CONGRESSIONAL OVERSIGHT PANEL

JANUARY OVERSIGHT REPORT *

EXITING TARP AND UNWINDING ITS IMPACT ON THE FINANCIAL MARKETS

JANUARY 13, 2010.—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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CONGRESSIONAL OVERSIGHT PANEL

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EXECUTIVE SUMMARY *

In its December oversight report, the Panel reviewed the successes and failures of the Troubled Asset Relief Program in 2008 and 2009. This month, the Panel focuses on the road ahead as Treasury closes the TARP. Now that Treasury has acquired hundreds of billions of dollars in assets, how does it plan to unwind its stake in the financial markets? How will Treasury balance its desire to sell these assets quickly with its goals of promoting financial stability and strengthening the return to taxpayers? What steps will Treasury take to unwind the implicit guarantee that the federal government will always stand behind too big to fail banks? In short, what is Treasury's exit strategy?

Ending the TARP will involve several stages of exit. The first milestone will be on October 3, 2010, when Treasury's authority to make new commitments to purchase assets, commit funds, and establish guarantees using TARP funds will expire. The end of this authority will not, however, constitute the end of the TARP; Treasury will be authorized to continue making purchases using funds that were committed in advance of the October 3, 2010 deadline. Finally, after Treasury completes all of its TARP purchases, it will hold a massive pool of financial assets likely worth hundreds of billions of dollars, and the process of unwinding some of these holdings may continue for a number of years.

As of December 31, 2009, Treasury's largest TARP-related assets include $58 billion in preferred securities issued by banks, $25 billion in Citigroup common stock, $46.9 billion in AIG preferred stock, and $61 billion in shares and debt of GM and Chrysler. Treasury also holds significant assets under the Public-Private In-

* The Panel adopted this report with a 5–0 vote on January 13, 2010.

vestment Program, the Term Asset-Backed Loan Facility, and the Capital Purchase Program, and it has announced plans to purchase further assets under new programs such as the small business initiative.

The Emergency Economic Stabilization Act authorized Treasury to hold its TARP assets until maturity or to sell them earlier. Treasury has articulated three principles that guide its determination of when to sell assets: maintaining the stability of the financial system, preserving the stability of individual financial institutions, and maximizing the return on the taxpayers' investment.

These principles may sometimes be at odds with one another. For example, the most profitable moment to sell a TARP asset may not be the moment that best promotes systemic stability or the moment that best serves a particular institution. Furthermore, Treasury is only one department of a much larger federal government, and the broader government may have additional goals for the TARP, such as preserving jobs or satisfying a political constituency.

The Panel is also concerned that, although Treasury has been consistent in articulating its principles, the principles as announced are so broad that they provide Treasury with a means of justifying almost any decision. This means that there is effectively no metric to determine whether Treasury's actions met its stated goals. Because any approach may alternatively be justified as maximizing profit, or maintaining the stability of significant institutions, or promoting systemic stability, almost any decision can be defended. Measuring Treasury's success against these metrics is problematic.

As Treasury enters the next stage of its administration of the TARP, it must learn from the mistakes it has made in the past—in particular, its failure to follow the money used to bail out large financial institutions. Because Treasury never required the institutions that received the first infusions of TARP funding to account for their use of these funds, taxpayers have not had a clear understanding of how their money has been used. As Treasury embarks on new programs, it must require that future recipients provide much greater disclosure of their use of TARP dollars.

Finally, and perhaps most significantly, the TARP has raised the long-term challenge of how best to eliminate implicit guarantees. Belief remains widespread in the marketplace that, if the economy once again approaches the brink of collapse, the federal government will inevitably rush in to rescue financial institutions deemed too big to fail. This belief distorts prices, giving large financial institutions an advantage in raising capital that mid-sized and smaller banks—those not too big to fail—do not enjoy. These implicit guarantees also encourage major financial institutions to take unreasonable risks out of the belief that, no matter what happens, taxpayers will not allow their failure. So long as markets continue to believe that an implicit guarantee exists, moral hazard will continue to distort prices and endanger the nation's economy, even after the last TARP program has been closed and the last TARP dollar has been repaid.

SECTION ONE: JANUARY REPORT

A. Overview

On December 9, 2009, Treasury Secretary Timothy Geithner announced that the Troubled Asset Relief Program (TARP) would be extended until October 3, 2010.[1] Although it may take years to unwind some of the assets acquired under the TARP, once the program expires, no new commitments may be made with respect to TARP funds and the end of the TARP will have begun.

In its December report, the Congressional Oversight Panel looked at the entire program in order to assess what the TARP has accomplished and where it has fallen short from various perspectives in the 14 months since its inception. This month the Panel looks at what the TARP will leave behind when it ultimately is wound down.

The TARP will leave behind a dual legacy: hard assets and an even harder problem. As a result of expenditures under the TARP, Treasury is now managing assets that rival in size a substantial sovereign wealth fund. Treasury's Office of Financial Stability (OFS) is managing a diverse portfolio of assets, worth approximately $258.1 billion at December 31, 2009, which it eventually must divest. Divesting these assets will call for a balance between maximizing the return to taxpayers, maintaining financial stability, and continuing to pursue other stated objectives of the TARP. There are, of course, also unavoidable political considerations that will affect these decisions, and that political context in the current environment can shift quickly and unpredictably.

Devising an exit strategy from the market impact of the TARP and related programs is even more difficult than deciding how and when to dispose of the assets. The Panel has several times noted the moral hazard that the financial rescue created: the market distortion arising from the belief among market participants and the managers of financial institutions that the government will guarantee the obligations and preserve the shareholders of large financial institutions.[2] Government intervention has created implicit guarantees of some undefined portion of the financial system, and any effective exit strategy from the TARP and related programs must address how to unwind or withdraw that implicit guarantee.

The primary focus of this report is to follow the money: To summarize the assets and obligations that Treasury holds or owes as a result of its expenditure of TARP funds, to explore how Treasury plans to divest itself of those assets or obligations and get the taxpayers' money back, and also to examine how the recipients intend to make sure taxpayers are made whole. This implicates several elements of the Panel's mandate, particularly the use of the Secretary's authority under the TARP, the effectiveness of the TARP

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[1] U.S. Department of the Treasury, *Treasury Department Releases Text of Letter from Secretary Geithner to Hill Leadership on Administration's Exit Strategy for TARP* (Dec. 9, 2009) (online at www.treasury.gov/press/releases/tg433.htm).

[2] *See* Congressional Oversight Panel, *November Oversight Report: Guarantees and Contingent Payments in TARP and Related Programs* (Nov. 6, 2009) (online at cop.senate.gov/documents/cop-110609-report.pdf) (hereinafter "COP November Oversight Report").

in minimizing costs and maximizing benefits to taxpayers, and contributions to transparency.[3]

As examined in more detail below, Treasury has described to the Panel an exit strategy based on Treasury's view of sound asset management practices and Treasury's understanding of the statutory obligations imposed by the Emergency Economic Stabilization Act of 2008 (EESA), the law that led to the TARP's establishment. In this Report, the Panel discusses a number of questions that arise from this approach. The Panel notes that the publication of audited TARP financial statements has improved the transparency of the program and provided some insight with respect to the value of Treasury's holdings.

This report also considers issues that arise with respect to further expenditures that may be made before the TARP expires; in particular under Treasury's small business initiatives and the continuing support provided to GMAC.

As for the broader and still evolving issue—the unwinding of the implicit guarantees created by the financial rescue—the Panel reviews the current state of the debate and identifies the issues that must be addressed before it can be said that the TARP has been truly unwound.

B. The Various Stages of "Exit" from the TARP

1. Secretary's Authority and Obligations

The end of the TARP will involve several stages of "exit": (1) The end of the Secretary's authority to purchase assets or commit funds, and to establish guarantees for troubled assets, on October 3, 2010; (2) the expenditure of all funds committed for the purpose of purchasing or supporting "troubled assets," as defined by EESA,[4] and (3) the eventual disposition of all assets held by Treasury that were purchased through the TARP.

The first and most talked-about stage will come on October 3, 2010, when the Secretary's authority to purchase troubled assets, or to commit funds for the purpose of purchasing troubled assets, will end.[5] Originally, this authority was to end on December 31, 2009.[6] The statute was written to permit the Secretary of the Treasury to extend the program, however, until October 3, 2010, provided he submitted to Congress "a written certification . . . includ[ing] a justification of why the extension is necessary to assist American families and stabilize financial markets, as well as the expected cost to the taxpayers for such an extension."[7] On December 9, 2009, the Secretary sent such a certification to Speaker of the House Nancy Pelosi and Senate Majority Leader Harry Reid, stating his intention to exercise his authority to extend the TARP

[3] 12 U.S.C. § 5233(b).

[4] "Troubled assets" as defined by EESA includes both assets associated with mortgage-based securities and "any other financial instrument that the Secretary, after consultation with the Chairman of the Board of Governors of the Federal Reserve System, determines the purchase of which is necessary to promote financial stability[.]" 12 U.S.C. § 5202(9). Under this definition, valuable assets from healthy institutions may nonetheless be defined as "troubled assets" under the statute if their purchase is deemed to promote stability.

[5] *See* 12 U.S.C. § 5230.

[6] 12 U.S.C. § 5230(a).

[7] 12 U.S.C. § 5230(b).

until October 2010.[8] According to this certification, Treasury will spend the remaining months of the TARP "terminating and winding down many of the government programs put in place last fall [2008]."[9] New commitments in 2010 will be limited to the following three areas:

- Mitigating foreclosures for homeowners;
- Providing capital to small and community banks, and other efforts to facilitate small business lending; and
- Potentially increasing Treasury's commitment to the Term Asset-Backed Securities Loan Facility (TALF), a program administered by the Federal Reserve Bank of New York (FRBNY) and aimed at unlocking the credit markets via loans for the purchase of certain types of asset-backed and commercial mortgage-backed securities.[10]

The certification notes that "[b]eyond these limited new commitments, we will not use remaining EESA funds unless necessary to respond to an immediate and substantial threat to the economy stemming from financial instability."[11]

The end of the authority to purchase assets or commit funds for their purchase will not, however, constitute a true "exit" from the TARP. The statute permits Treasury to commit funds until October 3, 2010, but spend them after that date.[12] Therefore, there may be funds that have been committed but that, as of October 4, 2010, have not yet been actually spent. It is too soon to know how many such unfunded commitments may exist by October 3. The current state of the various programs under the TARP, and the amounts that could yet be expended, are discussed in Sections D and E.

Even after the Secretary's authority to purchase assets has expired and all commitments have been funded, Treasury will still likely hold billions of dollars worth of assets purchased through the program. Treasury will have to provide for the management and prudent sale of these assets, which may continue over a number of years. Various sections of EESA contemplate such ongoing management and describe the structures that will remain in place to oversee and guide this process.

Section 5223 of EESA contains direct guidance to Treasury with respect to its obligations in holding and selling assets. According to this section, the Secretary shall: "hold the assets to maturity or for resale for and until such time as the Secretary determines that the market is optimal for selling such assets, in order to maximize the value for taxpayers" and "sell such assets at a price that the Secretary determines, based on available financial analysis, will maximize return on investment for the Federal Government."[13]

Section 5216 of EESA provides specific details regarding Treasury's authority. This section provides that the Secretary "may, at

[8] U.S. Department of the Treasury, *Letter from Secretary Geithner to Speaker Pelosi* (Dec. 9, 2009) (online at www.financialstability.gov/docs/press/Pelosi%20Letter.pdf); U.S. Department of the Treasury, *Letter from Secretary Geithner to Senator Reid* (Dec. 9, 2009) (online at www.financialstability.gov/docs/press/Reid%20Letter.pdf).

[9] *Id.*

[10] *Id.*

[11] *Id.*

[12] Under 12 U.S.C. § 5216(e), the Secretary may continue to hold assets purchased under TARP, and may purchase or fund purchases of assets after the October 3, 2010 expiration date if the commitment to make such purchase was made by October 3, 2010.

[13] 12 U.S.C. § 5223(a)(2).

any time, exercise any rights received in connection with troubled assets purchased under this chapter" and that the Secretary has the authority to "manage troubled assets purchased under this chapter, including revenues and portfolio risks therefrom." [14] As to the sale of troubled assets, this section grants the Secretary the ability to "at any time, upon terms and conditions and at a price determined by the Secretary, sell, or enter into securities loans, repurchase transactions, or other financial transactions in regard to, any troubled asset purchased under this chapter." [15] The proceeds from such sales as well as revenues from troubled assets are to be paid into "the general fund of the Treasury for reduction of the public debt." [16]

While it is clear that EESA contemplates some form of ongoing management of TARP assets, the scope of that authority is less clear. For example, section 5216 permits the Secretary to "exercise any rights received in connection with" TARP assets, and section 106(b) authorizes the Secretary "to manage troubled assets purchased under this Act, including revenues and portfolio risks therefrom." Clearly, if the Secretary purchased convertible preferred stock before the expiration of the TARP, that stock could be converted, according to its terms, into common equity after the TARP sunset date. The right to convert the stock was received in the transaction by which Treasury acquired the asset.

That leaves the question of whether Treasury could exchange a TARP asset for anything but cash after the sunset date. Suppose that Treasury sought to exchange non-convertible preferred stock after the sunset date for common stock in the same institution. Such a transaction might be characterized as an exercise of a right "received in connection with" the original asset, but it could perhaps more appropriately be characterized as a means of purchasing new common equity using the preferred stock, depending on the facts of the situation.

The statute provides no guidance as to whether the Secretary's authority to "manage" an asset includes using the stock to obtain a different class of stock, or whether such an exchange is permitted if it can be shown to "reduce portfolio risk." Whether an exchange, for example, of preferred for common stock, can be shown to "reduce portfolio risk" depends on the facts of particular situations. Treasury has stated that, while it is unwilling to speculate on such hypothetical situations, its position is that if the February 2009 Citigroup exchange offer, in which preferred stock was exchanged for common stock in an effort to bolster the company's regulatory capital, had occurred after the sunset date, Treasury would none-

[14] 12 U.S.C. § 5216(a), (b).

[15] 12 U.S.C. § 5216(c).

[16] 12 U.S.C. § 5216(d). Treasury apparently concedes that EESA bars the Secretary from taking amounts Treasury receives when stock and warrants are redeemed and spending those amounts again, rather than using them to reduce the public debt (allowing section 106(d) of EESA to operate). However, it argues that section 118 of EESA also permits the Secretary to issue new government securities to raise new funds "[f]or the purposes of the authorities granted in [EESA]," including use to restore the TARP fund to full strength (roughly, the amount by which the statutory funding ceiling exceeds outstanding purchases and commitments). *See, e.g.*, Congressional Oversight Panel, *Questions for the Record for U.S. Department of the Treasury Secretary Timothy Geithner*, at 13 (Sept. 23, 2009) (online at cop.senate.gov/documents/testimony-091009-geithner-qfr.pdf). The Panel takes no position on the validity of this position.

theless have the authority to engage in such a transaction as part of its authority to manage TARP assets.[17]

Another issue involves the conditions under which the Secretary may sell TARP assets. The Secretary has a statutory obligation to hold TARP assets until the Secretary determines the market for the sale of such assets is "optimal." This may prove to be a difficult standard to apply. Without the benefit of hindsight, determining when a market is "optimal" for a particular sale is extraordinarily difficult. As discussed in greater detail below, Treasury reads this provision to require sales to forward the broad policy views required and implied by EESA. "Optimal" timing might therefore not be the most profitable, but timing that best forwards Treasury's goals. As also discussed in Section D.2 below, such an understanding of "optimal timing" creates certain difficulties with regard to oversight.

2. Other Oversight and Management Entities

The same section of EESA that provides the Secretary with the authority to create the TARP also provides for the creation of the Office of Financial Stability (OFS) to implement programs created under the TARP.[18] The section of EESA that provides a sunset date for the authority granted the Secretary, however, explicitly excludes OFS from the sunset.[19] No other section in EESA provides an alternative sunset date for OFS. This office will remain the primary office for the administration, management, and disposition of TARP assets.

In addition, the Financial Stability Oversight Board (FSOB), created by EESA,[20] will remain in existence until 15 days after the later of either the date the last troubled asset purchased has been sold, or the last insurance contract entered into under the section to guarantee troubled assets has expired.[21] Because the statute provides explicitly for the FSOB to continue until Treasury has fully exited from all TARP-related transactions, this board is clearly intended to provide guidance not only for the implementation of the TARP, but for the ongoing management and sale of TARP assets. EESA requires the Secretary to make monthly reports to the FSOB regarding the current status of TARP programs and expenditures; this obligation continues until the date of the FSOB's termination.

The three main oversight bodies for the TARP—the Special Inspector General for the Troubled Asset Relief Program (SIGTARP), the Government Accountability Office (GAO), and the Panel—also have duties that extend beyond the October 3, 2010, sunset date. SIGTARP's oversight obligations expire on the same date as the

[17] Treasury conversations with Panel staff (Nov. 20, 2009).

[18] 12 U.S.C. § 5211(a)(3)(A).

[19] 12 U.S.C. § 5230(a).

[20] The FSOB's members are the Secretary of the Treasury, the Chairman of the Board of Governors of the Federal Reserve System, the Director of the Federal Housing Finance Agency, the Chairman of the Securities Exchange Commission, and the Secretary of Housing and Urban Development. 12 U.S.C. § 5214(b). Its duties include reviewing "policies implemented by the Secretary and [the OFS] . . . including the appointment of financial agents, the designation of asset classes to be purchased, and plans for the structure of vehicles used to purchase troubled assets." 12 U.S.C. § 5214(a).

[21] 12 U.S.C. § 5214(h). For a detailed analysis of the programs created under § 5212, please see the Congressional Oversight Panel's November report. COP November Oversight Report, *supra* note 2.

FSOB terminates.[22] GAO's obligations expire on the later of the date the last TARP asset is sold, or the last insurance contract ends.[23] The Panel's obligations expire on April 3, 2011.[24]

3. Effect on Other Related Programs

Treasury's exit from the TARP will have little to no effect on several programs that use TARP funds,[25] or on other related programs that are also aimed at stabilizing the country's economy.

The Home Affordable Modification Program (HAMP), which aims to assist homeowners seeking to avoid foreclosure, will be largely unaffected by the end of the TARP. Treasury initially committed up to $50 billion in TARP funds to this program, and as of the release of this report, there has been no announcement that any additional funds have been committed. But more funds may be committed in the future. In Secretary Geithner's recent letter extending the TARP, he cited foreclosure mitigation as one of the areas where additional TARP commitments may be made in 2010. Furthermore, the $50 billion in TARP funds already committed to HAMP may be paid out even after the expiration of the TARP. Because these funds are used to reduce homeowners' mortgage payments, there are no assets for Treasury to manage; therefore, no exit strategy is necessary.[26]

Two other programs that use TARP funds, the TALF and the Public-Private Investment Program (PPIP), will also be unaffected because the TARP funds that they use have already been committed. To the extent that the TALF and the PPIP are used to purchase assets, the assets are held and managed by private entities under the terms of the programs. Therefore, although OFS will have continuing oversight responsibility for these programs and the private entities that manage them, Treasury will not itself have responsibility for directly selling any assets purchased through these programs. Furthermore, both programs have their own fixed termination dates. Loans made under the TALF must not have a term limit beyond seven years and, currently, no loans may be made past June 30, 2010.[27] The investment funds established under the PPIP have a ten-year termination date.

A small business initiative that was announced by the White House in October 2009 has yet to take form.[28] But to the extent

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[22] 12 U.S.C. § 5231(h).

[23] 12 U.S.C. § 5226(e).

[24] 12 U.S.C. § 5233(f).

[25] One of the stated purposes of the EESA is to preserve homeownership, and section 109 of EESA directs the Secretary of the Treasury "[t]o the extent that [he] acquires mortgages, mortgage backed securities, and other assets secured by residential real estate" to "implement a plan that seeks to maximize assistance for homeowners and use the authority of the Secretary to encourage the servicers of the underlying mortgages, considering net present value to the taxpayer, to take advantage of the HOPE for Homeowners Program . . . or other available programs to minimize foreclosures. In addition, the Secretary may use loan guarantees and credit enhancements to facilitate loan modifications to prevent avoidable foreclosures." 12 U.S.C. §§ 5201(2)(B), 5219(a).

[26] The Panel requested from Treasury a legal opinion on its HAMP authority. *See, e.g.*, Congressional Oversight Panel, *COP Hearing with Treasury Secretary Timothy Geithner* (Dec. 10, 2009).

[27] Federal Reserve Bank of New York, *Term Asset-Backed Securities Loan Facility: Terms and Conditions* (Nov. 13, 2009) (online at www.newyorkfed.org/markets/talf__terms.html) (hereinafter "TALF Terms and Conditions").

[28] White House, *Weekly Address: President Obama Says Small Business Must be at the Forefront of the Recovery* (Oct. 24, 2009) (online at www.whitehouse.gov/the-press-office/weekly-address-president-obama-says-small-business-must-be-forefront-recovery).

that it includes any outright expenditures, there will similarly be no requirement for an exit strategy for assets. This does not mitigate the need for rigorous oversight of any such programs.[29]

Several related programs run by the Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve will likewise be unaffected by the TARP's end. An FDIC program under which bank accounts are guaranteed up to $250,000, up from the earlier level of $100,000, is unrelated to the TARP and will remain in place until December 31, 2013. Similarly, certain financing that the Federal Reserve has made available in response to the financial crisis is unrelated to the TARP and will be unaffected by the TARP's termination.

4. EESA Requirements Relating to Use of TARP Profits, or Approach to TARP Losses

Most of the programs established in the TARP's early days carry the potential of a return on Treasury's investments, which gives rise to the question of what is the best use of any profits from the TARP. While EESA provides that all profits are to be used to pay down the national debt,[30] there is an ongoing debate about what to do with TARP funds going forward. Should the TARP instead realize a net loss, EESA provides that "the President shall submit a legislative proposal that recoups from the financial industry an amount equal to the shortfall in order to ensure that the Troubled Asset Relief Program does not add to the deficit or national debt."[31]

The fact that the TARP morphed from the asset purchase program contemplated by the legislation to a capital infusion program complicated the issue somewhat, and later TARP programs such as HAMP, which are not intended to produce any return at all, complicated it further. It currently appears that, although some capital-injection programs will show a profit, the TARP as a whole will result in a loss.[32] Even if the capital-injection programs show a profit, these profits will have to be large enough to also make up for outlays under programs such as HAMP, which are structured without any contemplation of a return of capital or interest. It is thus possible that legislation may result in financial institutions being charged for losses made on investments in two automobile companies and on foreclosure mitigation efforts. On the other hand, it may be argued that many of the financial institutions that received TARP funds would not have survived absent such capital injections, or, even if they themselves were not short of capital, would have been vulnerable had other giants in the industry fallen, and therefore asking for these institutions to contribute to an overall TARP shortfall is appropriate. Ultimately, EESA specifies that the determination of whether the program has made a loss is to be

[29] *See* Section E, *infra.*
[30] 12 U.S.C. § 5216(d).
[31] 12 U.S.C. § 5239.
[32] Congressional Oversight Panel, Written Testimony of Treasury Secretary Timothy F. Geithner (Dec. 10, 2009) (online at cop.senate.gov/documents/testimony-121009-geithner.pdf) (hereinafter "Sec. Geithner Written Testimony"); U.S. Department of the Treasury, *Agency Financial Statement 2009*, at 3 (Sept. 30, 2009) (online at www.treas.gov/press/releases/OSF%20AFR%2009.pdf) (hereinafter "Agency Financial Statement 2009").

made after October 3, 2013,[33] and it may take several years for the results of some of the investments made under the TARP to be clear, although the TARP financial statements do calculate likely profit or loss for all TARP investments in fiscal year 2009.[34]

5. Continuing Market Effects of the TARP: The Implicit Guarantee

Even after the TARP has ended, it is likely that the effect of the TARP and related programs on the market will continue for some time. The decisions to rescue certain financial institutions have created an implicit government guarantee, the limits of which are unknown and the reasons for which are not fully articulated.[35] This guarantee goes beyond the so-called too big to fail problem: it is not clear how far the guarantee extends into the smaller banks, and even some of the banks subjected to the "stress tests"—which some commentators have viewed as the too big to fail list[36]—seem to pose no real threat to the financial system.[37]

Implicit guarantees affect the market's view of these institutions, and a perception that an institution will be protected by the government may in fact result in the government's continued protection. Those institutions may factor the implicit guarantee into their calculation of downside risk, assuming the government will backstop any failed investments while they preserve any upside. Such risk calculations will have a ripple effect across the market as the investment portfolios of the guaranteed institutions' risk profiles shift. For example, the government guarantees that were provided to money market funds at the height of the financial crisis have now officially lapsed, but at least one commentator has noted that the implicit guarantees may linger, and may be influencing both the funds' investment decisions and their cost of capital.[38] As discussed in the Panel's November report, capital tends to be cheaper for institutions that have strong guarantees, such as a guarantee backed by the U.S. government.[39] This has the dual effect of decreasing the cost of capital for the guaranteed institution and placing that institution at a competitive advantage over institutions without such a guarantee. These guarantees have lowered the cost

[33] *See* 12 U.S.C. § 5239.

