, 2009)—CURRENT MAXIMUM EXPOSURES

[i] This number includes investments under the SSFI Program: a $40 billion investment made on November 25, 2008, and a $30 billion investment committed on April 17, 2009 (less a reduction of $165 million representing bonuses paid to AIG Financial Products employees). *See* U.S. Department of the Treasury, *Troubled Asset Relief Program Transactions Report for Period Ending November 25, 2009,* (Nov. 30, 2009) (online at www.financialstability.gov/docs/transaction-reports/11-30-09%20Transactions%20Report%20 as%20of%2011-25-09.pdf).

[ii] This number represents the full $60 billion that is available to AIG through its revolving credit facility with the Federal Reserve ($44.9 billion had been drawn down as of November 27, 2009) and the outstanding principal of the loans extended to the Maiden Lane II and III SPVs to buy AIG assets (as of November 19, 2009, $16 billion and $19 billion respectively). Board of Governors of the Federal Reserve System, *Factors Affecting Reserve Balances of Depository Institutions and Condition Statement of Federal Reserve Banks* (Nov. 27, 2009) (online at www.federalreserve.gov/RELEASES/H41/20091127/). Income from the purchased assets is used to pay down the loans to the SPVs, reducing the taxpayers' exposure to losses over time. Board of Governors of the Federal Reserve System, *Federal Reserve System Monthly Report on Credit and Liquidity Programs and the Balance Sheet October 2009,* at 17 (online at www.federalreserve.gov/monetarypolicy/files/monthlyclbsreport200910.pdf) (accessed Dec. 7, 2009). On December 1, 2009, AIG entered into an agreement with FRBNY to reduce the debt AIG owes the FRBNY by $25 billion. In exchange, FRBNY received preferred equity interests in two AIG subsidiaries. This also reduced the debt ceiling on the loan facility from $60 billion to $35 billion. This figure does not reflect that agreement since the table is intended to represent exposure as of November 30, 2009. American International Group, *AIG Closes Two Transactions That Reduce Debt AIG Owes Federal Reserve Bank of New York by $25 billion* (Dec. 1, 2009) (online at phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MjE4ODl8Q2hpbGRJRD0tMXxUeXBlPTM=&t=1).

[iii] U.S. Department of the Treasury, *Troubled Asset Relief Program Transactions Report for Period Ending November 25, 2009,* (Nov. 30, 2009) (online at www.financialstability.gov/docs/transaction-reports/11-30-09%20Transactions%20Report%20as%20of%2011-25-09.pdf). This figure includes: (1) a $15 billion investment made by Treasury on October 28, 2008 under the CPP; (2) a $10 billion investment made by Treasury on January 9, 2009 also under the CPP; and (3) a $20 billion investment made by Treasury under the TIP on January 16, 2009.

[iv] U.S. Department of the Treasury, *Summary of Terms: Eligible Asset Guarantee* (Nov. 23, 2008) (online at www.treasury.gov/press/releases/reports/cititermsheet__112308.pdf) (granting a 90 percent federal guarantee on all losses over $29 billion after existing reserves (totaling a $39.5 billion first-loss position for Citigroup) of a $306 billion pool of Citigroup assets, with the first $5 billion of the cost of the guarantee borne by Treasury, the next $10 billion by FDIC, and the remainder by the Federal Reserve). *See also* U.S. Department of the Treasury, *U.S. Government Finalizes Terms of Citi Guarantee Announced in November* (Jan. 16, 2009) (online at www.treas.gov/press/releases/hp1358.htm) (reducing the size of the asset pool from $306 billion to $301 billion).

[v] U.S. Department of the Treasury, *Transactions Report* (Oct. 27, 2009) (online at www.financialstability.gov/docs/transaction-reports/10-927-09%20Transactions%20Report%20as%20of%2010-23-09.pdf). This figure includes: (1) a $25 billion investment made by Treasury under the CPP on October 28, 2008; and (2) a $20 billion investment made by Treasury under TIP on December 31, 2008.