[34] An amendment to a bill that passed the House on December 10, 2009 (*see* Section G.1, *infra*) permits the FDIC to make an assessment for the Systemic Dissolution Fund used to repay any shortfalls in the Troubled Asset Relief Program to ensure that such shortfalls do not add to the deficit or national debt. Rep. Gary Peters, *Amendment to the Wall Street Reform and Consumer Protection Act of 2009*, Congressional Record, H14748–14750 (Dec. 11, 2009) (online at frwebgate.access.gpo.gov/cgi-bin/getpage.cgi?dbname=2009__record&page=H14745&position=all). One potential issue with this approach is that institutions that repaid their TARP funds in full would be required to make up the shortfall for those banks that were unable to do so. During a meeting with Panel staff on December 16, 2009, OFS Chief Counsel Timothy Massad said that OFS was aware of this issue but that it was too early to consider any concrete plans for such recoupment.

[35] The ramifications of this may be visible in certain comments by rating agencies with regard to Citigroup. See Section D.5(b), *infra*.

[36] Thomas F. Cooley, *The Need for Failure*, Forbes.com (May 27, 2009) (online at www.forbes.com/ 2009/05/26/fdic-treasury-banks-too-big-to-fail-opinions-columnists-sheila-bair.html).

[37] Metlife, which operates in a confined segment of the financial services industry, was also one of the nineteen entities selected for the stress tests. Federal Reserve Board of Governors, *The Supervisory Capital Assessment Program: Overview of Results*, at 30 (May 7, 2009) (online at www.federalreserve.gov/newsevents/press/bcreg/bcreg20090507a1.pdf).

[38] Daisy Maxey, *Money Funds Again Take On Risk*, Wall Street Journal (Nov. 16, 2009) (online at online.wsj.com/article/SB10001424052748703811604574534011795078126.html).

[39] COP November Oversight Report, *supra* note 2, at 37.

of capital for many institutions.[40] Investors make similar calculations, taking on more risk when they are protected from the consequences of their decisions.[41] If there is no new crisis and bailout, the market-distorting effect of the TARP and related programs may dissipate as institutions and investors come to believe that the government will not step in to save failing institutions, or at least have no government bailout in their recent memories. The effect in the period immediately following the TARP's dissolution, however, must be taken into account when analyzing market behavior, especially with regard to risk calculations.

The implicit guarantee that has now been created will not end with the end of the TARP. The markets will assume that the government will intervene with a new TARP in the event of another crisis, unless the government credibly establishes that this will not happen. One of the first orders of business for the government as part of the unwinding of the TARP must be to clarify or rein in the implicit guarantee and the distortion it has on the markets.[42]

The term too big to fail has come to be used as shorthand for the implicit guarantee and to describe institutions that the government dare not let fail, because such failure would threaten to spread to the larger economy.[43] Such risk might be posed by reason of size or by the impact a company's failure would have on the financial system. Size alone does not determine this status, although the size of some institutions means that their collapse in markets that have not properly addressed the risk could have a significant impact on the economy. Financial institutions can also threaten the financial system by reason of their concentration of derivative risk or by the fact that they provide essential services, disruption of which could result in significant dislocations in the financial system. The securities processing services, custody, and cash management and treasury functions of some institutions are depended upon by so

[40] COP November Oversight Report, *supra* note 2, at 37 ("The research firm SNL Financial (SNL) . . . found that the DGP saved issuers 39 percent in interest costs").

[41] Moral hazard arises when the government agrees to guarantee the assets and obligations of private parties and protect them from loss. The insured party might take greater risk, especially when the protected party is not required to purchase the protection. 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.

For an in depth discussion of moral hazard in the context of TARP programs, see the Panel's November report. COP November Oversight Report, *supra* note 2, at 70–72.

[42] This process may have already begun with the failure of CIT in July 2009. Although the company received $2 billion in CPP funds, the federal government did not provide additional funding when it became clear that the company would not survive despite the capital injection. CIT Group, Inc., *CIT Announces That Discussions with Government Agencies Have Ceased* (July 15, 2009) (online at www.businesswire.com/portal/site/cit/?ndmViewId=news_view&newsId=20090715006374&newsLang=en). CIT's prepackaged bankruptcy plan was confirmed by a court in December. CIT Group, Inc., *CIT Prepackaged Plan of Reorganization Confirmed by Court* (Dec. 8, 2009).

[43] In this context, it is worth noting that "risk" is not the only multi-faceted concept. The too big to fail shorthand implies that there is only one kind of failure: where the dissolution of the relevant entity could create enormous labor or market disruptions. This arguably presents the choice facing Treasury and the U.S. government as always between chaos or moral hazard: to use concrete examples, that the only choices were either to let an entity—for example, Lehman Bros.—collapse into chaos, and bring other entities with it, or to provide the entity—for example, AIG—with bail-outs, distorting the markets. Under other circumstances, however, these extreme poles might not have formed the models for government intervention. Put another way, that these were the choices Treasury made in 2008–2009 does not mean that they were the only choices available to it. This report, however, deals with the problem of exit, and therefore does not address alternative actions that Treasury, the Bush or Obama Administrations, or Congress could have taken in the crisis. The TARP program may not have been the only means of responding to the crisis, but in discussing exit from the TARP program, this report can only assess exit from the choices that were actually made.

many large entities that their loss could cause significant problems in the global financial system. Risk is multi-faceted, and because risk derives from the very different functions and activities of the various financial institutions, it will be very difficult to find a one-size-fits-all definition of too big to fail.

In Section G of this report, the Panel reviews some of the options that are currently being proposed to address the risks posed by too big to fail institutions. The Panel takes no view on those options, but notes that it is essential that the unwinding of the TARP includes steps to address the moral hazard and market distortion that the TARP and related programs created.

6. Certain Tax Issues Affecting TARP Exit

TARP exit strategy and the operation of the CPP are affected by a series of Treasury Department decisions that limit the applicability of the Internal Revenue Code (Code) rules limiting the use of a corporation's net operating losses (NOLs).[44] NOLs can reduce the future income and hence the tax liability of a financial institution, or of any other corporation.[45] Equally important, a bank holding company's tier 1 regulatory capital will ordinarily include a portion of its NOLs.[46] Any cap on an institution's available NOLs could be expected to have a negative effect on the institution's value and regulatory capital position. If the institution has a large number of NOLs, the effect is likely to be substantial.

The NOL limitation rules, contained in section 382 of the Code, limit the annual availability of a corporation's NOLs after a "change in control" of that corporation to a small percentage of the otherwise usable amount.[47] The corporation does not have to be sold to trigger the limitation; a change in control occurs if the percentage of the corporation's stock owned by any of its "five percent shareholders" increases by more than 50 percent over a three-year period, whether by the corporation's sale or otherwise. A "five percent shareholder" is any shareholder that owns five percent or more of the stock of the corporation. The stock owned by all shareholders who are not five percent shareholders is treated as being owned by one or more groups which may be treated as five percent shareholders, referred to as the "public groups."

The Internal Revenue Service (IRS) issued several notices (the EESA Notices) containing guidance about the application of section

[44] An NOL, conceptually, is the excess of a corporation's deductions over its taxable income. Section 382 also applies to what are called "built-in losses" (in simplest terms, the amount by which the value of an asset is less than its cost), and its companion section 383 applies in a similar way to the carryforward of unused tax credits. NOLs, built-in losses, and tax credits together form a corporation's "deferred tax assets," whose value is greater than the value of the corporation's NOLs alone. Although not technically correct, the term "NOL" is used here for ease of presentation to refer to all three tax attributes.

[45] A corporation is generally permitted to carry forward NOLs for 20 years, to offset its future income.

[46] 12 CFR § 225 at appendix A.II.A.1. To summarize the rule, NOLs may constitute up to 10 percent of tier 1 capital, to the extent that the institution "is expected to realize [a tax deduction by their use] within one year . . . based on its projections of future taxable income for that year . . . ." 12 CFR § 225 at appendix A.II.B.4.a.i.

[47] 26 U.S.C. § 382. The limitation may be severe. If a change in control occurs, the amount of income that the "post-change" corporation can offset by "pre-change" losses is capped at a small percentage of the corporation's value, which is roughly equal to its market capitalization. This percentage, called "the long-term tax-exempt rate" and set monthly by the IRS, is currently at 4.14 percent. Thus, at present, a corporation whose market capitalization was $1 billion could use the NOLs generated before its change in control only to the extent of $41.4 million of taxable income each year.

382 to institutions engaged in transactions with the Treasury Department under EESA. The Notices extended to transactions under any of the TARP programs. The first three EESA Notices, issued in October 2008, January 2009, and April 2009, allowed Treasury to take, and the institutions to redeem eventually, stock and warrants without causing a change in ownership under section 382.[48] Any other result would have increased substantially the uncertainty created by TARP and the potential cost of participation in its programs. The tax and regulatory capital costs of participation by financial institutions might well have greatly limited TARP's effectiveness. All of the EESA Notices to date have been issued under both the Secretary's authority to issue income tax regulations and to issue "such regulations and other guidance as may be necessary or appropriate to define terms or carry out the authorities or purposes of [EESA]."[49]

In addition, the IRS issued a Notice at the end of September 2008, prior to the enactment of EESA, stating that important elements of section 382 would not apply to a change in ownership of a bank.[50] Any bank was allowed to rely on the Notice, but it was identified as having been issued to facilitate the acquisition of Wachovia by Wells Fargo and at least one other bank acquisition.[51] That Notice was rescinded by Congress, however, as part of the economic stimulus legislation, for any ownership change after January 16, 2009.[52] The effective date excluded transactions under

[48] IRS Notice 2008–100 (Oct. 15, 2008) (online at www.irs.gov/irb/2008-44_IRB/ar13.html); IRS Notice 2009–14 (Jan. 31, 2009) (online at www.irs.gov/pub/irs-drop/n-09-14.pdf); IRS Notice 2009–38 (April 13, 2009) (online at www.irs.gov/irb/2009-18_IRB/ar09.html). Each of the Notices was described as "amplifying" and was designated as "superseding" the immediately prior Notice. The first Notice applied only to preferred shares and warrants issued under the CPP. The second expanded the treatment to include the TIP, SSFI, and the AIFP. It also added a provision excepting from section 382 Treasury's ownership of stock "other than preferred stock." The April Notice extended the guidance to the CAP and AGP, and in anticipation of Treasury's exchange of preferred stock for common stock of Citigroup, exempted Treasury's receipt of that stock from section 382, even though such stock was not received directly under the TARP program. The Revenue Service had previously issued similar guidance for two pre-EESA transactions that were part of the financial stability effort.

[49] 12 U.S.C. § 5211(c)(5). In addition to the Secretary's overall authority to issue income tax regulations, section 382(m) specifically authorizes the Secretary to issue "such regulations as may be necessary or appropriate to carry out the purposes of this section." 26 U.S.C. § 382(m).

[50] IRS Notice 2008–83 (Sept. 30, 2008) (online at www.irs.gov/irb/2008-42_IRB/ar08.html). The items involved were "any deduction . . . for losses on loans or bad debts (including any deduction for a reasonable addition to a reserve for bad debts)."

[51] *See* Crowell & Moring, *Tax Notice Drives Wachovia Takeover Turmoil* (Oct. 6, 2008) (online at www.crowell.com/NewsEvents/Newsletter.aspx?id=1032); Baker Hostetler, *IRS Net Operating Loss Guidance to Banks* (Oct. 9, 2009) (online at www.bakerlaw.com/irs-net-operating-loss-guidance-to-banks-10-9-2008/); Press Release, *Grassley Seeks Inspector General Review of Treasury Bank Merger Move* (Nov. 14, 2008) (online at finance.senate.gov/press/Gpress/2008/prg111408c.pdf) ("The Notice, issued just days before Congress voted on the Emergency Economic Stabilization Act of 2008, appears to have had the effect of benefiting Wachovia Corporation executives and Wells Fargo . . . Treasury's issuance of the Notice apparently enabled Wells Fargo to take over Wachovia despite a pending bid from Citibank. Without the issuance of the Notice, Wells Fargo would have only been able to shelter a limited amount of income. Under the Notice, however, Wells Fargo could reportedly shelter up to $74 billion in profits"). *See also* Sen. Charles E. Schumer, *Schumer Seeks Answers from IRS, Treasury on Tax Code Change That Subsidizes Bank Acquisitions* (Oct. 30, 2008) (online at schumer.senate.gov/new_website/record.cfm?id=304737) ("Wells Fargo . . . stands to save $19.4 billion as a result of the tax change, PNC Financial is estimated to save more than $5.1 billion in its takeover of Cleveland-based National City").

[52] Congress found that:

(1) The delegation of authority to the Secretary of the Treasury under section 382(m) of the Internal Revenue Code of 1986 does not authorize the Secretary to provide exemptions or special rules that are restricted to particular industries or classes of taxpayers.

(2) Internal Revenue Service Notice 2008–83 is inconsistent with the congressional intent in enacting such section 382(m).

Continued

contracts entered into on or before January 16, so that the Notice did apply to lift the section 382 limitations for the acquisition of Wachovia. The accompanying Conference Committee Report mentioned without comment the EESA Notices that existed at the time of the report.[53]

The fourth EESA Notice was issued in December 2009.[54] The December Notice expands the prior guidance by stating that a sale by the Treasury Department of stock it had received under any of the EESA programs to a "public group," that is, to a group of less than five percent shareholders, would not trigger an ownership change. The December Notice applies to all Treasury shareholdings. Its most immediate application and likely most significant application, however, is to the planned sale of the shares of Citigroup that Treasury holds.[55]

The application of the section 382 limitations to Citigroup would have been harsh.[56]

Citigroup reported deferred tax assets (DTA) of $38 billion as of September 30, 2009, and stated that it would require "approximately $85 billion of taxable income during the respective carry-forward periods to fully realize its U.S. federal, state and local DTA."[57] Given Citigroup's current market capitalization of $80.02 billion, it could use its NOLs only to offset $3.31 billion in taxable income annually, under the section 382 limitation.[58]

Of course, any application of the limitation would have also reduced Citigroup's capital. Citigroup reported that as of September 30, 2009 "[a]pproximately $13 billion of [its] net deferred tax asset is included in Tier 1 and Tier 1 Common regulatory capital."[59] Citigroup reported that its tier 1 common and tier 1 regulatory capital were approximately $90 billion, and $126 billion respectively. It is difficult to calculate the capital reduction that imposition of the 382 limitations would cause, but the reduction would likely be a significant percentage of the $13 billion, and Citigroup would have been required to raise capital from other sources to restore its

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(3) The legal authority to prescribe Internal Revenue Service Notice 2008–83 is doubtful.

American Recovery and Reinvestment Act (ARRA), Pub. L. No. 111–5, at § 1261 (2009).

[53] *Conference Report to Accompany H.R. 1,* at 555–560, 111th Cong. (2009) (H.R. Rept. 111–16) (online at legislative.nasa.gov/ConferenceReport%20111-16.pdf).

[54] IRS Notice 2010–2 (Dec. 11, 2009) (online at www.irs.gov/pub/irs-drop/n-10-02.pdf).

[55] This section does not discuss the possible impact of the December Notice on future sales of stock held by Treasury under the Automotive Industry Financing Program, SSFI, or any common stock acquired by Treasury pursuant to its CPP warrants. However, as noted in the text, the December notice is likely to have its greatest significance as applied to Citigroup because any triggering of section 382 will likely reduce a financial institution's tier 1 capital. in the value of Citigroup's NOLs and in the amount of its tier 1 capital.

[56] Citigroup recognized the risk of the application of section 382. In early June 2009, as part of its Exchange Offer with Treasury, and as described in its 2009 Third Quarter 10–Q, its Board had adopted a "tax benefits preservation plan . . . to minimize the likelihood of an ownership change [under section 382] and thus protect Citigroup's ability to utilize certain of its deferred tax assets, such as net operating loss and tax credit carry forwards, to offset future income." However, the 10–Q continued: "[d]espite adoption of the [p]lan, future stock issuance our transactions in our stock that may not be in our control, including sales by the USG, may . . . limit the Company's ability to utilize its deferred tax asset and reduce its [tangible common equity] and stockholders equity." Citigroup, *Quarterly Report for the Third Quarter of 2009 (10–Q)*, at 11 (online at www.citibank.com/citi/fin/data/q0903c.pdf?ieNocache=106) (hereinafter "Citigroup Third Quarter 10–Q").

[57] It is not possible, or very difficult, to discern from public information how much taxable income Citigroup would need in order to use its DTAs if it were subject to section 382 limitations. Use of DTAs is not one to one against taxable income.

[58] $3.23 billion is Citigroup's market capitalization multiplied by the long-term tax exempt rate. *See supra* note 47.

[59] Citigroup Third Quarter 10–Q, *supra* note 56, at 11.

capital position.[60] Under the worst set of circumstances, such a reduction in tier 1 capital might have left Citigroup undercapitalized and postponed its eligibility for exit from the TARP altogether.

By eliminating the section 382 limitations, the Treasury Department avoided either reducing the value of its shares (and the capital held by Citigroup) or being forced to sell its shares serially over a period of years, in amounts small enough not to increase the holdings of Citigroup's public stockholders by more than five percent.

Nonetheless, the December Notice has attracted criticism as an additional subsidy to Citigroup and a loss to the taxpayers.[61] Section 382 is a highly reticulated statute, and this departure from its operation, under the authority both of the Code and EESA, has raised concerns.[62]

Congress' rescission of the September 2008 Notice directed at the Wells Fargo-Wachovia transaction is inconclusive.[63] The legislation indicated a congressional belief that section 382 was not intended to apply differently to "particular industries."[64] However, the Notice was arguably directed at private transactions and was announced before the enactment of EESA.[65] In addition, by the time Congress acted to reverse that Notice, the CPP, TIP, and SSFI were in operation, and the significance of the EESA Notices was apparent. The first two EESA Notices are cited in the ARRA Conference Committee Report without comment, positive or negative, and Congress has taken no action, either in ARRA or thereafter to rescind the EESA Notices.

Given the previous guidance, it is difficult to understand why Treasury waited until December 2009 to extend the earlier guidance to a sale of its shares to the public.[66] Treasury staff has indicated that, before the decision was made to sell the shares to the public, it was possible that Citigroup would repurchase the shares

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[60] Without an ability to know the amount of the $13 billion figure made up of federal NOLs, a precise calculation is impossible.

[61] House Committee on Oversight and Government Reform, Subcommittee on Domestic Policy, Opening Statement of Committee Chairman Dennis Kucinich, *The U.S. Government as Dominant Shareholder: How Should Taxpayers' Ownership Rights be Exercised?* (*Part II*), at 3 (Dec. 17, 2009) (online at oversight.house.gov/images/stories/121709__111th__DP__Opening__Statement__Chairman__Kucinich__121709.pdf); Sen. Charles Grassley, *Grassley Urges Fair Tax Treatment for Small Businesses Compared to Large Banks* (Dec. 23, 2009) (online at grassley.senate.gov/news/Article.cfm?customel__dataPageID__1502=24632). Senator Jim Bunning has introduced a bill to rescind 2010–2, and to require Treasury to receive congressional authorization for any future regulations under section 382 that provide an "exemption or special rule . . . which is restricted to dispositions of instruments acquired by the Secretary." S. 2916, 111th Cong. (Dec. 18, 2009).

[62] Binyamin Appelbaum, *U.S. gave up billions in tax money in deal for Citigroup's bailout repayment*, Washington Post (Dec. 16, 2009) (online at www.washingtonpost.com/wp-dyn/content/article/2009/12/15/AR2009121504534.html) (quoting Robert Willens, a tax accounting expert, that "I've been doing taxes for almost 40 years, and I've never seen anything like this, where the IRS and Treasury acted unilaterally on so many fronts").

[63] IRS Notice 2008-83 (Sept. 30, 2008) (online at www.irs.gov/irb/2008-42__IRB/ar08.html).

[64] *See* ARRA, *supra* note 52.

[65] Although EESA was close to enactment at the end of September, the consensus was that the TARP would be used to purchase "troubled assets" from financial institutions. Congressional Oversight Panel, *August Oversight Report: The Continued Risk of Troubled Assets* (Aug. 11, 2009) (online at cop.senate.gov/documents/cop-081109-report.pdf) (hereinafter "COP August Oversight Report").

[66] Some tax experts believe that the conclusion was implicit in the prior assurance that section 382 could not apply to any repurchase of CPP shares from Treasury. Amy Elliot, *Criticism of Notice Allowing Citigroup to Keep NOLs is Unfounded, Official Says,* Tax Analysts (Dec. 17, 2009) ("Most thought that 'even if it wasn't a redemption that shouldn't matter,'" said Todd B. Reinstein, a partner with Pepper Hamilton LLP. "If it was a sale to a public group it should be the same treatment. This just . . . confirms that").

itself, making the December Notice unnecessary; the Notice would, however, have been necessary in any event with respect to the other institutions in which Treasury continues to hold a common stock interest.[67] It is also possible that Treasury did not want to run a risk of attracting a negative congressional reaction such as that which led to the reversal of Notice 2008–83.

Treasury has pointed out to staff of the Panel that the December Notice balances the policies of section 382 and EESA by limiting the EESA relief to sales to the public and not to any freestanding five percent shareholders. This avoids the primary thrust of section 382 by not creating any single shareholder or shareholders with more than five percent of Citigroup stock through its sale. The limitation is significant, but its relevance in this case depends to some degree on the relationship between the timing of the Notice and Treasury's decision to sell its Citigroup shares to the public.

Assistant Secretary of the Treasury for Financial Stability Herb Allison's initial response to the criticism of the December Notice, in a letter to The Washington Post, emphasized that Treasury could not avoid taxes because it did not pay taxes.[68] The response sidesteps the fact that section 382 applies to Citigroup, not Treasury, and that the operation of the statute is not limited to sales of a company. A second argument, that Citigroup should not "be treated differently simply because the government intervened" comes closer to the core of the matter. The December Notice eliminated what could have been a major obstacle to the severance of Treasury's ownership of Citigroup common stock. Without the Notice, Treasury could still have eliminated the costs of the section 382 limitations for Citigroup by selling its shares into the market over a number of years, causing no revenue loss. Calculations of the extent to which taxpayers benefited or not from the lifting of the section 382 limitation are extremely difficult in any event, because they depend on assumptions about Citigroup's income in future years if use of its NOLs had been limited, and the value to the taxpayers of realizing an immediate gain from the sale of the Citigroup shares.

Finally, the EESA Notices, however sound in themselves, illustrate again the inherent conflict implicit in Treasury's administration of the TARP. In this case the conflict is a three-way one, pitting Treasury's responsibilities as TARP administrator, regulator, and tax administrator against one another. Perhaps the most troublesome aspect of the debate over the December Notice is posed by this conflict, in the perception that income tax flexibility is especially, and quickly, available for large financial institutions at a time of general economic difficulty.

C. Historical Precedents: the RFC and the RTC

The TARP is not the first U.S. government program to involve large-scale U.S. government acquisition of private assets.[69] The Re-

[67] Treasury conversations with Panel staff (Jan. 7, 2009).

[68] Assistant Secretary Herbert Allison, Letter to the Editor, *U.S. Isn't Evading Taxes on Citigroup,* Washington Post (Dec. 22, 2009) (online at www.washingtonpost.com/wp-dyn/content/article/2009/12/22/AR2009122200040.html).

[69] *See generally* Congressional Oversight Panel, *April Oversight Report: Assessing Treasury's Strategy: Six Months of TARP,* at 35–50 (Apr. 7, 2009) (online at cop.senate.gov/documents/cop-040709-report.pdf) (hereinafter "COP April Oversight Report").

construction Finance Corporation (RFC) and the Resolution Trust Corporation (RTC) provide prior models for the investment of public funds in struggling or insolvent private entities and the ensuing public sector management and disposition of the acquired assets. The RFC was established in 1932 and ultimately unwound in 1957,[70] while the RTC was established in 1989 and ultimately terminated in 1995.[71]

1. The RFC

President Herbert Hoover established the RFC in response to the credit freeze of the Great Depression.[72] The RFC provided liquidity to struggling institutions through investments in preferred stock and debt securities.[73] Initially, the RFC provided liquidity for healthier institutions but was prevented from offering long-term capital to weaker institutions by restrictions such as high interest rates, collateral requirements, and short-term lending requirements.[74] The Emergency Banking Act of 1933, however, gave the RFC the ability to offer investment capital, while looser collateral requirements expanded the RFC's lending capacity.[75] Ultimately, under President Franklin Roosevelt, successive expansions of authority helped the RFC evolve from its initial role as a short-term lender into an agency that provided federal support for the credit markets and became a major part of the New Deal program.[76]

The RFC investments in bank and industry capital took place in the shadow of the Emergency Banking Act and President Franklin Roosevelt's nation-wide bank holiday. After the holiday, only those banks that were liquid enough to do business were permitted to reopen. Banks with insufficient assets to return to depositors and creditors were reorganized with RFC assistance or liquidated.[77] The key steps the RFC followed in resolving failing banks have been cited as a model method for dealing with bank failures: (1) Write down a bank's bad assets to realistic economic values; (2) evaluate bank management and make any needed and appropriate changes; (3) inject equity in the form of preferred stock but only after the write-downs; and (4) receive the dividends and eventually

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[70] Congress terminated the lending power of the RFC in 1953, and its remaining duties were transferred to other agencies in 1957. *See* The National Archives, *Records of the Reconstruction Finance Corporation,* at 234.1 (online at www.archives.gov/research/guide-fed-records/groups/234.html) (accessed Jan. 13, 2010) (hereinafter "Records of the RFC").

[71] *See* Timothy Curry and Lynn Shibut, *The Cost of the Savings and Loan Crisis: Truth and Consequences,* FDIC Banking Review, at 28 (Dec. 2000) (online at www.fdic.gov/bank/analytical/banking/2000dec/brv13n2__2.pdf) (hereinafter "The Cost of the Savings and Loan Crisis: Truth and Consequences").

[72] James S. Olson, *Saving Capitalism: The Reconstruction Finance Corporation and the New Deal, 1933–1940*, at 14–15 (1988) (hereinafter "Olson").

[73] *See* Olson, *supra* note 72. The funds were provided to banks, railroads, financial institutions, commercial enterprises, industrial banks, farm collectives and a variety of other entities, as well as to other agencies. *See id.* at 43–44. *See generally* Records of the RFC, *supra* note 70.

[74] *See* Jesse Jones, *50 Billion Dollars: My Thirteen Years with the RFC* (*1932–1945*), at 19, 520 (1951) (hereinafter "Jones"); *see also* Olson, *supra* note 72, at 69.

[75] *See* Olson, *supra* note 72, at 69.

[76] *See* Olson, *supra* note 72, at 83, 88; *see also* Jones, *supra* note 74. In addition to financial sector entities, the many recipients of RFC loans included department stores, fabric and paper mills, and small business owners as well as banks and railroads. *See id.* at 184–85, 188, 190. Jack Dempsey also received a loan, which he used to refurbish a restaurant. *See id.* at 190.

[77] *See* Jones, *supra* note 74.

recover the par value of the stock as the bank returns to profitability and full private ownership.[78]

The RFC's involvement with the entities to which it provided funds was neither hands-off nor consistently interventionist. Although the RFC was the largest investor in the country, its head, Jesse Jones, expressed a preference for leaving competent executives in charge of their institutions, and preferred to offer advice and capital without trying to control or manage the institutions.[79] He stated generally that where he felt a bank was well run, the RFC would not become involved with management.[80] This general philosophical approach, however, did not prevent Jones from intervening where he thought it necessary and suggesting management and board changes for RFC debtors.[81] In some cases, the RFC loan was contingent upon the relevant entity accepting new management chosen by the RFC.[82] Jones also certified the appropriateness of the salaries received by executives at corporations accepting RFC loans and instituted a declining scale of salary reductions, under which cuts could exceed 50 percent.[83] On the other hand, Jones did not use the RFC to make economic and industrial policy decisions.[84] Jones stated that he resisted what he considered the New Dealers' plans to use the RFC funds as a "grab bag"[85] and instead ran the RFC according to business principles, using what he considered "proper accounting methods" to manage the RFC's investments.[86] In his memoirs, Jones stated that everyone assumed that the RFC was to provide the emergency relief necessary for weathering the crisis. When private enterprise was in a position to in-

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[78] Federal Reserve Bank of Kansas City, *Speech by President Thomas Hoenig: Too Big Has Failed,* at 7 (Mar. 6, 2009) (online at www.kc.frb.org/speechbio/hoenigPDF/Omaha.03.06.09.pdf).

[79] *See* Jones, *supra* note 74, at 125–127.

[80] *See* Jones, *supra* note 74, at 125–127.

[81] *See* Charles Calomiris and Joseph Mason, *How to Restructure Failed Banking Systems: Lessons from the U.S. in the 1930s and Japan in the 1990s,* National Bureau of Economic Research, at 20–24 (Apr. 2003) (online at papers.nber.org/papers/w9624.pdf?new_window=1).

[82] The most famous instances of t his kind of RFC control were Continental Illinois Bank and Trust Company and the Union Trust Company of Cleveland. *See* Olson, *supra* note 72, at 125; Joseph R. Mason, *Reconstruction Finance Corporation Assistance to Financial Intermediaries and Commercial & Industrial Enterprise in the U.S.,* 1932–1937, at 20–21 (Jan. 17, 2000).

[83] *See* Olson, *supra* note 72, at 125–126.

[84] *See* Olson, *supra* note 74, at 127.

[85] *See* Jones, *supra* note 74, at 290.

[86] Congressional Oversight Panel, Written Testimony of Alex Pollock *Taking Stock: Independent Views on TARP's Effectiveness,* at 3 (Nov. 19, 2009)(online at cop.senate.gov/documents/testimony-111909-pollock.pdf) (hereinafter "Pollock COP Testimony"). From its formation in 1932 onwards, the RFC and its subsidiaries prepared monthly financial statements setting forth cumulative assets, liabilities, and shareholder capital. Where applicable, these "Statement[s] of Condition" also listed the cumulative loan positions with recipient firms, including data such as authorized loan amount, proceeds disbursed/not disbursed, and repayments. These loan statements included detailed footnotes. *See generally* Reconstruction Finance Corporation, Statement of Condition (Dec. 31, 1934). In time, the RFC also added a "Statement of Income and Expense," that more explicitly detailed income, expenses, and profits (losses). *See* Reconstruction Finance Corporation, Statement of Condition (Dec. 31, 1937). By the 1930s, most publicly traded corporations produced some financial information for their investors. Principally, this meant two documents: the balance sheet and the income statement. The balance sheet was broadly divided into two section: "assets" and "liabilities" (or "liabilities and capital"). Income statements varied more widely, but almost always had a description of revenues and expenses, and some statement of profit and loss. *See generally* Mortimer Battey Daniels, *Corporation Financial Statements,* at 5–7 (first edition 1934, reprinted 1980). Thus, the RFC financial statements mirrored those of its non-government peers.

The financial statements prepared by OFS with rsepect to the TARP program, and the accompanying MD&A, provide extensive discussion of the results of all the TARP programs. The notes to the statements are not easily accessible for a lay leader, but the MD&A is easier to read and includes a short executive summary. Overall, Agency Financial Report seems broadly consistent with the RFC precedent. Agency Financial Statement 2009, *supra* note 32; *see* Section D.3, *infra.*

vest, he expected the RFC to cease operations.[87] By the end of 1935, the RFC had loaned or invested $10.6 billion ($167.38 billion in 2009 dollars)[88] in various businesses and government agencies, often (although not always) without interfering in the operations of the debtors.[89] Most of the RFC's investments in banks were ultimately recovered in full, and the RFC also received dividends from those investments, although its investments in railroads were less lucrative.[90]

2. The RTC

The RTC was established as part of the effort to address the savings and loan crisis of the 1980s.[91] Scholars have cited volatile interest rates, state and federal deregulation, market shifts and adverse economic conditions as factors contributing to the crisis.[92] By the end of 1986, 441 thrifts representing $113 billion were insolvent, and 533 thrifts representing $453 billion held severely impaired assets.[93] Together, those insolvent and struggling thrifts held nearly 50 percent of the assets in the industry.[94]

In response to the crisis, the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) created the RTC as a limited-term entity. (Although originally intended to operate for five years, it was extended twice, ultimately until 1995.)[95] It acted as conservator or receiver of eligible insolvent institutions, and was responsible for carrying assets of the insolvent institutions until it could sell them.[96] Its funding derived in part from the Resolution Funding Corporation, which was partially supported by the Federal Home Loan Banks and the Treasury and issued long-term bonds to the public.[97] Among other methods, the RTC created joint ventures with private parties to help dispose of thrift assets. The private sector partner purchased, managed and sold the assets, and shared returns with the RTC.[98] The RTC created 72 such joint ventures between 1992 and 1995, which collectively held assets with a book value of $21.4 billion.[99]

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[87] *See* Jones, *supra* note 74, at 191. The RFC also declined to provide loans to industries that had access to private capital. *See id.*

[88] A consumer price index inflation calculator is available via the Bureau of Labor Statistics (online at data.bls.gov/cgi-bin/cpicalc.pl).

[89] *See* Jones, *supra* note 74, at 127.

[90] *See* Pollock COP Testimony, *supra* note 86, at 2–3.

[91] *See* Lee Davison, *Politics and Policy: The Creation of the Resolution Trust Corporation, FDIC Banking Review,* at 17–18 (July 2005) (online at www.fdic.gov/bank/analytical/banking/2005jul/article2.pdf) (hereinafter "Politics and Policy: The Creation of the Resolution Trust Corporation").

[92] *See* The Cost of the Savings and Loan Crisis: Truth and Consequences, *supra* note 71, at 27 (describing the factors contributing to the crisis and citing sources).

[93] *See id.*

[94] *See id.*

[95] *See* Politics and Policy: The Creation of the Resolution Trust Corporation, *supra* note 91, at 19; *see also* The Cost of the Savings and Loan Crisis: Truth and Consequences, *supra* note 71, at 28.

[96] *See* The Cost of the Savings and Loan Crisis: Truth and Consequences, *supra* note 71, at 28–30.

[97] *See id*.

[98] Federal Deposit Insurance Corporation, *Managing the Crisis: The FDIC and RTC Experience, Chronological Overview: Chapter 15* (Jan. 5, 2005) (online at www.fdic.gov/bank/historical/managing/Chron/1992/index.html) (hereinafter "Managing the Crisis: The FDIC and RTC Experience").

[99] *See* Ralph F. MacDonald III, Mark V. Minton, Sarah H. Eberhard, Brett P. Barragate, Glenn S. Arden, James C. Olson, Valerie Pearsall Roberts, *FDIC Delays the PPIP Legacy Loan*

Continued

By the end of its existence, the RTC had disposed of more than $450 billion in assets, representing nearly 98 percent of the assets that were its responsibility, and resolved 747 failed thrifts.[100] Although the RTC ultimately realized losses from its investments, the losses were lower than the estimates made during the early- and mid-1990s, and the cost of intervention declined every year after 1991.[101] The savings resulted in part from the RTC's decision to follow conservative accounting principles and its efforts to avoid overvaluing the assets it had acquired.[102] In addition, the RTC benefited from the economic recovery of the 1990s, which lessened the rate of thrift failures and increased the prices that the RTC could get for its thrift asset holdings.[103]

3. Lessons from the RFC and the RTC

The RFC and the RTC were both established during extraordinary circumstances.[104] For the RFC, the market collapse of the Great Depression and the needs of the New Deal programs ultimately vested the agency with a role as an all-things lender and fixer. The RTC, by contrast, had a more limited brief: to organize and dispose of the mess left by the savings and loan crisis. TARP funds are not directly available for the wide variety of possible recipients that received RFC funds,[105] and in that sense the TARP is more targeted. Unlike the RTC, however, Treasury under the TARP has intervened in multiple types of market failures, and has not restricted its actions to just one sector.

In addition, Treasury is not predominantly acting to liquidate the entities that are part of the TARP, as did the RTC. Accordingly, it is difficult to draw too many parallels between Treasury's management of the TARP and either the RFC or the RTC. At a more abstract level, the crises to which the RTC and the RFC responded involved the sequential failure of multiple regulated entities over several years prior to government intervention.[106] By contrast, the TARP developed in response to rapidly-unfolding market events for which, in some cases, there was no obvious precedent. That said, however, in each situation—sale and management of assets for the RTC, unwinding of investments for the RFC—the U.S. government found itself in the position of a money-manager and/or conservator of private sector assets, from which they ultimately divested, over time, with attention to available returns and protection of government funds. When the RFC and the RTC had completed their tasks, they were dissolved.

Treasury has informed the Panel that it interprets its obligations in a way that, while not precisely analogous to the RFC and RTC

Program to Focus on Public-Private Programs to Sell Assets from Failed Bank, Jones Day (June 2009) (online at www.jonesday.com/pubs/pubs_detail.aspx?pubID=S6324).

[100] *See* Managing the Crisis: The FDIC and RTC Experience, *supra* note 98; *see also* Lee Davison, *The Resolution Trust Corporation and Congress*, 1989–1993, FDIC Banking Review, at 38 (Sept. 2006) (online at www.fdic.gov/bank/analytical/banking/2006sep/article2/article2.pdf).

[101] *See* The Cost of the Savings and Loan Crisis: Truth and Consequences, *supra* note 71, at 33.

[102] *See id.*

[103] Early estimates of the losses were lower, in part because the forecasts had not predicted the full extent of the crisis. *See id*.

[104] For additional discussion of the RFC and the RTC, *see* COP April Oversight Report, *supra* note 69, at 35–41, 44–50.

[105] *See* Jones, *supra* note 74, at 190.

[106] *See* COP April Oversight Report, *supra* note 69, at 35–41, 44–50.

precedents, appears to rest on similar principles. Like its predecessors, Treasury has stated that it intends to act as a reluctant shareholder and to exit while maximizing returns and preserving stability.[107] Treasury has stated that it does not intend to interfere with day-to-day business decisions, relying instead on the management of the covered entities, although Treasury has initiated board and management changes in some situations (for example, with General Motors), much as the RFC did in some situations.[108] Similarly, Treasury is experimenting with public-private partnerships to manage and dispose of its assets.

D. Disposal of the Assets

1. Introduction

Treasury currently holds assets and obligations as part of a number of different programs created under the TARP. These programs differ in scope, size, and state of maturity. The largest and most prominent use of TARP funding has been Treasury's injections of capital into financial institutions. There are three different capital injection programs under the TARP. The Capital Purchase Program (CPP) is the largest; under the CPP, 707 banks received capital injections totaling nearly $205 billion. The Targeted Investment Program (TIP) and American International Group, Inc. Investment Program (AIGIP), formerly known as the Systemically Significant Failing Institutions Program (SSFI),[109] are narrower efforts aimed at large institutions that Treasury and the bank regulators considered critical to the functioning of the financial system.[110] The only institutions that received TIP funds were Citigroup and Bank of America, each of which received $20 billion. AIG, which has received approximately $45.3 billion through AIGIP/SSFI to date, is that program's only beneficiary. Treasury has also provided capital assistance to banks outside the capital injection programs. Through the Asset Guarantee Program (AGP),

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[107] *See* Section D.2, *infra* (discussing the "three pillars").

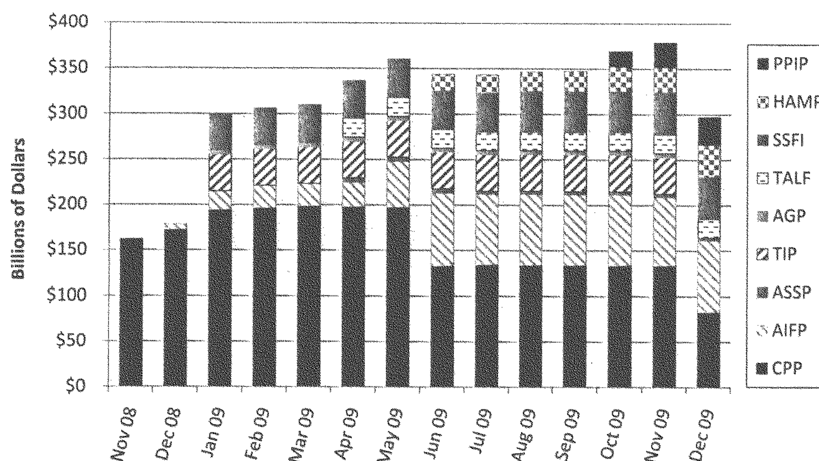
[108] *See* Congressional Oversight Panel, *September Oversight Report: The Use of TARP Funds in the Support and Reorganization of the Domestic Automotive Industry*, at 20 (Sept. 9, 2009) (online at cop.senate.gov/documents/cop-090909-report.pdf) (hereinafter "COP September Oversight Report").

[109] Treasury, without public announcement, recently changed the name of the TARP's SSFI Program to the more positive sounding American International Group, Inc. Investment Program. The Panel was made aware of this change only after reviewing OFS' recently issued TARP financial statements for fiscal year 2009.

[110] *See* 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) (hereinafter "Joint Statement on Citigroup") (stating that the decision to provide Citigroup with TIP assistance was based on the government's commitment "to supporting financial market stability, which is a prerequisite to restoring vigorous economic growth"); U.S. Department of the Treasury, *Treasury, Federal Reserve and the FDIC Provide Assistance to Bank of America* (Jan. 16, 2009) (online at www.treas.gov/press/releases/hp1356.htm) (stating that the objective of TIP is to "foster financial market stability and thereby to strengthen the economy and protect American jobs, savings, and retirement security."); U.S. Department of the Treasury, *Treasury to Invest in AIG Restructuring Under the Emergency Economic Stabilization Act* (Nov. 10, 2008) (online at www.treas.gov/press/releases/hp1261.htm) (hereinafter "Treasury to Invest in AIG Restructuring Under EESA") (highlighting that AIG is a "systemically important company"); Board of Governors of the Federal Reserve System, *Federal Reserve Board, with Full Support of the Treasury Department, Authorizes the Federal Reserve Bank of New York to Lend up to $85 billion to the American International Group (AIG)* (Sept. 16, 2008) (online at www.federalreserve.gov/newsevents/press/other/20080916a.htm) (hereinafter "Federal Reserve Board authorizes lending to AIG") (noting that the Federal Reserve Board "determined that, in current circumstances, a disorderly failure of AIG could add to already significant levels of financial market fragility and lead to substantially higher borrowing costs, reduced household wealth, and materially weaker economic performance").

Treasury, the FDIC, and the Federal Reserve guaranteed approximately $250.4 billion [111] in Citigroup assets until the termination of this program on December 23, 2009. Three other programs—TALF, PPIP and the small business initiative—account for a further $65 billion of TARP funds.

FIGURE 1: NET INVESTMENT AMOUNT IN TARP BY MONTH



2. Treasury's TARP Exit Strategy

Treasury must balance several potentially conflicting interests in managing its exit from the TARP. Because of the policy concerns related to the TARP and, more broadly, the requirements of EESA, Treasury has taken the position that it is not able to act simply as a prudent money-manager, seeking only an exit strategy that provides the best return on its investment.

The policy goals of EESA are laid out in several sections of the statute. The overarching purpose of EESA is 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." [112] While the Secretary "may, at any time, exercise any rights received in connection with troubled assets purchased under" EESA,[113] he must also specifically consider, among other concerns:

- Protecting the interests of taxpayers by maximizing overall returns and minimizing the impact on the national debt;
- Providing stability and preventing disruption to financial markets in order to limit the impact on the economy and protect American jobs, savings, and retirement security;
- The need to help families keep their homes and to stabilize communities;

[111] The $250.4 billion of Citigroup's assets reflected the value of the ring-fenced pool as of September 30, 2009. Citigroup Third Quarter 10–Q, *supra* note 56, at 35.
[112] 12 U.S.C. § 5201(1).
[113] 12 U.S.C. § 5216(a).

- In determining whether to engage in a direct purchase from an individual financial institution, the long-term viability of the financial institution in determining whether the purchase represents the most efficient use of funds[.][114]

Furthermore, the Secretary is to use his authority under EESA "in a manner that will minimize any potential long-term negative impact on the taxpayer, taking into account the direct outlays, potential long-term returns on assets purchased, and the overall economic benefits of the program, including economic benefits due to improvements in economic activity and the availability of credit, the impact on the savings and pensions of individuals, and reductions in losses to the Federal Government."[115] In carrying out this authority, the Secretary is to "hold the assets to maturity or for resale for and until such time as the Secretary determines that the market is optimal for selling such assets, in order to maximize the value for taxpayers" and "sell such assets at a price that the Secretary determines, based on available financial analysis, will maximize return on investment for the Federal Government."[116]

Treasury has interpreted its various obligations to require a management and exit strategy that rests on three pillars:

- Maintaining systemic stability;
- Preserving the stability of individual institutions; and
- Maximizing return on investment.[117]

Treasury officials have consistently stated that Treasury believes "the U.S. government is a shareholder reluctantly and out of necessity" and that Treasury "intend[s] to dispose of [its] interests as soon as practicable, with the dual goals of achieving financial stability and protecting the interests of the taxpayers."[118] This view, Treasury has stated, is consistent with EESA in that EESA does not specifically contemplate Treasury's taking positions in private companies or managing the day-to-day operations of these companies.[119] Treasury has also noted that the American system is premised on privately-owned industry and that it is therefore contrary to Treasury's nature as a government entity to hold shares in these companies. In an earlier meeting with Panel staff, a Treasury official noted that Treasury made its investments because it needed to stabilize the country's financial system, not because it needed a way to make money.[120] For that reason, he stated, exit from any TARP position must be done in a way that promotes stability and

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[114] 12 U.S.C. § 5213(1)–(4).
[115] 12 U.S.C. § 5223(a)(1).
[116] 12 U.S.C. § 5223(a)(2).
[117] Treasury conversations with Panel staff (Dec. 3, 2009).
[118] House Oversight and Government Reform Committee, Subcommittee on Domestic Policy, Written Testimony of Assistant Secretary of the Treasury Herbert Allison, Jr., *The Government As Dominant Shareholder: How Should the Taxpayers' Ownership Rights Be Exercised?*, 111th Cong. (Dec. 17, 2009) (online at oversight.house.gov/images/stories/Allison__Testimony__for__Dec-17-09__FINAL__2.pdf) (hereinafter "Allison Testimony before House Oversight and Government Reform Committee"). As part of his testimony, Secretary Allison also discussed the major principles guiding Treasury's role as a shareholder with regard to corporate governance issues. These principles were: (1) as a reluctant shareholder, Treasury intends to exit its positions as soon as practicable; (2) Treasury does not intend to be involved in the day-to-day management of any company; (3) Treasury reserves the right to set conditions on the receipt of public funds to ensure that "assistance is deployed in a manner that promotes economic growth and financial stability and protects taxpayer value"; and (4) Treasury will exercise its rights as a shareholder in a commercial manner, voting only on core shareholder matters.
[119] Treasury conversations with Panel staff (Jan. 8, 2010).
[120] Treasury conversations with Panel staff (Dec. 3, 2009).

the policy goals of EESA, even if that means that Treasury must hold securities longer than it would otherwise wish.

Treasury's multi-faceted approach to managing and winding down this program raises issues regarding an assessment of Treasury's performance with respect to its exit. If Treasury's only obligation were to maximize profit, the public would be able to compare Treasury's yield with yields on other similar investments and reach a conclusion as to whether Treasury had fulfilled its mandate.[121] Because Treasury identified a number of mandates to fulfill, any action that fails to fulfill one may be attributed to a step toward fulfilling another. Furthermore, two of the three pillars do not lend themselves to quantitative measures of performance.

Because of the various policy concerns at issue and the three-pillar approach to TARP strategy laid out above, Treasury reads its obligation to sell at a time that is "optimal" to encompass not only a determination that such a sale will directly maximize the benefit to taxpayers by fetching the highest price, but also a determination that the sale will at least not undermine systemic stability.[122] While the section of the statute in which this language resides states that the sale must be at the time determined to be "optimal . . . to maximize the value for taxpayers," this section also applies directly to an earlier subpart that directs the Secretary to use his authority under EESA to minimize long-term negative impact on taxpayers, taking into account "the direct outlays, potential long-term returns on assets purchase, and the overall economic benefits of the program, including economic benefits due to the improvements in economic activity and the availability of credit, the impact on the savings and pensions of individuals, and reduction in losses to the Federal Government."[123]

While this position may be the best way to meet the various policy goals outlined above, it may prevent Treasury from taking advantage of a true buy-and-hold strategy that would allow greater profits from companies on a strong upward trend over a years-long period. Such a strategy would, however, conflict with Treasury's position as a "reluctant shareholder" because it would require Treasury to hold shares for a long period of time.

These policy considerations raise an additional question: to what extent will Treasury's actions, whatever they may be, affect the markets? Not only is there the potential for Treasury's actions to have such an effect simply because Treasury's presence in the market is unlike that of a private firm, but the potential also exists for purposeful impact on the markets. This potential might conflict with Treasury's stated goal of minimizing government intervention in the markets and may raise objections from market participants who might claim that Treasury was deliberately disrupting the market. Treasury's statements to date have not explained how it will address this conundrum.