[vi] This figure represents the $218 billion Treasury has anticipated spending under the CPP, minus the $50 billion investment in Citigroup ($25 billion) and Bank of America ($25 billion) identified above, and the $71 billion in repayments that are reflected as uncommitted TARP funds. This figure does not account for future repayments of CPP investments, nor does it account for dividend payments from CPP investments. *See* U.S. Government Accountability Office, *Troubled Asset Relief Program June 2009 Status of Efforts to Address Transparency and Accountability Issues,* at 12 (online at www.gao.gov/new.items/d09658.pdf) (accessed Dec. 7, 2009); U.S. Department of the Treasury, *Troubled Asset Relief Program Transactions Report for Period Ending November 25, 2009* (Nov. 30, 2009) (online at

www.financialstability.gov/docs/transaction-reports/11-30-09%20Transactions%20Report%20 as%20of%2011-25-09.pdf).

[vii] The CAP was officially closed on November 9, 2009. Of the original 19 SCAP participants, GMAC was the only institution that requested additional capital under the CAP. U.S. Department of the Treasury, *Treasury Announcement Regarding the Capital Assistance Program* (Nov. 9, 2009) (online at www.financialstability.gov/latest/tg__11092009.html). As of yet, further details of this transaction, including the amount GMAC will receive, have not been released, and the Panel continues to reflect the program as dormant.

[viii] This figure represents a $20 billion allocation to the TALF special purpose vehicle on March 3, 2009. U.S. Department of the Treasury, *Troubled Asset Relief Program Transactions Report for Period Ending October 28, 2009* at 18 (Oct. 30, 2009) (online at financialstability.gov/docs/transaction-reports/10-30-09%20Transactions%20Report%20as%20of%2010–28-09.pdf). Consistent with the analysis in the Panel's August report, only $61.9 billion in TALF loans have been requested as of December 3, 2009, the Panel continues to predict that TALF subscriptions are unlikely to surpass the $200 billion currently available by year's end. Congressional Oversight Panel, *August Oversight Report: The Continued Risk of Troubled Assets,* at 10–22 (Aug. 11, 2009) (online at cop.senate.gov/documents/cop-081109-report.pdf) (discussing criteria for constituting a "troubled asset").

[ix] This number is derived from the unofficial 1:10 ratio of the value of Treasury loan guarantees to the value of Federal Reserve loans under the TALF. U.S. Department of the Treasury, *Fact Sheet: Financial Stability Plan* (Feb. 10, 2009) (online at www.financialstability.gov/docs/fact-sheet.pdf) (describing the initial $20 billion Treasury contribution tied to $200 billion in Federal Reserve loans and announcing potential expansion to a $100 billion Treasury contribution tied to $1 trillion in Federal Reserve loans). Because Treasury is responsible for reimbursing the Federal Reserve Board for $20 billion of losses on its $200 billion in loans, the Federal Reserve Board's maximum potential exposure under the TALF is $180 billion.

[x] The Panel continues to account for this program as dormant. It appears unlikely that resources will be expended under the PPIP Legacy Loans Program in its original design as a joint Treasury-FDIC program to purchase troubled assets from solvent banks. *See also* Federal Deposit Insurance Corporation, *FDIC Statement on the Status of the Legacy Loans Program* (June 3, 2009) (online at www.fdic.gov/news/news/press/2009/pr09084.html); Federal Deposit Insurance Corporation, *Legacy Loans Program—Test of Funding Mechanism* (July 31, 2009) (online at www.fdic.gov/news/news/press/2009/pr09131.html). The sales described in these statements do not involve any Treasury participation, and FDIC activity is accounted for here as a component of the FDIC's Deposit Insurance Fund outlays.