Although Treasury's exit strategy from the TARP has not always been transparent to the American public, Treasury has now clearly articulated the principles upon which it is operating with respect to exit strategy, however obscure the eventual application of those

[121] The comparison would be an imperfect one because no two investments are identical.
[122] Treasury conversations with Panel staff (Dec. 3, 2009).
[123] 12 U.S.C. § 5223(a)(1).

principles may be.[124] The Panel does not take a view either with respect to Treasury's "reluctant shareholder" approach or with respect to the strategy that Treasury is following, but it acknowledges that the approach has been enunciated with the objective of articulating a policy. In meetings and calls with the managers of the various asset classes at Treasury, those managers were consistent in their articulation of the exit strategy and the principles driving it.[125]

By comparison, in a previous Report the Panel suggested that Treasury consider dealing with the shareholder duties that have emerged from its investments in troubled companies by placing those investments in a privately managed trust,[126] thereby segregating these functions from the other oversight and intervention obligations occasioned by the TARP.

The principal benefit of such a trust would be that the assets could be managed for the sole benefit of the U.S. Treasury, and would be insulated from undue political influence.[127] While the creation of such a trust is authorized by the statute,[128] and has been considered by Treasury, Treasury has explained that the drawbacks of using a trust are currently outweighed by the benefits.[129] The belief is that if a trust were created, it would be difficult to determine which assets should be placed in the trust, and it would be difficult to carry out Treasury's policy goals—which include promoting market stability in addition to maximizing the benefit to taxpayers.[130] Treasury has also indicated that statutory requirements may prevent the implementation of a trust managed by an independent trustee, because of EESA's requirements for the Secretary to maintain supervision over investments held by vehicles established by Treasury. Treasury has not ruled out the use of such a trust when only a small pool of assets remain.[131]

The Panel is concerned that, although Treasury has been consistent in its description of its goals, the articulated principles are so broad that they provide Treasury with an easy means of justifying almost any decision—effectively giving no metric to determine whether Treasury's actions met its stated goals. Because either holding or selling, or a third approach, may alternatively be justified as maximizing profit, or maintaining the stability of significant

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[124] Allison Testimony before House Oversight and Government Reform Committee, *supra* note 118; Treasury conversations with Panel staff (Dec. 3, 2009); *see* Congressional Oversight Panel, *January Oversight Report: Accountability for the Troubled Asset Relief Program*, at 4 (Jan. 9, 2009) (online at cop.senate.gov/documents/cop-010909-report.pdf).

[125] In the course of drafting this report, Panel staff conducted extensive discussions with the managers of the various asset classes at Treasury. *See, e.g.,* Treasury conversations with Panel staff (Dec. 15, 2009, Dec. 16, 2009, and Jan. 5, 2010) (discussing Citigroup and AIG).

[126] *See* COP September Oversight Report, *supra* note 108, at 5.

[127] Treasury statements make it clear that Treasury sees a clear distinction between "managing assets" (which Treasury sees as the government's role) and "managing companies" (which Treasury does not see as its role). Allison Testimony before House Oversight and Government Reform Committee, *supra* note 118, at 5–6. While Treasury is clearly able to manage assets outside a trust, Treasury's direct involvement in, for example, deciding when to sell Citigroup shares, has the potential to send unintended signals to the markets, which signals would be tempered if a trustee were making the decisions. Additionally, while Treasury intends to vote its shares only on "core" shareholder matters, there are non-core matters that may be presented to shareholders where a failure to vote could lead to a governance vacuum and where a trustee could prove useful.

[128] 12 U.S.C. § 5219(c).

[129] Treasury conversation with Panel staff (Dec. 15, 2009). Trusts are also as prone as any group of people to suffer from disagreements among members or other internal politics.

[130] Treasury conversation with Panel staff (Dec. 15, 2009).

[131] Treasury conversation with Panel staff (Dec. 15, 2009).

institutions, or promoting systemic stability, almost any decision can be demonstrated to be forwarding one of these three principles.

3. Accounting for the TARP

EESA requires an annual financial statement prepared in accordance with generally accepted accounting principles and audited in accordance with generally accepted auditing standards.[132] On December 10, 2009, Treasury issued financial statements for the TARP for the federal fiscal year ending September 30, 2009.[133] The statements disclose that Treasury's final estimate for the cost of the transactions undertaken in fiscal year 2009 is $41.6 billion, approximately $110 billion lower than earlier estimated. This sizeable "downward reestimate" reflects improved equity prices and lower projected loss rates on the investments made in 2009, as well as faster repayment of some of those investments than was initially anticipated. Similarly, over the full multi-year course of the TARP's operations, the expected cost of the program is now estimated at $141 billion, roughly $200 billion lower than was initially forecast.[134] Of this estimated $141 billion in losses, Treasury has acknowledged that roughly $60 billion is attributable solely to the TARP investments in AIG and the auto companies.[135]

The TARP financial statements were prepared in accordance with generally accepted accounting principles. EESA further requires that the budgetary cost of the TARP be calculated under the rules of the Federal Credit Reform Act. This "credit reform" treatment means that TARP transactions are discounted to reflect the time value of money and the market risk of those investments.[136] As a result, the accounting and budget information that Treasury publishes for the TARP are a good measure of the economic value of the resources expended. The GAO audited the financial statements and stated that the Office of Financial Stability had maintained effective financial controls in all material respects.[137]

The next financial report on the TARP will be released by Treasury in early February 2010, at the time the President's 2011 Budget is transmitted to the Congress. While normal practice has been not to provide a further update of a particular federal program's financial information until the time of the Midsession Review of the budget on July 15th, Treasury has indicated that it expects to re-

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[132] 12 U.S.C. § 5226(b)(1).

[133] *See* Government Accountability Office, *Office of Financial Stability (Troubled Asset Relief Program) Fiscal Year 2009 Financial Statements* (Dec. 2009) (online at www.gao.gov/new.items/d10301.pdf) (hereinafter "OFS FY09 Financial Statements").

[134] The TARP Financial Statements were released on December 10, 2009. The Department of the Treasury issued a press release which stated, "[a]s additional funds are disbursed, particularly for the housing initiative, the total cost of TARP is likely to rise, although it is anticipated to be at least $200 billion less than the $341 billion estimate in the August 2009 Mid-Session Review." *See* U.S. Department of the Treasury, *New Report Shows Higher Returns, Lower Spending Under TARP Than Previously Projected* (Dec. 10, 2009) (online at ustreas.gov/press/releases/tg438.htm).

[135] *See* House Oversight and Government Reform Committee, Subcommittee on Domestic Policy, Transcript Testimony of Assistant Secretary of the Treasury for Financial Stability Herbert Allison, Jr., *The Government As Dominant Shareholder: How Should the Taxpayers' Ownership Rights Be Exercised?,* 111th Cong., (Dec. 17, 2009) (online at oversight.house.gov/index.php?option=com__content&task=view&id=4722&Itemid=31) (hereinafter "Allison Testimony Transcript").

[136] *See* 12 U.S.C. § 5232 (requiring that TARP transactions be measured for budget presentation purposes under credit reform procedures, but modified to reflect the market risk of those transactions).

[137] *See* OFS FY09 Financial Statements, *supra* note 133, at 1–2. GAO did note two internal control deficiencies in the OFS financial systems which OFS agreed to rectify.

lease interim financial reports on TARP transactions sometime between February and July 2010. The financial statements and accompanying "management's discussion and analysis" (MD&A) provide discussion of the results of all the TARP programs.[138] The notes to the statements are not easily accessible for a lay reader, but the MD&A is easier to read and includes a short executive summary.

4. CPP Preferred and Warrants

a. Acquisition of Assets and Current Value

Under the CPP, Treasury provided capital to financial institutions by purchasing senior preferred stock (CPP Preferred) or subordinated debentures. The purchases were made pursuant to a "Securities Purchase Agreement" (SPA), which has standard terms for most banks.[139] In addition, Treasury received warrants in order to give taxpayers "an opportunity to participate in the equity appreciation of the institution."[140] The CPP Preferred, which has no maturity date, pays quarterly dividends at a rate of five percent per year for the first five years, and nine percent thereafter.[141] The issuing financial institution may redeem the CPP Preferred at any time, subject to the requirement that regulators must approve the repayment.[142] The warrants, which have a 10-year life, may be exercised at any time.[143] The exercise price of the warrants for public financial institutions is based upon the 20-day average stock price

[138] Panel staff compared the financial statements and MD&As with those of financial institutions, and also considered the MD&A in the light of the many pronouncements on MD&A disclosure by the Securities and Exchange Commission (SEC). The MD&A discusses each of the programs under the TARP, addressing the purpose and impact of each program, the way in which assets were acquired, their current value, and the principles informing Treasury's management of the assets. The most significant criticisms that could be made of the MD&A are that: (a) a more thorough explanation of the accounting principles used would be helpful, as the notes to the financial statements, while thorough, are not written with the lay reader in mind; (b) more "forward-looking information" and a more expansive discussion of "trends and uncertainties" would be helpful; and (c) the graphic design and layout is distracting and inconsistent and could have benefitted from some reader-friendly, "plain English" editing. The second and third points are mitigated to some extent by the Executive Summary, which not all financial institutions provide, although the SEC encourages it. Commentators had urged that Treasury produce such disclosure. *See* Pollock COP Testimony, *supra* note 86, at 6.

[139] The terms of SPAs vary somewhat by institution type—public, private, S-corporation, mutual holding company or mutual bank—but are substantially similar. *See* Congressional Oversight Panel, *July Oversight Report: TARP Repayments, Including the Repurchase of Stock Warrants,* at 7 (July 10, 2009) (online at cop.senate.gov/documents/cop__071009__report.pdf) (hereinafter "COP July Oversight Report").

[140] *See* U.S. Department of the Treasury, *Factsheet on Capital Purchase Program* (updated Mar. 17, 2009) (online at www.financialstability.gov/roadtostability/CPPfactsheet.htm) (hereinafter "CPP Factsheet"); *see also* COP July Oversight Report, *supra* note 139, at 6 ("[W]arrants may be traded on public or private markets, and they can be highly valued by investors who believe the share price of the issuing company is likely to rise above the strike price").

[141] Dividends are cumulative for bank holding companies and their subsidiaries, and non-cumulative for banks. *See* COP July Oversight Report, *supra* note 139, at 8.

[142] *See id.,* at 10–11.

[143] *Id.,* at 8.

of the underlying common shares.[144] For non-public financial institutions, the exercise price is $0.01 per share.[145]

CPP funding ended on December 29, 2009.[146] The program provided approximately $205 billion in capital to 707 financial institutions.[147] CPP funding for qualifying financial institutions was based upon the size of the institution.[148] Of the 19 stress-tested financial institutions, 17 institutions received $164 billion through CPP funding.[149] As noted above, the issuing financial institution may redeem the CPP Preferred at any time, subject to the requirement that regulators must approve the repayment.[150] The redemption price of the CPP Preferred is set by the SPA, which provides that the shares are to be redeemed at the principal amount of the debt.[151] Subject to compliance with applicable securities laws, Treasury also has the ability to "sell, assign, or otherwise dispose of" the CPP Preferred it holds.[152] This means that the CPP Preferred could in theory be sold in private transactions to interested investors, or they could be offered to the public in a resale registered with the SEC.[153] The CPP-recipient institutions that report to the SEC are required, under the terms of the SPAs, to file a shelf registration statement, which would permit sales to the public.[154] Treasury is not limited to public sales, however, and could

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[144] The warrant exercise price is calculated taking the average of the closing prices for the 20 trading days up to and including the day prior to the date on which the TARP Investment Committee recommends that the Assistant Secretary for Financial Stability approve the investment. *See* U.S. Department of the Treasury, *FAQs on Capital Purchase Program Repayment and Capital Assistance Program,* at 2 (May 2009) (online at www.financialstability.gov/docs/FAQ__CPP-CAP.pdf). In addition, the number of warrants issued is equal to 15 percent (5 percent for a private financial institution) of the face value of the preferred investment divided by the exercise price. *See* U.S. Department of the Treasury, *Term Sheet for CPP Preferred* (online at www.financialstability.gov/docs/CPP/termsheet.pdf) (hereinafter "Term Sheet for CPP Preferred").

[145] U.S. Department of the Treasury, *TARP Capital Purchase Program (Non-Public QFIs, excluding S Corps and Mutual Organizations)* (online at www.financialstability.gov/docs/CPP/Term%20Sheet%20-%20Private%20C%20Corporations.pdf).

[146] Treasury conversations with Panel staff (Jan. 8, 2010). The application process ended on November 21, 2009. *See* U.S. Department of the Treasury, *FAQ on Capital Purchase Program Deadline* (online at www.financialstability.gov/docs/FAQ%20on%20Capital%20Purchase%20Program%20Deadline.pdf).

[147] Treasury conversations with Panel staff (Jan. 8, 2010). *See also* U.S. Department of Treasury, *Troubled Asset Relief Report, Monthly 105(a) Report—December 2009,* at 10 (Jan. 11, 2010) (online at financialstability.gov/docs/105CongressionalReports/December%20105(a)__final__1-11-10.pdf) (hereinafter "Monthly 105(a) Report").

[148] As stated in the term sheets for both public and private institutions, "[e]ach [qualifying financial institution] may issue an amount of Senior Preferred equal to not less than 1% of its risk-weighted assets and not more than the lesser of (i) $25 billion and (ii) 3% of its risk weighted assets." *See* Term Sheet for CPP Preferred, *supra* note 144, at 1. Risk weighted assets are the total assets of a financial institution, weighted for credit risk. *See* U.S. Department of the Treasury, *Decoder* (online at www.financialstability.gov/roadtostability/decoder.htm) (hereinafter "Treasury Decoder").

[149] MetLife, Inc. did not receive CPP funding. In addition, GMAC received $13.4 billion under the Automotive Industry Financing Program. See Section D.8, *infra.*

[150] *See* COP July Oversight Report, *supra* note 139, at 10–11.

[151] *See* COP July Oversight Report, *supra* note 139, at 10–11.

[152] *See* U.S. Department of the Treasury, *Securities Purchase Agreement: Standard Terms,* at § 4.4 (online at www.financialstability.gov/docs/CPP/spa.pdf) (accessed Jan. 4, 2010).

[153] The CPP financial institutions that report to the SEC are required, under the terms of the SPA, to file a shelf registration statement, which would permit sales to the public. *See* SPA § 4.5(a)(i). In addition, Treasury could make sales in private transactions exempt from or not subject to SEC registration.

[154] *See* SPA, *supra* note 153, at 4.5(a)(ii). A shelf registration statement allows the financial institution to offer and sell its securities for a period of up to two years. With the registration "on the shelf," the financial institution, by simply updating regularly filed annual and quarterly reports to the SEC can sell its shares in the market as conditions become favorable with a minimum of administrative preparation and expense.

make sales in private transactions exempt from or not subject to SEC registration.

After redemption of its CPP Preferred, a financial institution may also repurchase its warrants,[155] the warrants are "detachable" from the CPP Preferred,[156] which means that they can trade separately. Treasury is required to purchase the warrants at "fair market value." [157] The fair market value is determined using a negotiation and appraisal process between Treasury and the financial institution.[158] If a financial institution does not wish to repurchase its warrants,[159] or the parties cannot agree on a fair price and neither party wishes to invoke the appraisal procedure, Treasury will, as a matter of policy, auction the warrants to the public.[160] Treasury staff has stated that it is Treasury's policy to dispose of the warrants as soon as practicable.[161] Therefore, a financial institution may repurchase its warrants as soon as it redeems its preferred shares.[162] To date, of the 58 [163] financial institutions that have redeemed fully their CPP Preferred, 31 [164] financial institutions have also repurchased their warrants [165] and Treasury has received approximately $2.9 billion from warrant redemptions.[166]

[155] OFS Chief Counsel Timothy Massad confirmed in a meeting with Panel staff on December 15, 2009 that if Treasury sold its CPP Preferred to third party, a financial institution would be allowed to repurchase its warrants once the sale is completed. Treasury conversations with Panel staff (Dec. 15, 2009). *See also* COP July Oversight Report, *supra* note 139, at 8–17 (discussing the history and legal aspects of repayment of CPP Preferred and warrants

[156] *See* SPA, *supra* note 153, at § 1.2.

[157] *See* SPA, *supra* note 153, at § 4.9(a).

[158] The repurchase process for a financial institution is a multi-step procedure starting with the institution's proposal to Treasury of its determination of the fair market value of the warrants. Treasury has a choice of whether to accept this proposed fair value. If Treasury and the financial institution are unable to agree on the fair value determination, either party may invoke the appraisal procedure. In the appraisal procedure process, both Treasury and the financial institution select independent appraisers. If the appraisers fail to agree, a third appraiser is hired, and subject to certain limitations, a composite valuation of the three appraisals is used to establish fair market value. This composite valuation is determined to be the fair market value and is binding on both Treasury and the financial institution. If the appraisal procedure is not invoked, and neither party can agree on the fair market value determination, Treasury then sells the warrants through the auction process. *See* Robert A. Jarrow, *TARP Warrants Valuation Methods* (Sept. 22, 2009) (online at www.financialstability.gov/Jarrow%20TARP%20Warrants%20Valuation%20Method.pdf) (hereinafter "TARP Warrants Valuation Methods").

In addition, the process is different for private banks. Warrants of private financial institutions are immediately exercisable. *See* COP July Oversight Report, *supra* note 139, at 11.

[159] After the CPP preferred is redeemed, the financial institution has 15 days to decide whether it wishes to repurchase its warrants. *See* 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/latest/tg__06262009.html).

[160] In November 2009, Treasury announced that it intended to conduct auctions to sell its warrant positions in JPMorgan Chase, Capital One Financial Corporation, and TCF Financial Corporation. The issuers were allowed to bid in these auctions. *See* U.S. Department of the Treasury, *Treasury Announces Intent To Sell Warrant Positions in Public Dutch Auctions* (Nov. 19, 2009) (online at www.ustreas.gov/press/releases/tg415.htm) (hereinafter "Treasury Announces Intent To Sell Warrant Positions in Public Dutch Auctions").

[161] *See* COP July Oversight Report, *supra* note 139.

[162] *See id*.

[163] Treasury conversations with Panel staff (Jan. 8, 2010). *See also* Monthly 105(a) Report, *supra note* 147, at 11.

[164] Treasury conversations with Panel staff (Jan. 8, 2010).

[165] In its July Report, the Panel analyzed the prices at which Treasury was allowing the financial institutions to repurchase the warrants. The Panel was concerned that Treasury was undervaluing the warrants and/or not negotiating strongly enough. *See* COP July Oversight Report, *supra* note 139, at 8–17. 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. Also after the release of the July Report, Treasury retained an expert to perform an independent review of its valuation methodology. He found that it was "consistent with industry best practice and the highest academic standards." *See* TARP Warrants Valuation Methods, *supra* note 158.

[166] *See* U.S. Department of the Treasury, *Troubled Asset Relief Program Transactions Report for Period Ending December 30, 2009* (Jan. 4, 2010) (online at www.financialstability.gov/docs/

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In addition, as discussed in Section D.4.b below, Treasury has received approximately $1.1 billion in gross proceeds from third-party auction sales. The following table shows the valuation of Treasury's current holdings of CPP Preferred, common shares, and warrants as of December 31, 2009. In addition, the table shows the fair value (Net Asset Value) of Treasury's CPP Preferred and common share holdings.

FIGURE 2: VALUATION OF CURRENT HOLDINGS OF CPP PREFERRED SHARES, COMMON SHARES, AND WARRANTS AS OF DECEMBER 31, 2009

	Preferred Shares (billions of dollars)		Warrant Valuation (millions of dollars)		
	Principal Amount	Net Asset Value as of 9/30/2009[167]	Low Estimate	High Estimate	Best Estimate
Stress-Tested Financial Institutions with CPP Preferred and/or Warrants Outstanding:					
Wells Fargo & Company	$0.00	$0.00	$313.02	$1,727.96	$829.57
Bank of America Corporation[168]	0.00	0.00	561.18	2,581.16	1,036.20
Citigroup, Inc. (Common Shares)[169]	25.00	25.46	9.51	891.04	204.32
The PNC Financial Services Group Inc.	7.58	7.17	82.81	500.60	231.03
SunTrust Bank, Inc.	4.85	4.14	5.67	252.90	98.15
Regions Financial Corporation	3.50	3.01	3.61	155.48	65.41
Fifth Third Bancorp	3.41	3.05	63.74	317.82	161.23
KeyCorp	2.50	1.94	5.59	108.70	49.48
GMAC, LLC	[170] 14.11	[171] 7.17	[170]	[170]	[170]
Failed Banks Enrolled in CPP:					
Pacific Coast National Bancorp	0.00	0.00	[172] N/A	N/A	N/A
UCBH Holdings, Inc.[173]	0.30	0.02	0.00	0.07	0.01
CIT Group	2.33	0.00	0.00	3.19	2.84
All Other Banks	33.53	[174] 28.91	2,314.46	5,998.02	3,654.25
Total	**$97.11**	**$80.87**	**$3,359.59**	**$12,536.94**	**$6,332.49**

[167] Except for Citigroup, Net Asset Value for December 31, 2009 is not available. Net Asset Value is the per share value on September 30, 2009 as disclosed in the TARP Financial Audit Report. *See* OFS FY09 Financial Statements, *supra* note 133, at 36. Except for Citigroup, Inc., Net Asset Value is calculated by dividing the total value of all securities in the financial institution's portfolio, less any liabilities by the number of shares outstanding. *See* note 174, *infra*. The Net Asset Value of Citigroup was calculated using the common stock closing price of $3.31 on December 31, 2009 multiplied by Treasury's common ownership of 7.7 billion shares. On September 30, 2009, Citigroup's closing price was $4.84 per share.

[168] Warrant Valuation includes warrants outstanding from TIP investment (valuation of $459.1, $1,405.9, and $666.5 for Low, High, and Best Estimates, respectively).

[169] Warrant Valuation includes warrants outstanding from TIP (valuation of $6.4, $371.3, and $118.1 for Low, High and Best Estimates, respectively) and AGP investments (valuation of $2.3, $132.0, and $42.4 for Low, High, and Best Estimates, respectively).

[170] On December 30, 2009, Treasury provided an additional commitment to GMAC of approximately $3.8 billion. The $3.8 billion of new capital was provided in the form of $2.54 billion of Trust Preferred Securities (TruPs), which are senior to all other capital securities of GMAC, and $1.25 billion of Mandatory Convertible Preferred Stock (MCP). In addition, Treasury received warrants, which were exercised, to purchase an additional $127 million of TruPs and $63 million of MCP. U.S. Department of the Treasury, *Treasury Announces Restructuring of Commitment to GMAC* (Dec. 30, 2009) (online at ustreas.gov/press/releases/tg501.htm) (hereinafter ''Treasury Announces Restructuring of Commitment To GMAC''). *See also* Section D.8, *infra*.

[171] The Net Asset Valuation of GMAC was based $12.5 billion of preferred stock held by GMAC prior to the additional financing. Net Asset Value on December 31, 2009 is not available.

[172] Pacific Coast National Bancorp, *2008 Annual Report, Form 10–K*, Part II, Item 5 (online at www.sec.gov/Archives/edgar/data/1302502/000092708909000143/p–10k123108.htm). There are no warrants currently outstanding for Pacific Coast National Bancorp. At the date of initial TARP CPP investment, Pacific Coast National issued a warrant to Treasury to purchase 206.00206 shares of its Fixed Rate Cumulative Perpetual Preferred Stock, Series B, which Treasury immediately exercised in a cashless transaction, per the Company's 2009 10–K. The valuation of Pacific Coast National's preferred shares at September 30, 2009 was approximately $154,000.

[173] Agency Financial Statement 2009, *supra* note 32, at 34–35. The Net Asset Value of UCBH Holdings, Inc. includes warrants.

[174] Treasury conversations with Panel staff (Jan. 5, 2010). The Net Asset Value of ''All Other Banks'' was provided by OFS as an aggregate value. This is due to the inherent constraints of the model created and used by OFS in its valuation of CPP preferred stock and warrants, as discussed with the OFS modeling team on December 22, 2009. In this regard, generating a net asset value for Treasury's investment in a specific financial institution requires each institution to be separately modeled. The man-hours and model run-time required prevent each financial institution from being modeled separately. As such, OFS has valued the stress-tested financial institutions and those receiving the largest CPP investment and has provided an aggregate net asset value for Treasury's holdings in the remaining financial institutions.

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transaction-reports/1-4-10%20Transactions%20Report%20as%20of%2012-30-09.pdf) (hereinafter "TARP Transactions Report for Period Ending December 30, 2009").

Of the 19 stress-tested financial institutions, there are currently six that have not repaid their TARP funding.[175] One of the six is GMAC, which is discussed later in Section D.8.

b. Disposal of CPP Assets and Recovery of TARP Funds

In September 2009, Treasury issued a report that discussed the next phase of its financial and rehabilitation efforts—what it describes as "moving from rescue of our financial system to a period of stabilization, rehabilitation and rebuilding." [176] The report stated that the "next phase will focus on winding down those programs that were once necessary to prevent systemic failure." [177]

The report stated that Treasury anticipated financial institutions would repay another $50 billion in CPP Preferred over the next 12 to 18 months.[178] To date, Treasury has received approximately $122 billion from CPP recipients through principal repayments of preferred stock repurchases, an amount in excess of the September projection.[179] The report does not discuss the timing of repayment of the remaining balance of approximately $58 billion,[180] which largely comprises investments in approximately 600 smaller financial institutions. In this regard, Treasury has stated that it is looking at "lots of possibilities," including market sales, but it is "nowhere near" a decision process.[181] These smaller financial institutions have not publicly disclosed their intended exit strategy for CPP repayment. Non-disclosure by these financial institutions may be due to the fact that the banking regulators have not specifically disclosed their criteria for allowing a financial institution to redeem its CPP Preferred and the fact that some of these institutions may be unable to redeem due to high loan losses and "vulnerable capital ratios." [182]

Although Treasury has the ability to sell its CPP Preferred to third parties either in a private or public offering, it currently has no plans to use third-party sales.[183] Treasury stated in the TARP Financial Statements that although "it has not exercised these

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[175] MetLife, Inc. did not receive any funding. *See* Congressional Oversight Panel, *June Oversight Report: Stress Testing and Shoring Up Bank Capital*, at 15 (June 9, 2009) (online at cop.senate.gov/documents/cop–060909–report.pdf) (hereinafter "COP June Oversight Report"). As of December 31, 2009, the following stress tested banks have not repaid their TARP funding: PNC Financial Services Group, SunTrust Banks, Inc., Regions Financial Corp., Fifth Third Bancorp, Keycorp, and GMAC LLC. *See* TARP Transactions Report for Period Ending December 30, 2009, *supra* note 166.

[176] *See* U.S. Department of the Treasury, *The Next Phase of Government Financial Stabilization and Rehabilitation Policies*, at 1 (Sept. 14, 2009) (online at www.treas.gov/press/releases/docs/Next%20Phase%20of%20Financial%20Policy,%20Final,%202009-09-14.pdf) (hereinafter "Treasury Status Report on Financial Stabilization").

[177] *See* Treasury Status Report on Financial Stabilization, *supra* note 176, at 1.

[178] *See* Treasury Status Report on Financial Stabilization, *supra* note 176, at 3.

[179] The $50 billion of projected repayments was based upon total repayments of approximately $70 billion received by September 30, 2009. *See* Treasury Status Report on Financial Stabilization, *supra* note 176, at 3. In addition, Treasury estimated that total bank repayments "could reach up to $175 billion by the end of 2010." *See* Treasury Announces Intent To Sell Warrant Positions in Public Dutch Auctions, *supra* note 160.

[180] The remaining balance owed is based upon the cash outlay of $205 billion less cash repayments of $122 billion less $25 billion of Citigroup's common shares.

[181] Treasury conversations with Panel staff (Dec. 15, 2009).

[182] Some financial institutions may continue to need the CPP funding due to "staggering loan losses and vulnerable capital levels." *See* Kevin Dobbs, *For Some Regional Banks, TARP remains necessary* (Jan 5, 2010) (online at snl.com/InteractiveX/article.aspx?Id=10545545&KPLT=4).

[183] Treasury conversations with Panel staff (Dec. 3, 2009).

rights, it may do so in the future."[184] Treasury's preference, however, as it stated in the TARP Financial Statements and in meetings with Panel staff, is to hold the preferred stock with the objective of receiving redemption in full from the CPP participant, as opposed to selling to third parties at a likely discount.[185] Similarly, in the event of a severe downturn in the market, Treasury indicated that it would not immediately sell its CPP investments. Treasury stated that it would need to evaluate its investment objectives (i.e., minimization of costs, maximization of returns to the taxpayers, and preservation of market stability), before it would sell those investments. In this regard, as stated in the TARP Financial Statements, "Treasury-OFS must also consider the limited ability to sell an investment to a third party due to the absence of a trading market or lack of investor demand, and the possibility of achieving potentially higher returns through a later disposition."[186] Accordingly, Treasury has not decided at what point the option of selling to third parties might be used for any of the investments it currently holds, but has stated that this remains a possible mode of exit to be considered in the future.[187]

With respect to a CPP recipient's warrants, to date it has been Treasury's policy to conduct third party sales by auction.[188] As a result, Treasury has somewhat less leeway with respect to the disposal of warrants than it does with respect to the CPP Preferred. Upon redemption of its CPP Preferred, a financial institution has 15 days to elect whether it will repurchase its warrants. If it does not, Treasury will sell the warrants through auction sales.[189] In December 2009, Treasury conducted auctions to sell its warrant positions in JPMorgan Chase, Capital One, and TCF Financial Corporation, and received approximately $1.1 billion in gross proceeds.[190] Treasury informed Panel staff that the next auction sale will not take place before February 2010.[191]

As of December 31, 2009, 60 financial institutions, including three that have declared bankruptcy, had outstanding dividend payments to Treasury of approximately $140 million.[192] TARP-re-

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[184] Treasury conversations with Panel staff (Dec. 3, 2009); Treasury conversations with Panel staff (Dec. 15, 2009); *See also* OFS FY09 Financial Statements, *supra* note 133, at 73.

[185] Treasury conversations with Panel staff (Dec. 15, 2009).

[186] *See* OFS FY09 Financial Statements, *supra* note 133, at 68–69.

In connection with warrant sales, the Panel stated in its July report that "Treasury would be more likely to maximize taxpayer returns if it sold the warrants through auctions," since the process is straightforward. *See* COP July Oversight Report, *supra* note 139.

[187] Treasury conversations with Panel staff (Dec. 3, 2009); Treasury conversations with Panel staff (Dec. 15, 2009). However, the Panel recommended in its June report that "[t]he CPP repayment process should be more transparent." *See* COP June Oversight Report, *supra* note 175.

[188] In November 2009, Treasury announced that it would conduct auctions for warrant positions it holds in financial institutions that have repaid CPP investments and do not reach agreement with Treasury on the warrant price. The auctions are done through a modified Dutch auction methodology that establishes a market price by allowing investors to submit bids at specified increments above a minimum price specified for each auction. *See*, Treasury Announces Intent To Sell Warrant Positions in Public Dutch Auctions, *supra* note 160.

[189] Treasury conversations with Panel staff (Dec. 3, 2009).

[190] Gross proceeds received for JPMorgan Chase, Capital One, and TCF Financial Corporation were approximately $950 million, $148 million, and $9 million, respectively. *See* TARP Transactions Report for Period Ending December 30, 2009, *supra* note 166.

[191] Treasury conversations with Panel staff (Dec. 3, 2009).

[192] *See* SIGTARP, *Quarterly Report to Congress*, at 58 (Oct. 21, 2009) (online at www.sigtarp.gov/reports/congress/2009/October2009_Quarterly_Report_to_Congress.pdf) (hereinafter "SIGTARP October Report"). When institutions were given TARP assistance, there was no time to perform any due diligence in view of the immediacy of the situation. However, TARP was supposedly given to healthy banks but in many instances this was not the case. For example, Citigroup needed further assistance from the TARP. In addition there are further dif-

cipient financial institutions pay two different kinds of dividends—cumulative dividends, which are paid by bank holding companies and their subsidiaries, and non-cumulative dividends, which are paid by banks—with different consequences for the funds' potential recovery. When CPP Preferred are redeemed, if cumulative dividends remain unpaid, Treasury will be paid any accrued and unpaid dividends. However, non-cumulative dividends do not have to be paid, unless such dividends have been accrued.[193]

Of the $140 million in unpaid dividends, approximately $66 million represented unpaid cumulative dividends from the three failed financial institutions.[194] CIT filed for bankruptcy on November 1, 2009,[195] while UCBH Holdings, Inc. (UCBH) and Pacific Coast National Bancorp (Pacific Coast) filed for bankruptcy on November 24, 2009, and December 17, 2009, respectively.[196] Beyond dividend payments, the amount that can be recovered from these three failed institutions, if any, will depend on the outcome of the bankruptcy proceedings.[197] As shown in Figure 2, on September 30, 2009, Treasury's investment in CIT was valued at zero,[198] and the aggregate value of Treasury's investments in UCBH and Pacific Coast totaled approximately $22.5 million.[199]

In certain circumstances, TARP recipients may seek approval from Treasury for exchange offers, recapitalizations, or other restructuring actions to improve their financial condition.[200] Treasury evaluates each such proposal on a case-by-case basis, and before it grants approval of such transactions, it takes into account the following principles:[201]

- Pro forma capital position of the institution;
- Pro forma position of Treasury investment in the capital structure;
- Overall economic impact of the transaction to the government;
- Guidance of the institution's primary regulator; and
- Consistent pricing with comparable marketplace transactions.

During 2009, two exchange transactions were completed. In August, Popular, Inc. completed an exchange of $935 million of preferred stock held by Treasury for an identical amount of newly

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ficulties in valuing an institution once the government provides external support, since values tend to be inflated. *See* discussion below regarding the difficulties of valuation once there is government support. *See also* David Enrich, *TARP Can't Save Some Banks,* Wall Street Journal (Nov. 17, 2009) (online at online.wsj.com/article/SB10001424052748704538404574539954068634242.html).

[193] At December 31, 2009, non-cumulated dividends totaled approximately $2.4 million. Information provided by Treasury on January 4, 2010.

[194] Information provided by Treasury on January 4, 2010. On December 31,2009, CIT, UCBH Holdings, and Pacific Coast National Bancorp owed $58.3 million, $7.5 million, and $168,000 in dividends, respectively.

[195] *See* OFS FY09 Financial Statements, *supra* note 133, at 125.

[196] Treasury conversation with Panel staff (Jan. 7, 2010).

[197] *See* OFS FY09 Financial Statements, *supra* note 133.

[198] *See* OFS FY09 Financial Statements, *supra* note 133, at 36. *See also* Figure 2.

[199] The CPP investment in UCBH was valued at $22.5 million which include the warrants; the CPP Investment in Pacific Coast was valued at $154,000. *See* OFS FY09 Financial Statements, *supra* note 133, at 125. *See also* Figure 2.

[200] *See* OFS FY09 Financial Statements, *supra* note 133, at 70.

[201] *See* OFS FY09 Financial Statements, *supra* note 133, at 70–71.

issued trust preferred securities.[202] Similarly, on December 11, 2009, Superior Bancorp completed an exchange of $69 million of preferred stock held by Treasury for an identical amount of newly issued trust preferred securities.[203] Two exchange offers are currently pending with Independent Bank Corp[204] and Midwest Banc Holdings.[205] Treasury has stated that exchange transactions will be approved only on a case-by-case basis once all the relevant information is evaluated.[206]

Panel staff asked Treasury whether it has considered divestment alternatives such as a bundled sale of CPP Preferred issued by various banks. Treasury indicated that it would consider all types of divestment alternatives, especially in regard to the relatively small CPP investments in a large number of smaller institutions, as the program winds down. At present, however, the focus is on an institution-by-institution approach.

c. Analysis of Intended Exit Strategy

As noted above, CPP recipients may redeem their CPP Preferred only after receiving approval from their primary banking regulators.[207] The banking regulators have not specifically disclosed their criteria for allowing a financial institution to redeem its CPP Preferred,[208] a lack of clarity that has led to frustration at some banks.[209] Until the banking regulators are more transparent about their redemption policies, the Panel cannot assess the propriety of Treasury's investment strategy, which is to hold onto the stock

[202] Banco Popular paid Treasury a $13 million exchange fee. *See* SIGTARP October Report, *supra* note 192, at 61. *See also*, Popular, Inc., *Form 10–Q for the quarter ended September 30, 2009*, at 60 (online at www.sec.gov/Archives/edgar/data/763901/000095012309060126/g20716e10vq.htm#107) (accessed Jan. 12, 2010).

[203] On December 14, 2009, Superior Bancorp filed with the SEC a Form 8–K which announced the completion of the exchange transaction with Treasury (online at www.sec.gov/Archives/edgar/data/1065298/000114420409064449/v168906_ex99.htm).

[204] On November 25, 2009, Independent Bank Corp. filed a preliminary proxy statement asking its shareholders to vote on a potential exchange of the bank's common stock for preferred stock held by Treasury. *See* Independent Bank Corp., *Preliminary Proxy Statement filed by Independent Bank Corp on November 25, 2009* (Nov. 25, 2009) (online at www.sec.gov/Archives/edgar/data/39311/000092604409000561/ibc-prer14a_093009.htm).

[205] On December 3, 2009, Midwest Banc Holdings announced that it is in discussions with Treasury regarding an exchange transaction (online at www.sec.gov/Archives/edgar/data/1051379/000091384909000815/ex99-1.htm). Since this announcement, Midwest has entered into a written agreement with the Federal Reserve Bank of Chicago and the Illinois Department of Financial and Professional Regulation, Division of Banking (online at www.sec.gov/Archives/edgar/data/1051379/000095012309073372/c55234e8vk.htm).

[206] Treasury conversations with Panel staff (Dec. 15, 2009).

[207] If Treasury sells its investment in CPP Preferred to a third party, approval by a financial institution's primary regulator is not required. Treasury conversations with Panel staff (Dec. 15, 2009).

[208] As the Panel indicated in its August report, the banking regulators "see the stress test and the repayment of assistance as working together to protect the bank's balance sheet;" however "supervisory flexibility underlies the stress test's assumptions." *See* COP August Oversight Report, *supra* note 65, at 42.

[209] Bank of America, Citigroup, and SunTrust have all expressed their frustrations with the lack of clarity about the criteria for TARP repayment. In November, Bank of America announced that it was ready and willing to repay TARP but was "waiting for the government to establish the appropriate time." *See BofA, Feds at odds over when TARP gets repaid*, Charlotte Observer (Nov. 24, 2009) (online at www.charlotteobserver.com/597/story/1072637.html). Similarly, Citigroup announced it was ready to repay its TARP funding, but said its regulators were undecided over the amount of capital it should raise. SunTrust's Chairman and CEO views "the rules for repaying TARP assistance as ever-changing." *See* J. Scott Trubey, *SunTrust CEO wants to repay TARP*, Atlanta Business Chronicle (Sept. 15, 2009) (online at atlanta.bizjournals.com/atlanta/stories/2009/09/14/daily34.html); Samil Surendran, *Citi's plan to exit TARP hits roadblock* (Dec. 9, 2009) (online at www.snl.com/InteractiveX/article.aspx?ID=10454610&BeginDate=12/09/2009&KPLT=2); David Enrich, *Banks, U.S. Spar Over TARP Repayments,* Wall Street Journal (Dec. 7, 2009) (online at online.wsj.com/article/SB10001424052748704825504574582311943469506.html).

with the goal of eventually receiving redemption in full from the CPP recipient, rather than selling to another investor at a likely discount.

In addition, at the Panel's December hearing Secretary Geithner could not definitively answer the Panel's questions in regard to the banking regulators' criteria for redemption. He stated that a financial institution would not be allowed to make repayments if it would "leave the system or these financial institutions with inadequate capital."[210] He further stated that a financial institution would be required to "raise capital from the markets" so that it "can repay the taxpayer with interest."[211] Secretary Geithner did not, however, provide a definitive answer about whether a financial institution would be required to raise the full amount of its TARP debt.[212] Although it is the banking regulators' responsibility to disclose their criteria for allowing repayments, Treasury also should be able to articulate this policy in view of the broader economic issues it raises. This lack of clarity breeds uncertainty and instability in the financial markets and provides a disservice to taxpayers as well as investors.

To prevent a truly healthy bank from repaying its TARP funding is a disservice to that bank's investors as well as taxpayers.[213] It is, moreover, inconsistent with Treasury's "systemic stability" principle. Repayment is, or should be, a signal of health to the markets, and delaying repayment risks withholding valuable information from the markets. Permitting premature repayment for whatever reason, however, including escape from executive compensation limitations,[214] serves no public purpose if the institution in question cannot survive on its own. Financial institutions in 2010 will be faced with a substantial amount of debt that will be maturing over the next few years.[215] This fact could lead to the government having to decide whether to provide additional assistance if a repaying institution is not truly healthy. The Panel is concerned about reports of dissent among the banking supervisors and ten-

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[210] *See* Congressional Oversight Panel, Transcript of Hearing with Treasury Secretary Timothy Geithner (Dec. 10, 2009) (publication forthcoming) (online at http://cop.senate.gov/hearings/library/hearing-121009-geithner.cfm) (hereinafter "Dec. 10 Hearing Transcript").

[211] *See* Dec. 10 Hearing Transcript, *supra* note 210.

[212] *See* Dec. 10 Hearing Transcript, *supra* note 210.

[213] Some commentators have pointed out that the replacement of CPP Preferred with common stock, which is generally more expensive, places an additional burden on the ability of a TARP recipient to earn its way back to profitability. *See, e.g.*, James Kwak, *Why Did Bank of America Pay Back the Money?* (Dec. 4, 2009) (online at baselinescenario.com/2009/12/04/why-did-bank-of-america-pay-back-the-money/).

[214] For example, the financial press has indicated that Citigroup's and Bank of America's exit from TARP was due to the release of executive compensation restrictions, especially in view of Bank of America's CEO search. *See, e.g.*, Bradley Keoun, *Citigroup Said to Near Accord on TARP Repayment, US Stake Sale, Business Week* (Dec. 13, 2009) (online at businessweek.com/bwdaily/dnflash/content/dec2009/db20091213__027634.htm); David Mildenberg, *Bank of America TARP Payment May Aid Shares, Search,* Bloomberg (Dec. 3, 2009) (online at bloomberg.com/apps/news?pid=20601087&sid=a8MHKJc4D3bc).

[215] Banks will have trillions of dollars of debt maturing over the next few years, potentially forcing them to refinance their debt at substantially higher rates. Data provided under subscription by BLOOMBERG Data Services (Instrument: Map Debt, filtered for average maturity date under 5 years). *See also* Carrick Mollenkamp and Serena Ng, *Banks Scramble as Debt Comes Due*, Wall Street Journal (Nov. 25, 2009) (online at online.wsj.com/article/SB10001424052748703819904574554223793153390.html); Federal Deposit Insurance Corporation, *FDIC Board Approves 2010 Operating Budget* (Dec. 15, 2009) (online at www.fdic.gov/news/news/press/2009/pr09228.html) (FDIC Chairman Sheila Bair explained that a 55 percent increase in the FDIC operating budget "will ensure that we are prepared to handle an even-larger number of bank failures next year, if that becomes necessary, and to provide regulatory oversight for an even-larger number of troubled institutions").

sions between Treasury and the supervisors, and the extent to which institutions might be permitted to exit the TARP when not financially stable.[216] The underlying issue here relates to the bank regulators' position that their assessment of a bank's condition should remain confidential in order to maximize their effectiveness in promoting bank safety and soundness. This traditional position of the regulators conflicts with the need for Treasury as investor in particular banks to know as much as possible about the financial condition of those banks. In these circumstances, the regulators' traditional lack of transparency may do a disservice to the taxpayers, investors, and to the marketplace in financial institutions' securities.

There exists a range of views on how transparent Treasury should be as it seeks to divest from its stakes in financial institutions. Vincent Reinhart, a fellow at the American Enterprise Institute and a former official at the Federal Reserve, states that "[b]y and large, government officials are big fans of constructive ambiguity."[217] While it may be beneficial for the government to retain flexibility in certain situations, others disagree about the merits of a policy of constructive ambiguity. For example, James B. Thomson, vice president of the Office of Policy Analysis at the Federal Reserve Bank of Cleveland, has argued that a "policy of supervisory transparency is superior to constructive ambiguity."[218] This debate illustrates the inherent challenges and obstacles associated with the government's involvement in the private sector. In this regard, the government acknowledges that it does not function like an ordinary investor; however, its investments are purely taxpayer-funded. This means that the government has a heightened responsibility to the taxpayers whose money is being spent, and an even greater responsibility to be transparent and forthcoming about all aspects of its reasoning and decision-making.

In its July report, the Panel examined the repurchase of stock warrants. At that time, 11 public financial institutions had repur-

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[216] *See, e.g.*, David Enrich and Damian Paletta, *Discord Behind TARP Exits*, Wall Street Journal (Dec. 18, 2009) ("Bank regulators at the Federal Reserve and Federal Deposit Insurance Corp. . . . have disagreed with other government officials about banks' plans to repay government funds, and have privately complained that Treasury officials pushed them to allow banks to quickly leave TARP, according to people familiar with the matter").

[217] See Mark DeCambre, No Pity for Citi, New York Post (Sept. 4, 2009) (online at www.nypost.com/p/news/business/no__pity__for__Citi__F7vQTwjTr4ogsVyyEQ4K6N). Henry Kissinger first employed this term in the context of diplomatic negotiations, and it has been used in economic policy to refer to a "policy of using ambiguous statements to signal intent while retaining policy flexibility." *See, e.g.,* Marvin Goodfriend and Jeffrey M. Lacker, *Limited Commitment and Central Bank Lending*, Economic Quarterly Federal Reserve Bank of Richmond, at 19–21 (Fall 1999) (hereinafter "Limited Commitment and Central Bank") (discussing the benefits and weaknesses of a policy of constructive ambiguity with regard to central bank lending).

[218] James B. Thompson, *On Systemically Important Financial Institutions and Progressive Systemic Mitigation*, Federal Reserve Bank of Cleveland, at 9 (2009) (online at clevelandfed.org/research/policydis/pdp27.pdf); see also Limited Commitment and Central Bank, *supra* note 217, at 19–21 ("Constructive ambiguity in the absence of an ability to precommit may actually increase the drift toward expansion"); see also International Monetary Fund, *Global Economic Prospects and Principles for Policy Exit*, at 7 (2009) ("Basic principles and plans for the exit and beyond should be established early and communicated clearly and consistently by policymakers to the public"). Similarly, two officials from the Federal Reserve Bank of Boston refer to "less than constructive ambiguity." Jane Sneddon Little and Giovanni P. Olivei, *Why the Interest in Reform?*, Rethinking the International Monetary System, Proceedings from the Federal Reserve Bank of Boston Conference Series, at 81 (1999) (online at www.bos.frb.org/economic/conf/conf43/41p.pdf). In addition, Reinhart has expressed doubts about the benefits of constructive ambiguity, stating that "[n]ow is the time to articulate an exit strategy." Craig Torres and Scott Lanman, *Bernanke May Explain Fed Exit Strategy in Testimony Next Week*, Bloomberg (July 13, 2009) (online at www.bloomberg.com/apps/news?pid=20601087&sid=aNU.UkT9EB68).

chased their warrants from Treasury. The Panel's analysis of the numbers indicated that taxpayers had received only 66 percent of the Panel's best estimate of the value of the warrants.[219] As the Panel stated then, "[T]reasury should promptly provide written reports to the American taxpayers analyzing in sufficient detail the fair market value determinations for any warrants either repurchased by a TARP recipient from Treasury or sold by Treasury through an auction, and it should disclose the rationale for its choice of an auction or private sale." [220] In order to ensure that taxpayers receive the maximum value as financial institutions exit the TARP, the Panel urged Treasury to make its process, reasoning, methodology, and exit strategy absolutely transparent.[221]

Although there has not been the robust disclosure called for by the Panel, the return to taxpayers has increased since the July report was published. Subsequent to the publication of the July report, an additional 25 financial institutions have repurchased their warrants or sold warrants in auction sales, generating total aggregate proceeds to Treasury of $4.0 billion, which represented more than 92 percent of the Panel's best estimate of their values.[222] With specific regard to large TARP recipients, in December 2009, Treasury conducted auctions to sell its warrant positions in JPMorgan Chase, Capital One, and TCF Financial Corporation, and received approximately $1.1 billion in gross proceeds.[223] Treasury stated that the auction sales were "a robust alternative to negotiations" since it received market price for the warrants.[224] The Panel's analysis of the numbers indicated that the taxpayer received approximately 89 percent of the Panel's best estimate of the value of the warrants.[225]

As noted above, as the CPP program winds down, Treasury has indicated to Panel staff that it would consider all types of divestment alternatives, especially in regard to relatively small CPP investments in a large number of smaller institutions. At present, however, the focus is on an institution-by-institution approach.

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[219] *See* COP July Oversight Report, *supra* note 139, at 27.

[220] *See* COP July Oversight Report, *supra* note 139, at 44–45.