[xi] U.S. Department of the Treasury, *Joint Statement By Secretary of the Treasury Timothy F. Geithner, Chairman of the Board Of Governors Of The Federal Reserve System Ben S. Bernanke, and Chairman of the Federal Deposit Insurance Corporation Sheila Bair: Legacy Asset Program* (July 8, 2009) (online at www.financialstability.gov/latest/tg__07082009.html) ("Treasury will invest up to $30 billion of equity and debt in PPIFs established with private sector fund managers and private investors for the purpose of purchasing legacy securities"); U.S. Department of the Treasury, *Fact Sheet: Public-Private Investment Program,* at 4–5 (Mar. 23, 2009) (online at www.treas.gov/press/releases/reports/ppip__fact__sheet.pdf) (outlining that, for each $1 of private investment into a fund created under the Legacy Securities Program, Treasury will provide a matching $1 in equity to the investment fund; a $1 loan to the fund; and, at Treasury's discretion, an additional loan up to $1). As of November 30, 2009, Treasury reported $17.8 billion in outstanding loans and $8.8 billion in membership interest associated with the program, thus substantiating the Panel's assumption that Treasury may routinely exercise its discretion to provide $2 of financing for every $1 of equity 2:1 ratio. U.S. Department of the Treasury, *Troubled Asset Relief Program Transactions Report for Period Ending November 25, 2009* (Nov. 30, 2009) (online at www.financialstability.gov/docs/transaction-reports/11-30-09%20Transactions%20Report%20as%20of%2011-25-09.pdf).

[xii] U.S. Government Accountability Office, *Troubled Asset Relief Program: June 2009 Status of Efforts to Address Transparency and Accountability Issues,* at 2 (June 17, 2009) (GAO09/658) (online at www.gao.gov/new.items/d09658.pdf). Of the $50 billion in announced TARP funding for this program, $27.4 billion has been allocated as of November 30, 2009. U.S. Department of the Treasury, *Troubled Asset Relief Program Transactions Report for Period November 30, 2009,* at 22 (Nov. 30, 2009) (online at financialstability.gov/docs/transaction-reports/11-30-09%20Transactions%20Report%20 as%20of%2011-25-09.pdf).

[xiii] Fannie Mae and Freddie Mac, GSEs that were placed in conservatorship of the Federal Housing Finance Housing Agency on September 7, 2009, will also contribute up to $25 billion to the Making Home Affordable Program, of which the HAMP is a key component. U.S. Department of the Treasury, *Making Home Affordable: Updated Detailed Program Description* (Mar. 4, 2009) (online at www.treas.gov/press/releases/reports/housing__fact__sheet.pdf).

[xiv] U.S. Department of the Treasury, *Troubled Asset Relief Program Transactions Report for Period Ending November 25, 2009* (Nov. 30, 2009) (online at www.financialstability.gov/docs/transaction-reports/11-30-09%20Transactions%20Report%20 as%20of%2011-25-09.pdf). A substantial portion of the total $80 billion in loans extended under the AIFP have since been converted to common equity and preferred shares in restructured companies. $20.2 billion has been retained as loans (with $7.7 billion committed to GM and $12.5 billion to Chrysler). This figure represents Treasury's current obligation under the AIFP. There have been $2.1 billion in repayments and $2.4 billion in de-obligated funds under the AIFP.

[xv] U.S. Department of the Treasury, *Troubled Asset Relief Program Transactions Report for Period Ending November 25, 2009* (November 30, 2009) (online at www.financialstability.gov/docs/transaction-reports/11-30-09%20Transactions%20Report%20 as%20of%2011-25-09.pdf).

[xvi] U.S. Department of the Treasury, *Fact Sheet: Public-Private Investment Program,* at 1 (Mar. 23, 2009) (online at www.treas.gov/press/releases/reports/ppip__fact__sheet.pdf).

[xvii] This figure represents the current maximum aggregate debt guarantees that could be made under the program, which, in turn, is a function of the number and size of individual financial institutions participating. $315 billion of debt subject to the guarantee was outstanding as of October 31, 2009. This represents approximately 52 percent of the cap. Federal Deposit Insurance Corporation, *Monthly Reports on Debt Issuance Under the Temporary Liquidity Guarantee Program: Debt Issuance Under Guarantee Program* (Sept. 30, 2009) (online at www.fdic.gov/regulations/resources/TLGP/total__issuance9-09.html) (updated Nov. 30, 2009). The FDIC has collected $10.4 billion in fees and surcharges from this program since its inception in the fourth quarter of 2008. Federal Deposit Insurance Corporation, *Monthly Reports on Debt Issuance Under the Temporary Liquidity Guarantee Program* (Oct. 31, 2009) (online at www.fdic.gov/regulations/resources/TLGP/fees.html) (updated Nov. 30, 2009).