[221] The Panel's July report stated ". . . it is critical that Treasury make the process—the reason for its decisions, the way it arrives at its figures, and the exit strategy from our future use of the TARP—absolutely transparent. If it fails to do so, the credibility of the decisions it makes and its stewardship of the TARP will be in jeopardy." COP July Oversight Report, *supra* note 139, at 4. Similarly, the Panel's November report echoed the same concerns regarding transparency by stating, ". . . in light of these guarantees' extraordinary scale and their risk to taxpayers, the Panel believes that these programs should be subject to extraordinary transparency. The Panel urges Treasury to disclose greater detail about the rationale behind guarantee programs, the alternatives that may have been available and why they were not chosen, and whether these programs have achieved their objectives." *See* COP November Oversight Report, *supra* note 2, at 4. Lastly, Panel Chair Elizabeth Warren stated in her September testimony that "[i]n order to ensure that taxpayers would receive the maximum value as banks exited TARP, the Panel urged Treasury to make its process, reasoning, methodology, and exit strategy absolutely transparent." *See* Senate Committee on Banking, Housing and Urban Affairs, Testimony of Elizabeth Warren, *Emergency Economic Stabilization Act: One Year Later*, 111th Cong., at 3 (Sept. 24, 2009) (online at cop.senate.gov/documents/testimony-092409-warren.pdf).

[222] *See* TARP Transactions Report for Period Ending December 30, 2009, *supra* note 166.

[223] Gross proceeds received for JPMorgan Chase, Capital One, and TCF Financial Corporation were approximately $950 million, $147 million, and $9 million, respectively. See TARP Transactions Report for Period Ending December 30, 2009, *supra* note 166.

[224] Treasury conversations with Panel staff (Dec. 15, 2009).

[225] The valuation was derived by dividing total net proceeds received ($1.1 billion) by total aggregate value of Panel's best estimate ($1.3 billion). For the individual auction sales of JPMorgan Chase, Capital One, and TCF Financial Corporation, the taxpayers received 94 percent, 64 percent, and 81 percent, respectively, of the Panel's best estimate of the value of the warrants.

One form of exit from the TARP that has not drawn much attention from commentators involves those TARP-recipient financial institutions that fail, an event that can be expected to wipe out the taxpayers' investment. Ironically, when no further government intervention occurs, this kind of early and involuntary exit from TARP may have the effect of reducing moral hazard and restoring market discipline.

5. Citigroup

a. Acquisition of Assets and Current Value

Between October 2008 and January 2009, Treasury invested a total of $50 billion in Citigroup through three separate programs: the CPP, the TIP, and the AGP.[226] After Citigroup's repayment of trust preferred securities in December, Treasury currently holds 7.7 billion shares of Citigroup's common stock, worth $25.49 billion on December 31, 2009. Treasury is Citigroup's largest shareholder, with 27.04 percent of Citigroup's equity.

The first Citigroup investment was made through the CPP. On October 28, 2008, Treasury used the program to inject $25 billion into Citigroup. Treasury received $25 billion face value of CPP Preferred and warrants to purchase 210,084,034 shares at a strike price of $17.85. The second TARP investment in Citigroup was made through the TIP. Although Citigroup's TIP capital infusion was announced on November 23, 2008 and finalized on December 31, 2008, the guidelines for the TIP were not announced until January 2, 2009.[227] Under the TIP, Treasury purchased $20 billion in preferred stock from Citigroup.[228] This preferred stock paid dividends of 8 percent. Treasury also took warrants to accompany the preferred stock. There are no standard terms for the TIP; terms and conditions were determined on a case-by-case basis.[229] Any institutions participating in the TIP were required to comply with strict executive compensation standards.

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[226] The Panel notes that Treasury's Transaction Reports state that the total TARP assistance to Citigroup is $49 billion, based on the $25 billion CPP investment, $20 billion TIP investment, and Treasury's receipt of $4.03 billion in preferred stock under the AGP. While the total amount Treasury has invested under the AGP is $4.03 billion, Treasury's actual maximum loss position under the AGP was $5 billion, which is the number used by the Panel since that represents Treasury's actual exposure. For further information on the AGP accounting, *see* Figure 22, *infra*. The AGP agreement was structured so that losses on assets in the pool will be shared among Citigroup, Treasury, the FDIC and the Federal Reserve. As of September 30, 2009, the total asset pool was approximately $250.4 billion. U.S. Securities and Exchange Commission, *Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for Citigroup Inc.*, at 33–34 (Nov. 6, 2009) (online at www.sec.gov/Archives/edgar/data/831001/000104746909009754/a2195256z10-q.htm). Citigroup would absorb up to $39.5 billion of initial losses arising from the covered pool (losses of $8.1 billion had been recorded at September 30, 2009), and would then absorb 10 percent of any losses in excess of that amount. *Id.* The federal government would absorb the remainder, with Treasury absorbing the first $5 billion in federal liability, the FDIC absorbing the second $10 billion, and the Federal Reserve covering any further federal liability by way of a non-recourse loan to Citigroup. *Id.* The guarantee was structured to run for up to 10 years for residential assets and five years for non-residential assets. *Id.*

[227] *See* U.S. Department of the Treasury, *Treasury Releases Guidelines for Targeted Investment Program* (Jan. 2, 2009) (online at treasury.gov/press/releases/hp1338.htm) (hereinafter "Treasury Releases Guidelines for Targeted Investment Program"); Joint Statement on Citigroup, *supra* note 110.

[228] TARP Transactions Report for Period Ending December 30, 2009, *supra* note 166; Citigroup, *Citi Issuance of $20 Billion Perpetual Preferred Stock and Warrants to U.S. Treasury As Part of TARP Program* (Dec. 31, 2008) (online at www.citigroup.com/citi/fin/data/fs081231a.pdf).

[229] Treasury Releases Guidelines for Targeted Investment Program, *supra* note 227.

Under the AGP, Treasury, the FDIC, and the Federal Reserve guaranteed, until the program was ended, approximately $250.4 billion of Citigroup's assets.[230] The guarantee, originally for $301 billion, followed a continuing deterioration of Citigroup's financial status after it received CPP funds. As consideration for the guarantee, Citigroup issued Treasury with $4.034 billion face value of preferred stock (the AGP Preferred)[231] and warrants to purchase 66,531,728 shares of common stock at a strike price of $10.61.[232]

On July 30, 2009, Treasury and Citigroup agreed to exchange Treasury's $25 billion in CPP Preferred for 7.7 billion shares of common stock priced at $3.25 per share. The two parties also agreed to exchange Treasury's $20 billion in TIP holdings and $4 billion of preferred stock acquired under the AGP into trust preferred securities.[233] These exchanges took place as part of a larger $58 billion exchange offer with public and private holders of Citigroup's debt in which Citigroup bolstered its common tangible equity and thus its reserves. The company received shareholder approval for the exchange on September 3, 2009.[234]

On December 14, 2009, Citigroup, Treasury, and the regulators announced an agreement regarding Citigroup's plan to repay part of its outstanding TARP assistance.[235] Pursuant to the agreement,

[230] According to Citigroup's SEC filing for the third quarter of 2009, the total asset pool had declined by approximately $50 billion on a GAAP basis to approximately $250.4 billion as of September 30, 2009. *See* Citigroup Third Quarter 10–Q, *supra* note 56, at 33. COP November Oversight Report, *supra* note 2 (describing the Citigroup and Bank of America guarantees). 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).

[231] The FDIC was issued $3.025 billion in preferred stock. Treasury and the FDIC's holding were exchanged for separate trust preferred securities with a coupon of 8 percent in the subsequent exchange offer.

[232] The AGP Preferred have a perpetual life and pay dividends at 8 percent per annum. They can be redeemed in stock or cash, as mutually agreed between Treasury and Citigroup, otherwise the redemption terms of CPP preferred terms apply. Citigroup is not permitted to pay common stock dividends, in excess of $0.01 per share per quarter, for a period of three years without Treasury consent. With respect to repurchase rights, the same terms apply as for the CPP Preferred, meaning they could be sold in private transactions to interested investors, or that they could be offered to the public in a resale registered with the SEC. *Master Agreement Among Citigroup Inc., Certain Affiliates of Citigroup Inc. Identified Herein, Department of the Treasury, Federal Deposit Insurance Corporation and Federal Reserve Bank of New York* (Jan. 15, 2009) (online at www.financialstability.gov/docs/AGP/Citigroup__01152009.pdf).

[233] The trust preferred securities are senior in right of repayment to preferred stock. They pay dividends at 8 percent per annum, and are paid on a quarterly basis. The term is for 30 years. Treasury may, subject to applicable securities laws, transfer, sell, assign, or otherwise dispose of its trust preferred shares provided that it consults with Citigroup for the first three years to see if such action is feasible. Upon regulatory approval, Citigroup has the right to redeem such shares, either at its discretion or upon the occurrence of specified events, but cannot redeem less than all of the outstanding securities unless all accumulated and unpaid dividends have been paid. In certain circumstances, these securities carry limited voting rights. These securities are also ranked equally, meaning payment thereon shall be made pro rata with the common securities, except in the case of default. *Exchange Agreement dated June 9, 2009 between Citigroup Inc. and United States Department of the Treasury*, at Schedule A (June 9, 2009) (online at www.financialstability.gov/docs/agreements/08282009/Citigroup%20Exchange%20Agreement.pdf).

[234] Citigroup, *Citi Announces Shareholder Approval of Increase in Authorized Common Shares, Paving Way to Complete Share Exchange* (Sept. 3, 2009) (online at www.citibank.com/citi/press/2009/090903a.htm).

[235] Treasury conversations with Panel staff (Dec. 15, 2009); *see also* Citigroup, *Repaying TARP and Other Capital Actions* (Dec. 14, 2009) (online at www.sec.gov/Archives/edgar/data/831001/000095012309070371/x80976bfwp.htm) (hereinafter "Repaying TARP and Other Capital Actions"); U.S. Department of the Treasury, *Treasury Statement Regarding Citigroup's Intention to Repay Taxpayers* (Dec. 14, 2009) (online at www.financialstability.gov/latest/pr__12142009.html) (hereinafter "Treasury Statement Regarding Citigroup's Intention to Repay Taxpayers"). As part of the agreement, Citigroup also decided to issue $1.7 billion of common stock equivalents to its employees in January 2010 as a substitution for the cash they would

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Citigroup would repay Treasury the $20 billion it held in trust preferred securities and terminate its loss-sharing agreement under the AGP, meaning that the government would no longer be liable for any losses arising from the covered asset pool.[236] To fund this repayment, Citigroup successfully completed a securities offering of $21.08 billion of equity securities, comprising $17 billion of common stock (with an additional over-allotment option of 184.9 million shares exercised on December 23, 2009)[237] and $3.5 billion of tangible equity units.[238] On December 23, 2009, Citigroup completed its TARP repayment and terminated its loss-sharing agreement after Treasury permitted it to cancel $1.8 billion of the $7 billion in AGP Preferred that Citigroup had issued to Treasury and the FDIC as consideration.[239] Following Citigroup's repayment of the $20 billion of trust preferred securities and the termination of the loss-sharing agreement, Citigroup is no longer deemed a beneficiary of "exceptional financial assistance" under the TARP (even though some AGP Preferred is still outstanding), meaning that it will no longer be subject to the jurisdiction of Special Master for Compensation Kenneth Feinberg.[240]

FIGURE 3: INCOME FROM CITIGROUP TARP INVESTMENTS AS OF NOVEMBER 30, 2009[241]

Program	Dividends Earned
CPP	$932,291,666.67
AGP	255,486,666.66
TIP	1,333,333,333.33

have otherwise received. Subject to shareholder approval at the company's annual meeting on April 1, 2010, the common stock equivalents will be replaced by common stock.

[236] Citigroup has used the proceeds from its offerings to repay Treasury's TIP investments (the preferred securities exchanged for trust preferred securities in July 2009). Trust preferred securities possess characteristics of both equity and debt issues. These securities are generally long-term, allow early redemption by the issuer, make periodic fixed or variable interest payments, and mature at face value. When issued by a bank holding company such as Citigroup, trust preferred securities are treated as capital rather than as debt for regulatory purposes.

[237] An over-allotment option is granting the underwriter in a public offering with the option, for a period of anywhere from 15 to 45 days after the offering date, to purchase additional securities from the issuer (usually up to 15 percent of the shares being sold) at the initial price to the public, in order to cover over-subscriptions for the securities.

[238] Repaying TARP and Other Capital Actions, *supra* note 235; Citigroup, *Forms 424(b)* (Dec. 16, 2009) (online at www.sec.gov/Archives/edgar/data/831001/000095012309071618/y80953b2e424b2.htm and www.sec.gov/Archives/edgar/data/831001/000095012309071909/y81064e424b2.htm) (SEC filings detailing the issuances of securities by Citigroup in connection with the TARP repayment); Treasury conversations with Panel staff (Dec. 15, 2009).

[239] Treasury conversations with Panel staff (Dec. 15, 2009); Treasury conversations with Panel staff (Jan. 7, 2010); Allison Testimony before House Oversight and Government Reform Committee, *supra* note 118, at 11; Citigroup, *Citi Completes $20 Billion TARP Repayment, Terminates Loss-Sharing Agreement* (Dec. 23, 2009) (online at www.citigroup.com/citi/press/2009/091223b.htm). In discussions with Panel staff, Treasury staff indicated that the $5.259 billion in trust preferred securities that will be retained reflects a $1.8 billion reduction since the loss-sharing agreement was terminated after one year. Treasury will incur the $1.8 billion haircut initially, but will receive up to $800 million of the Citigroup trust preferred securities currently held by the FDIC, provided that Citigroup repays its outstanding debt issued under the FDIC's Temporary Liquidity Guarantee Program (TLGP).

[240] Treasury conversations with Panel staff (Dec. 15, 2009); Treasury conversations with Panel staff (Jan. 7, 2010). Although Citigroup is no longer considered a participant in the CPP due to the exchange of CPP preferred securities for common stock, Treasury has specifically stated that Citigroup will remain subject to EESA's general corporate governance standards and executive compensation restrictions, as amended by the American Recovery and Reinvestment Act of 2009. This is because Treasury, when agreeing to the exchange, did not want to surrender the leverage and taxpayer protections that these restrictions afford. In addition, Citigroup has agreed to abide by Mr. Feinberg's 2009 executive compensation determinations for its 100 most highly compensated employees.

FIGURE 3: INCOME FROM CITIGROUP TARP INVESTMENTS AS OF NOVEMBER 30, 2009 [241]—Continued

Program	Dividends Earned
Total	**$2,521,111,666.66**

[241] U.S. Department of the Treasury, *Cumulative Dividends Report as of November 30, 2009* (Dec. 18, 2009) (online at www.financialstability.gov/docs/dividends-interest-reports/November%202009%20Dividends%20and%20Interest%20Report.pdf) (hereinafter "Cumulative Dividends Report as of November 30, 2009").

The following table shows Treasury's holdings in Citigroup as of December 31, 2009:

FIGURE 4: TREASURY HOLDINGS IN CITIGROUP AS OF DECEMBER 31, 2009

[Dollars in millions]

Asset	Number	Acquisition Cost	Revenues Generated	Estimated Valuation as of 12/31/09		
				Low Estimate	High Estimate	Best Estimate
Preferred Stock (CPP).	0	$25,000	$932			N/A
Preferred Stock (TIP).	0	$20,000	933			N/A
Preferred Stock (AGP).	0	$5,000 [242]	175			N/A
Common Stock (CPP).	7,692,307,692	$25,000	0			$25,462
Trust Preferred	Received in exchange for AGP Preferred.	$2,234	[243] 737			1,871
Warrants (CPP, TIP, AGP).	210,084,024 shares at $17.85 (CPP). 188,501,414 at $10.61 (TIP).	(Received as part of CPP Preferred, TIP. Preferred and AGP)		$10	$891	204
	66,531,728 at $10.61 (AGP).					
Total						**$27,537**

[242] Treasury's potential maximum loss position under the AGP was $5 billion; Treasury received $4,034 billion in preferred stock under the AGP.

[243] Of the total Trust Preferred revenues generated, $636 million relates to dividends received from TIP Trust Preferred securities.

b. Disposal of Assets and Recovery of Expended Amounts

As shown in Figure 4 above, Treasury owns trust preferred securities, common stock, and warrants for common stock in Citigroup. The taxpayers' money can be recovered from the trust preferred securities so long as Citigroup generates profits sufficient to make dividend payments on them and eventually redeem them. Alternatively, the trust preferred securities could be sold into the markets. Recovery of the taxpayers' investment in the common stock and warrants depends on the performance of the common stock, which in turn depends on Citigroup's actual performance and the market's perception of its likely performance in the future. Treasury may sell its common stock holdings publicly or privately. Since Citigroup has repaid its trust preferred securities, it may also repurchase its warrants issued under the TIP.[244] The repurchase

[244] See Securities Purchase Agreement dated December 31, 2008 between Citigroup Inc., as Issuer and United States Department of the Treasury, at 4.9(a).

must happen at "fair market value."[245] As discussed above, fair market value would be determined using a negotiation and appraisal process between Treasury and Citigroup. If Citigroup chooses not to repurchase its warrants, or if an agreement cannot be reached on a fair price and neither party wishes to invoke the appraisal procedure, Treasury will auction the warrants to the public. Unlike other auctions that have occurred relatively shortly after the TARP recipient has repaid its TARP funds, Treasury has indicated that, if Citigroup's warrants were to be auctioned to the public, the auction would not take place in the near future.[246] This is due to an agreement by Treasury to refrain from selling its common stock holdings until March 16, 2010, as well as the size of those holdings.[247]

FIGURE 5: VALUE OF CITIGROUP'S STOCK SINCE OCTOBER 2008 [248]

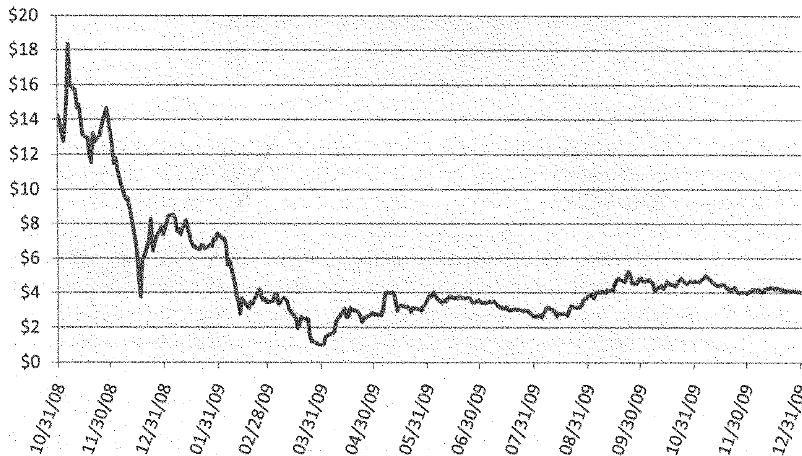

Figure 5 above reflects the decline of and volatility in Citigroup's stock price since October 3, 2008, the date that President Bush signed EESA into law. Throughout most of the period it has received TARP assistance, Citigroup's stock price has been trading at approximately $4 per share, and it plummeted to around $1 per share in March 2009. Government intervention in the private sector has significantly influenced both Citigroup's credit ratings and stock price.[249]

[245] *Id.*
[246] Treasury conversations with Panel staff (Jan. 7, 2010).
[247] Treasury conversations with Panel staff (Jan. 7, 2010).
[248] SNL Financial, *Citigroup Inc. Historical Stock Price* (online at www.snl.com/InteractiveX/historyCP.aspx?ID=4041896&Tabular=True&GraphType=3&Frequency=0&TimePeriod2=9&BeginDate=1%2F13%2F2009&EndDate=1%2F13%2F2010&ctl00%24ctl11%24IndexPreference=default&ComparisonIndex2=25&ComparisonYield2=-1&CustomIndex=0&ComparisonTicker2=&Action=Apply).
[249] For further discussion on how government intervention impacts credit ratings and equity pricing, see Section B.5, *infra*.

The Panel notes that the government assistance has boosted Citigroup's credit ratings,[250] and that although it is dif- ficult to analyze Citigroup's stock price, that price has been significantly affected by the extraordinary government intervention.

Pro-rating the original $25 billion "acquisition cost" of Citigroup shares under the CPP against the number of shares received in the exchange (ignoring shares already sold and warrants), Citigroup shares need to be worth approximately $3.25 for Treasury to "break even." In Citigroup's December offering, Treasury agreed initially to sell up to $5 billion of its shares in a concurrent secondary offering, while announcing plans to sell the remainder of its shares over the next six to twelve months.[251] Although Citigroup managed to raise over $21 billion in the capital markets on December 16, 2009 (the largest equity offering in the U.S. equity markets), it priced the new shares at $3.15 each, below Treasury's break-even price.[252] Rather than incur a $770 million loss, Treasury decided not to participate in the secondary offering and postponed plans to start divesting its common shares.[253] Treasury has now agreed not to sell its common stock until after March 16, 2010 and plans to sell the remainder of its holdings over the next 12 months.[254] Until it does so, Treasury will remain the major shareholder.[255] Because Treasury's sales of its holdings in Citigroup common stock would constitute a change in ownership, that sale would not be feasible without the recent IRS guidance that allows Treasury to conduct the sales and Citigroup to maintain its deferred tax assets, discussed above in Section B.6.[256]

On December 31, 2009, Citigroup's stock price was $3.31 a share, meaning that the value of Treasury's remaining holdings in

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[250] Credit ratings tend to be higher than they would otherwise be, since government support provides the public and stockholders an added degree of confidence in the company's health. For example, in its July 31, 2009 report, Standard & Poor's gave Citigroup a credit rating of "A" but noted "the potential for additional extraordinary government support, if necessary," and further stated that Citigroup's rating "reflects a four-notch uplift from our assessment of Citigroup's stand-alone credit profile" (emphasis added). *See also* Fitch Ratings, *Citigroup Inc.* (Nov. 2, 2009) (hereinafter "Fitch Ratings for Citigroup"); Moody's Investors Service, Global Credit Research, *Issuer Comment: Citigroup: Earnings Commentary—Third Quarter 2009* (Oct. 16, 2009) (hereinafter "Moody's Earnings Commentary for Citigroup").

[251] Treasury Statement Regarding Citigroup's Intention to Repay Taxpayers, *supra* note 235.

[252] As noted above, Citigroup's offering was the largest offering in American history. Even before its offering occurred, Citigroup faced a number of factors that impacted its market pricing. These included its size, its occurrence at year-end with resulting time constraints, its timing after several similar types of transactions, including the Bank of America and Wells Fargo offerings to facilitate their TARP repayments (and the limited demand for financial stocks as a result), and eagerness on the part of Citigroup's management to repay the TARP funds to get out from under the government's thumb. *See* Kevin Dobbs, *Conditions improving, but Citi still faces confidence crisis*, SNL Financial (Jan. 7, 2010) (hereinafter "Conditions improving, but Citi still faces confidence crisis") (suggesting that Citigroup's pricing of the deal at 20 percent below its announced target was due in part to "poor timing").

[253] This decision underscores Treasury's commitment to "protect[ing] the taxpayers' investment." Allison Testimony before House Oversight and Government Reform Committee, *supra* note 118.

[254] Allison Testimony before House Oversight and Government Reform Committee, *supra* note 118. As part of Treasury's agreement to delay selling its common stock holdings for 90 days, Citigroup agreed to compensate Treasury for all of the costs associated with its future common stock sales, including commissions.

[255] While Treasury remains the major shareholder, Treasury does not have any Citigroup board seats. The Shareholders Agreement between Treasury and Citigroup stipulates that Treasury will exercise its right to vote only on particular matters (e.g., the election or removal of directors, major corporate transactions including mergers, dissolution, amendments to charter or bylaws). On other issues, Treasury "will vote its shares in the same proportion" as all other company shares are voted. Allison Testimony before House Oversight and Government Reform Committee, *supra* note 118.

[256] For further discussion on the recent IRS guidance and its tax impact, see discussion in Section B.6.

Citigroup common stock was $25.49 billion, and the value of the warrants held, by the Panel's best estimate, was $204.32 million. By that measure, Citigroup stock would need to be worth approximately $3.25 a share for the TARP investment in common stock to be repaid. The warrants derive from three separate investments in Citigroup, and in each case were part of a package of securities issued to Treasury, so it is difficult to attribute an "acquisition cost" to specific components such as the warrants.[257] As part of the consideration for Treasury's TARP investment, the warrants are supposed to permit the taxpayers to benefit from the "upside" deriving from the government's intervention.[258]

In conversations with Panel staff, Treasury indicated that it has spent much time thinking about how to make an orderly exit from Citigroup, and emphasized that there are many different possibilities for how to sequence the sales of its common stock holdings.[259] According to Assistant Secretary Allison, Treasury concluded that "by gradually selling the shares, [it] will be in a better position to achieve the best possible prices for the American public." [260]

With respect to Citigroup's plans and strategies for future profitability, in the first quarter of 2009, Citigroup reorganized itself into Citicorp and Citi Holdings, the former consisting of operations considered central to the bank's future, including worldwide retail banking, investment banking, and transaction services for institutional clients, and the latter holding the assets and business units that Citigroup does not regard as its core business, such as asset management and consumer lending, and which it will presumably sell off.[261] Citigroup has already made some material asset sales, including brokerage and asset management business units, as set out in Figure 6 below. Due in part to the current difficulties in obtaining what it considers to be reasonable prices, some of these sales have been made at low prices.[262] It remains unclear whether Citigroup's primary impetus for these sales was to strengthen its capital base and reduce risk by concentrating on core business areas and simplifying the institution, or to reduce government involvement with its business. As a result of these changes, as well as reductions in headcount and expenses since the beginning of 2008, Citigroup stated it has raised "considerable capital" and has built "considerable liquidity." [263]

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[257] Citigroup financial statements distinguish between preferred and warrants. However, when the initial investments were made there were part of a package of securities.

[258] As the Panel noted in its February Oversight Report, "[t]he warrants allowed the Treasury to buy common stock of each institution for an additional amount—called the "exercise price"—that was calculated so that Treasury benefit [sic] if the value of the common stock increased." Congressional Oversight Panel, *February Oversight Report: Valuing Treasury's Acquisitions*, at 5 (Feb. 6, 2009) (online at cop.senate.gov/documents/cop-020609-report.pdf).

[259] Treasury conversations with Panel staff (Dec. 3, 2009).

[260] Allison Testimony Transcript, *supra* note 135.

[261] Citigroup conversations with Panel staff (Dec. 4, 2009); see Bank of America—Merrill Lynch Financial Services Conference, *Presentation by Citigroup Vice Chairman Ned Kelly*, at 1 (Nov. 11, 2009) (online at www.citigroup.com/citi/fin/data/p091111a.pdf?ieNocache=311) (hereinafter "Citigroup Ned Kelly Presentation"); *Citi Statement to the Congressional Oversight Panel on Asset Sales and Business Divestitures* (Dec. 22, 2009) (hereinafter "Citi Statement on Asset Sales and Business Divestitures").

[262] *See* Figure 6 and related footnotes identifying the amounts Citigroup has realized on its asset sales as compared to Citigroup's prior valuations of those assets.

[263] Citigroup conversations with Panel staff (Dec. 4, 2009).

FIGURE 6: CITIGROUP ASSET SALES [264]

Asset Sold	Date of Sale	Amount Realized
German Retail Banking Operation	12/5/2008	$6.6 billion [265]
Citigroup Global Services Limited	12/31/2008	$512 million [266]
Citigroup Technology Services Ltd	1/20/2009	$127 million [267]
Smith Barney	6/1/2009	$2.75 billion [268]
Three North American Partner Credit Card Portfolios	8/31/2009	Undisclosed [269]
Nikko Cordial Securities Inc	10/1/2009	$8.7 billion [270]
Nikko Citi Trust and Banking Corporation	10/1/2009	$212 million [271]
Nikko Asset Management	10/1/2009	$844 million [272]
Portugal Credit Cards Business	11/30/2009	Undisclosed [273]
Norwegian Consumer Finance Business	12/15/2009	Undisclosed [274]
Phibro LLC	12/31/2009	~$250 million [275]
Diners Club North America [276]	12/31/2009	Undisclosed [277]
Primerica, Inc	Not closed (announced 11/5/2009).	TBD [278]

[264] Citigroup had divested $281 billion in ''non-core businesses and assets'' from its Citi Holdings subsidiary at the end of Q3 2009. Citigroup, *Repaying TARP and Other Capital Actions*, at 13 (Dec. 14, 2009) (online at www.citibank.com/citi/fin/data/p091214a.pdf). Citigroup divested a further $25 billion in assets during Q4 2009. *Id.* This table only includes publicly disclosed transactions; other non-public transactions have taken place which, although not reflected in this table, are reflected in the $306 billion total. Citi Statement on Asset Sales and Business Divestitures, *supra* note 261.

[265] Citigroup, *Citi Successfully Completes Sale of German Retail Banking Operation to Crédit Mutuel-CIC* (Dec. 5, 2008) (online at www.citi.com/citi/press/2008/081205a.htm). Citigroup previously valued the assets at $15.6 billion, meaning that the sale took place at almost a 50 percent discount. *See id.*

[266] Citigroup, *Citi Completes Sale of Citigroup Global Services Limited* (Dec. 31, 2008) (online at www.citi.com/citi/press/2008/081231a.htm).

[267] Citigroup, *Form 10–Q for the Quarterly Period Ending March 31, 2009*, at 10 (Mar. 31, 2009) (online at www.citigroup.com/citi/fin/data/q0901c.pdf?ieNocache=664); Citigroup, *Citi Completes Sale of Citigroup Technology Services Ltd.* (*India*) (Jan. 20, 2009) (online at www.citi.com/citi/press/2009/090120e.htm).

[268] Citigroup sold 100 percent of its Smith Barney, Quilter and Australia private client networks in exchange for a 49 percent stake in a joint venture with Morgan Stanley and an upfront cash payment of $2.75 billion. Citigroup, *Form 10–Q for the Quarterly Period Ending June 30, 2009*, at 14 (June 30, 2009) (online at www.citi.com/citi/fin/data/q0902c.pdf?ieNocache=410). CEO Vikram Pandit has publicly indicated that Citigroup will eventually sell its stake in the joint venture. Matthias Rieker, *Citi Plans to Shed Stake in Smith Barney*, Wall Street Journal (Sept. 17, 2009) (online at online.wsj.com/article/SB125312761700516895.html).

[269] Citigroup, *Citi Holdings Update: Citi Sells Three Credit Card Portfolios* (Aug. 31, 2009) (online at www.citi.com/citi/press/2009/090831d.htm). Although Citigroup has not disclosed the terms of the sale, it previously valued the assets it sold at $1.3 billion. *Id.*

[270] Citigroup, *Form 10–Q for the Quarterly Period Ending September 30, 2009*, at 99 (Sept. 30, 2009) (online at www.citigroup.com/citi/fin/data/q0903c.pdf?ieNocache=909). Citigroup previously valued these assets at $23.6 billion. *Id.* at 11. Contemporaneous press reports indicate that robust bidding among major Japanese financial institutions took place for the right to acquire Nikko Cordial. Alison Tudor, *Citi's Nikko Sale Ignites Japanese Bid War*, Wall Street Journal (Apr. 2, 2009) (online at online.wsj.com/article/SB123863295192980917.html).

[271] Citigroup, *Citi Successfully Completes Sale of NikkoCiti Trust and Banking Corporation to Nomura Trust and Banking* (Oct. 1, 2009) (online at www.citi.com/citi/press/2009/091001b.htm).

[272] Citigroup, *Citi Successfully Completes Sale of Nikko Asset Management to Sumitomo Trust* (Oct. 1, 2009) (online at www.citi.com/citi/press/2009/091001a.htm).

[273] Citigroup, *Citi to Sell Portugal Credit Cards Business to Barclays Bank PLC* (Sept. 29, 2009) (online at www.citi.com/citi/press/2009/090929b.htm). Although Citigroup has not disclosed the terms of the sale, it previously valued the assets at €644 million, about $938 million. *See id.*

[274] Citigroup, *Citi to Sell Norwegian Consumer Finance Business to Gjensidige Bank ASA* (Oct. 8, 2009) (online at www.citi.com/citi/press/2009/091008a.htm). Although Citigroup has not disclosed the terms of the sale, it previously valued the assets it sold at $470 million. *Id.*

[275] Citigroup announced that it would sell Phibro LLC for a purchase price equal to the net asset value of the business. Citigroup, *Citi to Sell Phibro, LLC* (Oct. 9, 2009) (online at www.citi.com/citi/press/2009/091009a.htm). Occidental announced that it anticipated the net asset value of Phibro would be about $250 million when the deal closed. Occidental Petroleum, *Occidental Petroleum Announces Acquisition of Phibro* (Oct. 9, 2009) (online at newsroom.oxy.com/portal/site/oxy/?ndmViewId=news__view&newsId=20091026006112&newsLang=en). Citing government pressure to sell the energy-trading business, news reports characterized the sale price as ''bargain-basement.'' David Enrich, Ben Casselman and Deborah Solomon, *How Occidental Scored Citi Unit Cheaply*, Wall Street Journal (Oct. 12, 2009) (online at online.wsj.com/article/SB125509326073375979.html).

[276] Citigroup, *Citi Sells Diners Club North America Business* (Nov. 24, 2009) (online at www.citibank.com/citi/press/2009/091124a.htm) (hereinafter ''Citi Sells Diners Club North America Business'').

[277] Citi Sells Diners Club North America Business, *supra* note 276. Although Citigroup has not disclosed the terms of the sale, it previously valued the assets involved at $1 billion.

[278] Primerica, Inc. has filed the paperwork to conduct an initial public offering, with proceeds going to Citigroup, as part of a reorganization and eventual divestiture by Citigroup. U.S. Securities and Exchange Commission, *Form S–1 Registration Statement: Primerica, Inc.*, at 1, 6–7, 39 (Nov. 5, 2009) (online at www.sec.gov/Archives/edgar/data/1475922/000119312509225601/ds1.htm). Citigroup attempted to sell Primerica to another financial institution or other investor but could not find a buyer. David Enrich, *An IPO of Primerica Will End a Citi Era*, Wall Street Journal (Nov. 6, 2009) (online at online.wsj.com/article/SB125746499148732279.html). The IPO has not yet taken place; Primerica held $12.1 billion in assets as of June 30, 2009. U.S. Securities and Exchange Commission, *Form S–1 Registration Statement: Primerica, Inc.*, at 11 (Nov. 5, 2009) (online at www.sec.gov/Archives/edgar/data/1475922/000119312509225601/ds1.htm).

c. Analysis of Intended Exit Strategy

Given the recent announcement by Citigroup concerning its TARP repayment, the Panel notes that Treasury is left with 7.7 billion common shares, which it is free to sell at any time after the 90-day lockup period which expires on March 16, 2010, and $2.23 billion of trust preferred securities issued originally under the

AGP.[279] Given the regulators' decision to allow Citigroup to repay, there are only a few remaining prospective issues with respect to Treasury's exit strategy. This discussion focuses on those remaining challenges.

In making the decision to sell the 7.7 billion common shares that it holds in Citigroup, Treasury will need to balance the desire to exit "as soon as practicable"[280] with the need to maximize the return (or minimize the loss) to the American taxpayers and maintain institutional and systemic stability, as identified by EESA.[281] There are strong arguments from a pure investment perspective for Treasury to hold its investments as long as possible, with the expectation that equity values will increase and taxpayers will see a greater return. The Panel notes that Treasury opted recently to postpone divesting its common shares in order to avoid incurring a $770 million loss. Instead, as discussed above, Treasury anticipates disposing of its remaining common stock holdings during the next 12 months. At the current market price, Treasury's common shares are worth about $27.6 billion.[282] Because the common shares were converted from $25 billion of preferred shares, that is a gain of more than $2 billion, or 10.4 percent, on paper. Even if Treasury sells now at a profit, there remains the possibility that it could be second-guessed if the shares were to increase in value at a later date. In conversations with Panel staff, however, Treasury staff emphasized that Treasury is a "reluctant shareholder" and that the TARP was not designed primarily to make money.[283] Treasury is not trying to pick trading spots, meaning that its actions are not driven purely by a desire to maximize shareholder value.[284] Due to its desire to preserve the stability of individual institutions, however, Treasury is unlikely to sell its stakes all at once since that would likely depress the share price. As of December 9, 2009, Citigroup's trading volume was averaging 471 million shares per day, or about 6 percent of Treasury's holdings. The challenge, therefore, is to dispose of its stakes in an orderly but deliberate fashion. Treasury's interests in preserving institutional stability are also illustrated by its agreement to a 90-day lockup period. There has been some speculation that Treasury only agreed to this after Citigroup notified Treasury of its challenges in attracting investors, some of whom indicated they would only buy shares if Treasury agreed to such a restriction.[285] The Panel notes that Treasury previously had the capacity to sell its Citigroup common shares at its discretion. By agreeing to the 90-day lockup period, Treasury may have limited for a time its ability to sell when circumstances might be more favorable. On balance, Treasury's ac-

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[279] For further discussion of the AGP termination and the related effect on the government's holding of trust preferred securities, *see supra* note 239.

[280] Allison Testimony before House Oversight and Government Reform Committee, *supra* note 118, at 5.

[281] *See* 12 U.S.C. § 5213.

[282] This figure reflects Citigroup stock's closing price as of Friday, January 8, 2010.

[283] Treasury conversations with Panel staff (Dec. 15, 2009); Allison Testimony before House Oversight and Government Reform Committee, *supra* note 118, at 5 (stating that "the U.S. government is a shareholder reluctantly and out of necessity. We intend to dispose of our interests as soon as practicable, with the dual goals of achieving financial stability and protecting the interests of the taxpayers").

[284] Treasury conversations with Panel staff (Dec. 15, 2009).

[285] David Enrich, *Treasury Halts Plan to Sell Off Citi Stock*, Wall Street Journal (Dec. 18, 2009) (online at online.wsj.com/article/SB126100573858094185.html).

tions suggest the tensions and competing interests that exist in its three-pillared management strategy. While it is difficult to determine which if any pillar has been the primary driving force behind Treasury's decision-making with respect to the disposition of its Citigroup common stock holdings, Treasury's strategy of intending to balance taxpayer return, institutional stability and systemic stability, tips in favor of institutional and systemic stability, which are now very much the same.

Since 2008, Citigroup has made some tangible progress in setting forth a new strategic direction and working towards stability and profitability. Chief Executive Officer Vikram Pandit's strategy is to dismantle the company's financial supermarket structure, reduce assets, and focus on the company's core business operations contained in Citicorp (wholesale banking for large corporate clients and retail banking for consumers).[286] In recent months, Citigroup has changed its senior management team, appointing a new chief risk officer and making changes in finance, treasury, and consumer and corporate banking. Citigroup recently named its fifth chief financial officer in five years. These actions were, in large part, a reaction to Citigroup's continued poor asset quality performance. While credit rating agencies such as Moody's Investors Service note that Citigroup's current management is making progress in improving its risk management system, Moody's concludes that "these changes will take time to achieve and the complexity of the effort is enormous."[287] It is still too early to tell whether the new management slate has the commercial and retail banking experience necessary. In addition, four new independent directors with substantial banking experience commenced service in 2009. The ultimate success of Citigroup's strategy, however, is contingent upon how soon the economy recovers. Given that Citigroup still remains a large, complex company with 200 million customer accounts and operations in over 100 countries, there remains the potential for a return to profitability once economic recovery sets in. Thanks in large part to the U.S. government's substantial assistance, Citigroup's financial position has strengthened considerably, and the company has nearly doubled its cash holdings to $244.2 billion over the past year.

Citigroup's record has been mixed, however, with regard to its reorganization and Mr. Pandit's strategy of "reducing assets while optimizing value and mitigating risk."[288] Citigroup has made some progress in reducing noncore operations with the completion of a joint venture between its Smith Barney unit and Morgan Stanley's wealth management group, as well as with sale of Nikko Cordial Securities and Nikko Asset Management. By December 2009, Citigroup had conducted asset sales, business divestitures, and natural portfolio run-off, reducing Citi Holdings' assets by $281 billion

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[286] Citigroup, *Citi to Reorganize into Two Operating Units to Maximize Value of Core Franchise* (Jan. 16, 2009) (online at www.citibank.com/citi/press/2009/090116b.htm) (quoting Mr. Pandit as saying that "[g]iven the economic and market environment, we have decided to accelerate the implementation of our strategy to focus on our core businesses"); Bank of America—Merrill Lynch Financial Services Conference, *Presentation by Citigroup Vice Chairman Ned Kelly*, at 1 (Nov. 11, 2009) (online at www.citigroup.com/citi/fin/data/p091111a.pdf). Citi Statement on Asset Sales and Business Divestitures, *supra* note 261.

[287] Moody's Investors Service, Global Credit Research, *Credit Opinion: Citigroup Inc.* (Oct. 1, 2009).

[288] Citigroup Ned Kelly Presentation, *supra* note 261.

since the first quarter of 2008. Citigroup expects an additional $25 billion reduction in assets resulting from the Nikko divestitures.[289] On the other hand, Citigroup's December 2009 fire sale of Phibro, its commodity-trading arm and one of its few consistently profitable business units, for only $250 million demonstrates the obstacles Citigroup continues to face with maximizing value in a difficult economic climate, and emphasizes the need for restrictions on the sale of good assets.[290] Much work remains until noncore assets are reduced substantially, including the disposition of large noncore businesses with substantial consumer credit exposure.[291] Therefore, Citigroup's intended further downsizing of Citi Holdings will likely take place over several years.

In addition, some analysts have suggested that a significant downside of Citigroup's new strategy is that the institution's operations have become less transparent. As compared to JPMorgan, Wells Fargo, and Bank of America—institutions that are growing and becoming more complex—these analysts argue that Citigroup does a poorer job of explaining its strengths and weaknesses.[292] In their view, Citigroup needs to substantially improve disclosure in its securities and banking business as well as more country-specific information relating to its international consumer banking operations.[293] While some of this lack of transparency may be due in part to the complexity of Citigroup's organization as compared to other financial institutions, the Panel notes that the lack of transparency makes it very difficult to evaluate Citigroup's progress and efforts to regain profitability.

While the regulators have permitted Citigroup to repay, the critical question is whether Citigroup can become a viable and profitable financial institution again.[294] After two consecutive quarterly profits, Citigroup incurred a loss of $3.2 billion in the third quarter of 2009, as consumer loan losses exceeded trading profits from its bond and currency businesses.[295] Citigroup's credit card and mortgage units contributed to approximately $9.4 billion in consumer losses for the third quarter alone. Analysts anticipate that Citigroup will post a loss of 32 cents per share for the fourth quar-

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[289] Citi Statement on Asset Sales and Business Divestitures, *supra* note 261.

[290] This illustration further underscores the influence of the U.S. government on TARP-recipient institutions, as Citigroup had intended to maintain its core profitable businesses while off-loading its "legacy" businesses.

[291] Such major noncore businesses include the CitiFinancial consumer loan business, the retail partner credit card business, and Primerica Financial Services.

[292] Conditions improving, but Citi still faces confidence crisis, *supra* note 252 (stating that "vagueness tends to raise concerns about weakness," in large part due to its recent financial troubles) (based on SNL interviews with Jeff Harte, Sandler O'Neill & Partners analyst, Jeff Saut, chief investment strategist at Raymond James & Associates, and Christopher Whalen, a managing director at Institutional Risk Analytics); *see also* Peter Eavis, *Bright Lights, Transparent Citi*, Wall Street Journal (Dec. 18, 2009) (online at online.wsj.com/article/SB20001424052748703323704574602310167166196.html?) ("For instance, Citicorp says its Asian consumer operations have $92 billion of assets, but doesn't disclose specifically where they are, let alone the types of loans that exist in each country. Oddly, Citi has given a country breakdown for the problematic businesses bunched under Citi Holdings, but not for Citicorp").

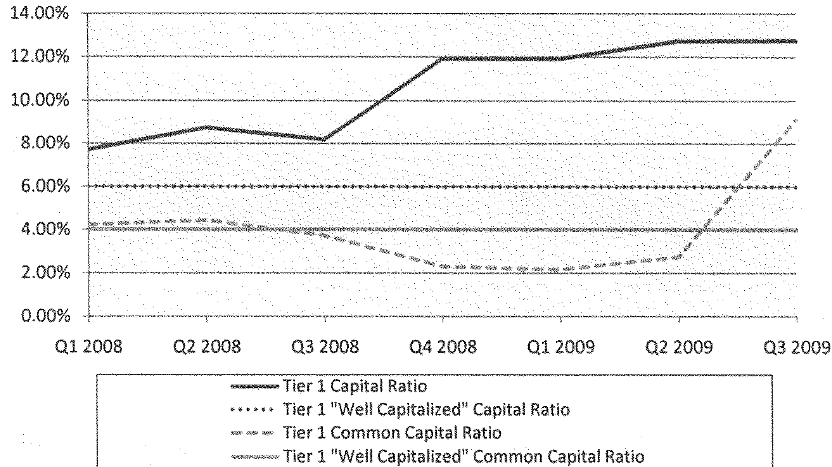
[293] Conditions improving, but Citi still faces confidence crisis, *supra* note 252.

[294] *See* discussion of the additional financial burden assumed by banks repaying CPP Preferred at Note 213, *infra*. *See also* Figure 7, *infra*, for a representation of changes in Citigroup's capital structure.

[295] Furthermore, unlike JPMorgan Chase or Goldman Sachs, Citigroup's operations have not yet generated enough profits to cover potentially substantial write-downs in the future. In the third quarter of 2009, its core business units did not show an increase in revenue.

ter of 2009, marking its “eighth quarterly loss, on a per-share basis, in the past nine reporting periods.”[296]

FIGURE 7: CITIGROUP’S CAPITAL RATIOS SINCE THE FIRST QUARTER OF 2008[297]



While Citigroup’s stock has climbed back from a low of $1.02 per share in March 2009 to its current price of $3.59,[298] it remains unclear whether it can regain its footing and reemerge as a profitable institution going forward. Citigroup’s market capitalization is currently less than Bank of America, JPMorgan Chase, and Wells Fargo, all institutions that have repaid their TARP assistance in full. Another lingering concern is whether Citigroup will be able to refinance its obligations coming due in the next few years. Citigroup has approximately $30 billion of debt coming due in 2010, plus $39.5 billion in 2011 and $59.3 billion in 2012.[299]

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[296] Conditions improving, but Citi still faces confidence crisis, *supra* note 252. While analysts expect Citi to incur a fourth quarter loss, this is due in large part to one-time accounting changes that Citi needed to take as part of its recent TARP repayment.

[297] The Tier 1 “Well Capitalized” Capital ratio and Tier 1 “Well Capitalized” Common ratio of 6 percent and 4 percent, respectively, are based on the Supervisory Capital Assessment Program’s desired ratio of capitalization for bank holding companies to ensure a sufficient capital buffer against future economic challenges. *See* Board of Governors of the Federal Reserve System, *Joint Statement by Secretary of the Treasury Timothy F. Geithner, Chairman of the Board of Governors of the Federal Reserve System Ben S. Bernanke, Chairman of the Federal Deposit Insurance Corporation Sheila Bair, and Comptroller of the Currency John C. Dugan regarding The Treasury Capital Assistance Program and the Supervisory Capital Assessment Program* (May 6, 2009) (online at www.federalreserve.gov/newsevents/press/bcreg/20090506a.htm). The Tier 1 Capital includes core capital. Tier 1 Common Capital includes Tier 1 Capital less non-common elements (i.e., qualifying perpetual preferred stock, qualifying noncontrolling interests in subsidiaries, and qualifying mandatorily redeemable securities of subsidiary trusts). For the purposes of the SCAP, both ratios are stated as a percentage of risk-weighted assets. As losses hit common equity first and dividend payment schedules are not fixed, the Tier 1 Common capital ratio drills deeper into the capital structure by showing the institution’s permanent loss absorption capacity. According to Citigroup’s press release on December 23, 2009, if the TARP repayment had been in effect at the end of Q3 2009, the Tier 1 Capital ratio would have been 11.0 percent and the Tier 1 Common Capital ratio would have been 9.0 percent.

[298] This figure reflects Citigroup stock’s closing price as of Friday, January 8, 2010.

[299] Citigroup, *2008 Annual Report on Form 10–K*, at 170 (online at www.citigroup.com/citi/fin/data/k08c.pdf?ieNocache=265) (hereinafter “Citigroup 2008 Annual Report on Form 10–K”) (detailing aggregate annual maturities of long-term debt obligations (based on final maturity dates)).

If Citigroup is unable to refinance at affordable rates or has insufficient cash to cover its maturing obligations, it may be forced to face much higher borrowing costs, possibly resulting in renewed liquidity problems.

In addition, Citigroup's exit from the TARP does not come without cost. As a result of its TARP repayments and accounting charges taken on the value of the repaid trust preferred securities and the termination of the AGP loss-sharing agreement, Citigroup will incur a $10.1 billion pre-tax loss for the fourth quarter of 2009.[300] The recent stock offering also caused substantial dilution for existing Citigroup shares, including Treasury's holdings. While Citigroup has written down billions of dollars' worth of mortgages on its books, there are looming problems in its huge credit card and mortgage portfolios.[301] Citigroup raised interest rates on some credit card holders to 29.99 percent in October 2009. Analysts at Fitch Ratings predict that Citigroup will continue to need substantial loan loss reserves and that its operations will remain weak into 2010, but that write-downs on capital market exposures are expected to be much lower due to the large amount of write-downs already incurred,[302] while Standard & Poor's predicts that Citigroup "will likely face a tough credit cycle over the next two years."[303]

Citigroup has been the recipient of substantial government assistance on at least three occasions over the past 80 years.[304] If Citigroup were to run into trouble again, perhaps because of some market disruption, recent history suggests that the government would not let it fail. The American people and Congress are forced to place an enormous amount of faith and trust in Treasury and the regulators' decision to allow Citigroup to repay its TARP assistance in the hope that it will not return for further rescue in the future. During his recent testimony before the Panel, Secretary

[300] Repaying TARP and Other Capital Actions, *supra* note 235.