[xviii] This figure represents the FDIC's provision for losses to its deposit insurance fund attributable to bank failures in the third and fourth quarters of 2008 and the first and second quarters of 2009. Federal Deposit Insurance Corporation, *Chief Financial Officer's (CFO) Report to the Board: DIF Income Statement (Fourth Quarter 2008)* (online at www.fdic.gov/about/strategic/corporate/cfo__report__4qtr__08/income.html); Federal Deposit Insurance Corporation, *Chief Financial Officer's (CFO) Report to the Board: DIF Income Statement (Third Quarter 2008)* (online at www.fdic.gov/about/strategic/corporate/cfo__report__3rdqtr__08/income.html); Federal Deposit Insurance Corporation, *Chief Financial Officer's (CFO) Report to the Board: DIF Income Statement (First Quarter 2009)* (online at www.fdic.gov/about/strategic/corporate/cfo__report__1stqtr__09/income.html); Federal Deposit Insurance Corporation, *Chief Financial Officer's (CFO) Report to the Board: DIF Income Statement (Second Quarter 2009)* (online at www.fdic.gov/about/strategic/corporate/cfo__report__2ndqtr__09/income.html). This figure includes the FDIC's estimates of its future losses under loss share agreements that it has entered into with banks acquiring assets of insolvent banks during these four quarters. Under a loss sharing agreement, as a condition of an acquiring bank's agreement to purchase the assets of an insolvent bank, the FDIC typically agrees to cover 80 percent of an acquiring bank's future losses on an initial portion of these assets and 95 percent of losses of another portion of assets. For example, *see* Federal Deposit Insurance Corporation, *Purchase and Assumption Agreement Among FDIC, Receiver of Guaranty Bank, Austin, Texas, FDIC and Compass Bank,* at 65–66 (Aug. 21, 2009) (online at www.fdic.gov/bank/individual/failed/guaranty-tx__p__and__a__w__addendum.pdf).

[xix] In past reports, the Panel has classified as loans the Federal Reserve's purchases of federal agency debt securities and mortgage-backed securities issued by GSEs. With this report, the Panel adopts a different approach. Instead, these purchases will be accounted as outlays made under the Federal Reserve's credit expansion effort. Federal Reserve Liquidity Facilities classified in this table as loans include: Primary credit, Secondary credit, Central bank liquidity swaps, Primary dealer and other broker-dealer credit, Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, Net portfolio holdings of Commercial Paper Funding Facility LLC, Seasonal credit, Term auction credit, Net Portfolio Holdings of

TALF LLC, and loans outstanding to Bear Stearns (Maiden Lane I LLC). While the Federal Reserve does not employ the outlays, loans and guarantees classification, its accounting clearly separates its mortgage-related purchasing programs from its liquidity programs. *See* Board of Governors of the Federal Reserve, *Credit and Liquidity Programs and the Balance Sheet November 2009,* at 2 (online at www.federalreserve.gov/monetarypolicy/files/monthlyclbsreport200911.pdf) (accessed Dec. 7, 2009).

[xx] The term "outlays" is used here to describe the use of Treasury funds under the TARP, which are broadly classifiable as purchases of debt or equity securities (e.g., debentures, preferred stock, exercised warrants, etc.). The outlays figures are based on: (1) Treasury's actual reported expenditures; and (2) Treasury's anticipated funding levels as estimated by a variety of sources, including Treasury pronouncements and GAO estimates. Anticipated funding levels are set at Treasury's discretion, have changed from initial announcements, and are subject to further change. Outlays as used here represent investments and assets purchases and commitments to make investments and asset purchases and are not the same as budget outlays, which under section 123 of EESA are recorded on a "credit reform" basis.

[xxi] While many of the guarantees may never be exercised or exercised only partially, the guarantee figures included here represent the federal government's greatest possible financial exposure.

[xxii] This figure is roughly comparable to the $3.0 trillion current balance of financial system support reported by SIGTARP in its July report. SIGTARP, *Quarterly Report to Congress,* at 138 (July 21, 2009) (online at www.sigtarp.gov/reports/congress/2009/July2009_Quarterly_Report_to_Congress.pdf). However, the Panel has sought to capture additional anticipated exposure and thus employs a different methodology than SIGTARP.