[301] Standard & Poor's has characterized Citigroup's credit cards and residential mortgages as "[c]hief among its most problematic exposures." Standard & Poor's, Global Credit Portal, *Citigroup Inc.* (July 31, 2009) (hereinafter "S&P Citigroup").

[302] Fitch Ratings for Citigroup, *supra* note 250; Moody's Earnings Commentary for Citigroup, *supra* note 250 (expecting that loan loss provisions will rise over the next few quarters, "increasing the probability that Citigroup will report quarterly losses").

[303] S&P Citigroup, *supra* note 301.

[304] Prior to the TARP bailout, the U.S. government rescued Citigroup on at least two other occasions. As part of its response to the Great Depression, the federal government instituted several policies aimed at preventing the financial sector from failing. Because of these policies, Citibank's predecessor, National Bank, was able to weather the storm while thousands of smaller banks failed. The risky activities of National Bank that contributed to the crash prompted Congress to pass the Glass-Steagall Act, which required the separation of commercial banking activities from those of investment banks. Citibank, operating as Citicorp, was again bailed out in the 1980s following the LDC (less-developed-country) debt crisis, in which several Latin American countries were unable to meet interest payments on massive debts to large American banks due to rising LIBOR rates (which were used to price credits to LDCs). In response to the crisis, U.S. banking officials waived several capital and accounting standards, such as the requirement that banks set aside reserves to cover restructurings of loans. Without such regulatory forbearance, it is possible that Citicorp would have been deemed insolvent, thereby causing a widespread panic. *See* Robert A. Eisenbeis and Paul M. Horvitz, *The Role of Forbearance and Its Costs in Handling Troubled and Failed Depository Institutions, Reforming Financial Institutions in the United States,* at 68 (George G. Kaufman ed., 1993) ("Had these institutions been required to mark their sometimes substantial holdings of underwater debt to market or to increase loan-loss reserves to levels close to the expected losses on this debt (as measured by secondary market prices), then institutions such as Manufacturers Hanover, Bank of America, and perhaps Citicorp would have been insolvent"). By the 1990s, Citicorp had not fully recovered and so was again helped by a cash infusion from Saudi Prince Walid bin Talal. The federal government simultaneously aided in this rescue by cutting interest rates so that large banks could borrow money at low rates from the Federal Reserve, while lending at higher rates to their customers.

Geithner expressed great confidence in the strength of the regulators' decisions concerning repayment, and noted that the regulators would not allow or support premature repayment by a weak institution.[305] In addition, Secretary Geithner, on a separate occasion, responded to concerns that the regulators are allowing the large financial institutions to exit from the TARP too quickly, calling the TARP repayments "good news for everyone."[306] While such statements and assurances are encouraging, the capital markets do not seem so convinced.[307] The repeated failure of Citigroup underscores the gravity and seriousness of these repayment decisions and raises critical questions about the redesign of the institution so that it is less likely to become a systemic risk in the future.

6. AIG

a. Acquisition of Assets and Current Value

Along with Citigroup and Bank of America, AIG is one of the largest recipients of TARP assistance, and has received even more assistance from the Federal Reserve. Through a series of coordinated efforts, Treasury and the Federal Reserve have committed over $182.3 billion to AIG since September 2008.[308] Treasury's share of this commitment is $69.8 billion, which it holds under the AIGIP/SSFI in the form of preferred shares (AIGIP/SSFI Preferred). As of December 31, 2009, $46.9 billion in principal amount of the AIGIP/SSFI Preferred was outstanding. Like the TIP, the AIGIP/SSFI 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" and carries strict executive compensation guidelines.[309] AIG is the only institution to be provided assistance under this initiative.

The government's assistance to AIG began on September 16, 2008—one day after the collapse of Lehman Brothers. FRBNY, pursuant to the authorization of the Federal Reserve and with the support of Treasury,[310] provided AIG with an $85 billion revolving

[305] Agency Financial Statement 2009, *supra* note 32 (noting that Treasury and the regulators "would not support" allowing institutions to repay their TARP assistance due to the institution's desire to increase executive compensation).

[306] MarketWatch.com, *Geithner Dismisses Worry Over Bank TARP Repayments,* MarketWatch (Dec. 15, 2009) (online at www.marketwatch.com/story/story/print?guid=3941CA39-8EB4-408C-B147-1BBEE978EB14).

[307] As discussed above, Citigroup priced its offering designed to facilitate its TARP repayment at $3.15 per share on December 16, 2009, reflecting a 20 percent discount from the intended target.

[308] According to Treasury, each decision to provide assistance was driven by the recognition that AIG faced increasing pressure on its liquidity following a downgrade in its credit ratings in May and September 2008 and the real risk of further downgrades unless extraordinary steps were taken. Treasury conversations with Panel staff (Dec. 3, 2009). While AIG tried to raise additional capital in the private market in early September 2008, its attempt was unsuccessful. AIG, in an unusual set of terms, agreed to post collateral upon downgrades in its credit ratings, and also allowed counterparties to assert claims. The company's destabilization can be attributed, in large part, to these terms.

[309] U.S. Department of the Treasury, *Road to Stability: Programs* (online at www.financialstability.gov/roadtostability/programs.htm) (accessed Jan. 13, 2010). The Panel notes, however, that Special Master Feinberg has exempted certain AIG executives from his default $500,000 cash salary cap after at least five employees reportedly threatened to resign because of the compensation limits. *See* Steve Eder and Paritosh Bensal, *AIG executive resigns over pay limits,* Reuters (Dec. 30, 2009) (online at www.reuters.com/article/idUSTRE5BT45E20091231).

[310] The Board of Governors of the Federal Reserve System authorized FRBNY to lend under section 13(3) of the Federal Reserve Act, which authorizes the Federal Reserve Board to make secured loans to individuals, partnerships, or corporations in "unusual and exigent cir-

Continued

credit facility.[311] In exchange for the facility and $0.5 million,[312] AIG agreed to establish a trust for the sole benefit of the United States Treasury, providing the United States Treasury with a 77.9 percent voting interest in AIG, held in trust (the Trust Shares).[313] While Treasury has a limited consultative role to the FRBNY in its administration of the Trust,[314] the Trust Shares are not technically TARP assets.

On November 25, 2008, Treasury provided AIG with a $40 billion capital infusion under the AIGIP/SSFI.[315] Treasury received $40 billion face value of preferred shares and a warrant to purchase ap-

cumstances" and when the borrower is "unable to secure adequate credit accommodations from other banking institutions." This authority was designed to allow the Federal Reserve to respond to emergency circumstances. It was amended in 1991 to allow the Federal Reserve to lend directly to securities firms during financial crises.

[311] Federal Reserve Board authorizes lending to AIG, *supra* note 110; Board of Governors of the Federal Reserve System and U.S. Department of the Treasury, *U.S. Treasury and Federal Reserve Board Announce Participation in AIG Restructuring Plan* (Mar. 2, 2009) (online at www.federalreserve.gov/newsevents/press/other/20090302a.htm) (hereinafter "AIG Restructuring Plan Announcement"). The facility was subsequently revised:

- In November 2008, the initial $85 billion to be made available was reduced to $60 billion. Additionally, the facility's initial term of 24 months was extended to five years. These and other changes in terms were prompted by the fact that credit rating agencies were prepared to further downgrade the company's credit ratings based upon their conclusion that the FRBNY revolving credit facility, in the form of debt, made the company overleveraged.
- In March 2009 the Federal Reserve made several changes to the facility. The facility was reduced from $60 billion to no less than $25 billion, in exchange for FRBNY taking preferred interests in two special purpose vehicles created to hold all of the outstanding common stock of American Life Insurance Company (ALICO) and American International Assurance Company Ltd. (AIA), two life insurance holding company subsidiaries of AIG. While AIG will retain control of ALICO and AIA, FRBNY has certain governance rights in order to protect its interests. The Federal Reserve also authorized FRBNY to make new loans, up to an aggregate amount of approximately $8.5 billion, to special purpose vehicles (SPVs) created by these life insurance subsidiaries, which would repay the loans from cash flows from designated blocks of existing life insurance policies. The proceeds of these new FRBNY loans would be used to pay down an equivalent amount of outstanding debt under the facility. On December 1, 2009, AIG announced that it consummated these two debt-for-equity transactions by selling preferred equity stakes in these two subsidiaries to FRBNY, thereby reducing AIG's debt to FRBNY to $17 billion, excluding interest and fees. AIG's recent decision to have a public stock offering for AIA on the Hong Kong stock exchange (which might raise as much as $20 billion) is designed to help AIG repay its government assistance.

[312] As a discount, the initial commitment fee AIG paid for the Revolving Credit Facility was reduced by $0.5 million and will not be repaid. Initially, AIG drew down $28 billion on this facility on September 17, 2008.

[313] Federal Reserve Board authorizes lending to AIG, *supra* note 110.

The Credit Facility Trust Agreement provides that the trust is for the sole benefit of the United States Treasury, meaning that any property distributable to the United States Treasury as a beneficiary must be paid to the Treasury for deposit into the U.S. Treasury General Fund as miscellaneous receipts. *See* AIG Credit Facility Trust Agreement, at § 1.01 (Jan. 16, 2009) (online at www.newyorkfed.org/newsevents/news/markets/2009/AIGCFTAgreement.pdf) (hereinafter "AIG Credit Facility Trust Agreement").

The interest is in the form of preferred stock, convertible into AIG's common stock. The AIG Credit Facility Trust Agreement was not executed until January 16, 2009. On March 4, 2009, AIG, as required by the Trust Agreement governing the Revolving Credit Facility, AIG agreed to issue shares of convertible preferred stock an approximately 77.9 percent equity interest in AIG to an independent trust for the sole benefit of the United States Treasury. The conversion formula stipulates that the trust will receive 79.9 percent of AIG's common stock, less the percentage of common stock that may be acquired by or for the benefit of the United States Treasury as a result of warrants or other convertible preferred stock held by Treasury. Treasury received a warrant to purchase a number of shares equal to two percent of AIG's common stock in connection with its November 2008 preferred stock purchase, and an additional warrant to purchase AIG common stock in connection with its April 2009 preferred stock purchase. Subsequent to the initial agreement, a reverse stock split of AIG's common stock increased the government's equity interest to 79.8 percent.

[314] Under section 1.02 of the Credit Facility Trust Agreement, FRBNY has to consult with the Treasury Department in appointing the trustees. FRBNY also has to consult with the Treasury with respect to filling any trustee vacancies. Trustees can be removed for engaging in criminal conduct or if it has been reasonably determined by FRBNY, in consultation with Treasury, that a trustee has "demonstrated untrustworthiness or to be derelict in the performance of his or her duties." AIG Credit Facility Trust Agreement, *supra* note 313.

[315] Treasury to Invest in AIG Restructuring Under EESA, *supra* note 110; U.S. Department of the Treasury, *TARP AIG SSFI Investment Term Sheet* (online at www.treas.gov/press/releases/reports/111008aigtermsheet.pdf) (hereinafter "AIG SSFI Investment Term Sheet").

proximately two percent of the shares of AIG's common stock.[316] AIG used these funds to pay down $40 billion of the amounts under the Revolving Credit Facility that FRBNY had provided in September, $72 billion of which was the maximum that had been drawn down at that point, but the cumulative outstanding balance was $69.25 billion on the particular days preceding the AIGIP/SSFI infusion.[317]

During March and April 2009, Treasury and the Federal Reserve provided additional assistance and further restructured the terms of their existing assistance.[318] On April 17, 2009, Treasury provided AIG with a commitment to invest an additional $29.8 billion on certain terms and conditions. This facility, to be used on a standby basis, allows AIG to issue to Treasury up to $29.8 billion in AIGIP/SSFI Preferred over five years to meet its liquidity and capital needs as they arise. Treasury will receive AIGIP/SSFI Preferred in the amount of each drawdown. In connection with providing AIG this additional commitment, Treasury received a warrant to purchase up to 3,000 shares of AIG common stock.[319] As of December 31, 2009, $5.3 billion had been drawn down under this facility. AIG can continue to draw on the AIGIP/SSFI investments through April 17, 2014, provided it remains in compliance with certain conditions.

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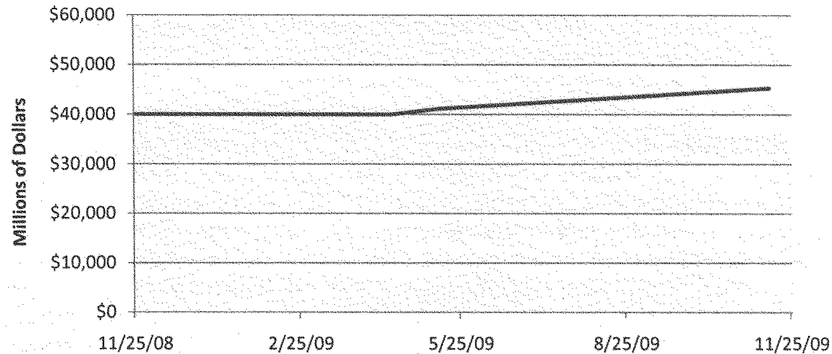
[316] AIG SSFI Investment Term Sheet, *supra* note 315. See Note 314 for further discussion of the conversion calculation.

[317] At the same time, the Federal Reserve created two separate lending facilities for AIG assets. In addition to authorizing FRBNY to restructure the terms of its revolving credit facility to AIG, the Federal Reserve authorized FRBNY to create, and lend up to $22.5 billion to, an SPV called Maiden Lane II LLC, designed to purchase residential mortgage-backed securities from AIG life insurance companies. AIG will absorb the first $1 billion of losses due to its acquisition of a subordinated $1 billion interest in the facility. On December 12, 2008, FRBNY extended a $19.5 billion loan to Maiden Lane II LLC. The Federal Reserve further authorized FRBNY to create and lend up to $30 billion to another SPV called Maiden Lane III LLC designed to purchase collateralized debt obligations (CDOs) from AIG's counterparties. In two separate disbursements in November and December 2008, FRBNY funded Maiden Lane III LLC with a $24.3 billion senior loan and AIG agreed to absorb the first $5 billion of losses after providing a $5 billion equity investment. AIG's counterparties, in exchange for agreeing to terminate their credit default swap (CDS) contracts, were allowed to retain the $35 billion in collateral previously posted by AIG. TARP funds were not directly used in either the Maiden Lane II or III transactions.

[318] *See* Note 311, for further discussion of some of the key components of the March restructuring.

[319] U.S. Department of the Treasury, *U.S. Treasury and Federal Reserve Board Announce Participation in AIG Restructuring Plan* (Mar. 2, 2009) (online at www.treas.gov/press/releases/tg44.htm) (hereinafter "Participation in AIG Restructuring Plan Announcement").

FIGURE 8: TREASURY'S PREFERRED STOCK HOLDINGS IN AIG [320]



On April 17, 2009, the $40 billion face amount of AIGIP/SSFI Preferred that Treasury received in its November 2008 AIGIP/SSFI investment was exchanged for $41.6 billion [321] of noncumulative preferred shares, allowing AIG to reduce its leverage and dividend requirements.[322]

The following tables show Treasury's and the Federal Reserve's holdings in AIG as of December 31, 2009.

FIGURE 9: DEPARTMENT OF TREASURY HOLDINGS IN AIG AS OF DECEMBER 31, 2009
[Dollars in millions]

Assets	Principal Amount	Acquisition Cost	Revenues Generated	Estimated Value as of 12/31/09		
AIGIP/SSFI Non-Cumulative Preferred.	[323] $46,900,000,000	$45,300	[324] $0	[325] $13,200		
Warrants	[326] 53,798,766	Received as part of initial AIGIP/SSFI investments.	N/A	Low $44.9	High $1,052.8	Best $556.4

[323] The $1.6 billion difference between the principal amount and acquisition cost reflects a compounding of accumulated but unpaid dividends owed by AIG to Treasury.

[324] According to Treasury, there have been no revenues generated from its AIGIP/SSFI investments in AIG because AIG has not declared or paid any dividends since the inception of Treasury's preferred equity investments.

[325] This figure reflects Treasury's estimated value of its AIGIP/SSFI investments in AIG as of September 30, 2009. Agency Financial Statement 2009, *supra* note 32, at 17.

[326] AIG's stock split 20 to 1 in April 2009. The U.S. Government will get 1/20th share of AIG common stock every warrant exercised, so the government will get 2,690,088.3 shares of common stock if all warrants are exercised.

[320] The value of Treasury's preferred stock holdings in AIG does not include the additional obligations of $1.6 billion in cumulative unpaid dividends outstanding at the time of exchange from cumulative preferred to non-cumulative preferred shares (April 17, 2009) and $165 million commitment fee to be paid in three equal installments over the five-year life of the commitment facility. *See* TARP Transactions Report for Period Ending December 30, 2009, *supra* note 166.

[321] The $1.6 billion difference reflects a compounding of accumulated but unpaid dividends owed by AIG to Treasury on the cumulative preferred stock.

[322] Participation in AIG Restructuring Plan Announcement, *supra* note 319.

FIGURE 10: U.S. TREASURY HOLDINGS IN AIG AS OF DECEMBER 31, 2009

[Dollars in millions]

Asset	Number	Estimated Value as of 9/30/09
Preferred Securities Convertible into Common, held by Trust	100,000	[327] $23,500

[327] According to Treasury, "[t]he value recorded is based on the market value of the trust's AIG holdings at September 30, 2009; as the underlying AIG common stock is actively traded on the New York Stock Exchange, this represents the best independent valuation available for the government's beneficial interest." U.S. Department of the Treasury, *2009 Agency Financial Report—Department of Treasury*, at 182, 194–95 (online at www.treas.gov/offices/management/dcfo/accountability-reports/2009–afr.shtml). Treasury will re-value the trust each year until the trust is liquidated.

FIGURE 11: FEDERAL RESERVE HOLDINGS IN AIG AS OF DECEMBER 31, 2009

[Dollars in millions]

Asset	Amount of assistance authorized	Outstanding Balance
Revolving Credit Facility	[328] $35,000	[329] $22,000
Maiden Lane II	[330] 22,500	[331] 15,700
Maiden Lane III	[332] 30,000	[333] 18,200
Total	87,500	55,900

[328] The facility was initially $85 billion but was reduced to $60 billion in November 2008, and further reduced to $35 billion in December 2009.

[329] This amount includes outstanding principal and capitalized interest, net of unamortized deferred commitment fees and allowance for loan restructuring.

[330] While FRBNY was authorized to provide a loan to Maiden Lane II up to $22.5 billion, it lent only $19.5 billion of this amount.

[331] As of December 31, 2009, the outstanding principal amount was $15.739 billion, and the accrued interest payable to FRBNY was $265 million. The net portfolio holdings of Maiden Lane II as of December 31, 2009, as defined by FRBNY, were $15.697 billion.

[332] While FRBNY was authorized to provide a loan to Maiden Lane III up to $30 billion, it lent only $24.3 billion of this amount.

[333] As of December 31, 2009, the outstanding principal amount was $18.159 billion, and the accrued interest payable to FRBNY was $340 million. The net portfolio holdings of Maiden Lane III as of December 31, 2009, as defined by FRBNY, were $22.660 billion.

b. Disposal of Assets and Recovery of Expended Amounts

The Administration and Treasury in particular have articulated the view that public ownership of financial institutions is not a policy objective.[334] While public ownership has been the outcome of the federal government's intervention in AIG, the primary objective of Treasury and the Federal Reserve with respect to AIG is to stabilize the company enough to replace federal government assistance with private sector resources in order to create a "more focused, restructured, and viable economic entity as rapidly as possible."[335]

Treasury's approach to its AIG investment now seems to have shifted from balancing its three pillars of asset management to a strategy based largely on preventing the detrimental effect on market confidence that would result if Treasury were to not deliver on its promise to provide financial assistance, as well as preserving the value of its investment.[336] The public purpose in keeping the AIG parent company solvent, therefore, is based on the govern-

[334] Agency Financial Statement 2009, *supra* note 32; Allison Testimony before House Oversight and Government Reform Committee, *supra* note 118, at 5. The Administration has also articulated a set of four guidelines that will govern its approach to managing ownership interests in financial and automotive companies. These include a desire not "to own equity stakes in companies any longer than necessary," and the objective "to dispose of its ownership interests as soon as practicable." White House, *Fact Sheet: Obama Administration Auto Restructuring Initiative General Motors Restructuring* (June 30, 2009) (online at financialstability.gov/latest/05312009_gm-factsheet.html) (listing the guidelines governing the government's ownership interests in financial institutions and automotive companies).

[335] AIG Restructuring Plan Announcement, *supra* note 311.

[336] Treasury conversations with Panel staff (Dec. 15, 2009).

ment's initial decision to not let AIG fail in September 2008, and if the U.S. government were to act otherwise, it would jeopardize not only its financial credibility, but also the value of its sizeable investment.[337]

Earlier government pronouncements with respect to divestment included maximizing value as an objective. In 2008, Treasury and the Federal Reserve noted that the federal government "intends to exit its support of AIG over time in a disciplined manner consistent with maximizing the value of its investments and promoting financial stability."[338] At the beginning of 2009, the focus appeared to shift somewhat with the change in the overall market situation, toward a faster exit to the extent possible without destabilization. Earlier this year, Secretary Geithner stated that the U.S. government "will continue our aggressive efforts to resolve the future status of AIG in a manner that will reduce the systemic risks to our financial system while minimizing the loss to taxpayers. And we will explore any and all responsible ways to accelerate this wind down process."[339] Moreover, when asked whether he would like to see AIG "prosper, make a lot of money again and be successful" in a recent *Meet the Press* interview, Secretary Geithner commented that he would like to see AIG "bring down the risk that brought that company to the edge of collapse and to restructure its business so the taxpayer can get out."[340] Treasury's focus is clearly on medium-term exit rather than long-term investment, although AIG is not expected to fully repay the government's assistance for several years.[341]

Similar to the CPP Preferred, the AIGIP/SSFI Preferred shares have no mandatory redemption date, and can be disposed of, at least in theory, to third parties.[342] FRBNY's Revolving Credit Facility is available until September 16, 2013. The government agencies are not, however, intending to remain involved in AIG through that date.

While Treasury's objective is to make an orderly exit "as soon as practicable," Treasury understands that the government's exit from AIG is constrained by the same factors that prompted the government to provide AIG with assistance in late 2008—the threat of continued downgrades in the company's credit ratings and the loss in market confidence that would cause. Credit rating agencies such as Moody's have indicated that AIG's current credit ratings are maintained only because of the extraordinary government assistance,[343] making the government extra cautious about any pre-

[337] Treasury conversations with Panel staff (Dec. 15, 2009).

[338] Board of Governors of the Federal Reserve System, *Federal Reserve Board and Treasury Department Announce Restructuring of Financial Support to AIG* (Nov. 10, 2008) (online at www.federalreserve.gov/newsevents/press/other/20081110a.htm); Treasury conversations with Panel staff (Dec. 3, 2009).

[339] U.S. Department of the Treasury, *Letter from Secretary Geithner on AIG to House Speaker Nancy Pelosi* (Mar. 17, 2009) (online at www.treas.gov/press/releases/tg61.htm).

[340] Interview with Treasury Secretary Timothy F. Geithner, *Meet the Press with David Gregory*, NBC (Nov. 1, 2009) (online at www.msnbc.msn.com/id/33562673/ns/meet_the_press/).

[341] Treasury conversations with Panel staff (Dec. 16, 2009); Treasury conversations with Panel staff (Dec. 3. 2009).

[342] *See* Securities Purchase Agreement dated as of April 17, 2009 between American International Group, Inc. and United States Department of the Treasury, at § 4.9 (online at www.financialstability.gov/docs/agreements/Series.F.Securities.Purchase.Agreement.pdf).

[343] Treasury conversations with Panel staff (Dec. 16, 2009); Treasury conversations with Panel staff (Dec. 3, 2009); *see* Moody's Investors Service, *Issuer Comment: Moody's sees AIG holding its ground through 3Q09* (Nov. 9, 2009) (hereinafter "Moody's sees AIG holding its ground

mature exit that might trigger a ratings downgrade and thereby destabilize AIG and the financial system. In Treasury's view, therefore, the key to allowing the government to exit in an orderly fashion is to do so in a manner that allows AIG to maintain its credit ratings on a stand-alone basis and to remain well-capitalized without government assistance.[344] Given the extraordinary government assistance provided to AIG, such an exit will take time to effectuate, but Treasury believes that it is the optimal way to protect the value of its investments and to avoid causing a loss in market confidence, as discussed above.[345]

Treasury's AIGIP/SSFI investments are junior to the FRBNY's revolving credit facility, which is collateralized by all the assets of AIG and of its principal non-regulated subsidiaries. This means that AIG's repayment of Treasury's AIGIP/SSFI equity investments can only occur after it has completely repaid the Revolving Credit Facility.

The Federal Reserve expects that the Revolving Credit Facility will be repaid from the proceeds of the sale of certain of AIG's assets and businesses, including the future initial public offerings of its two insurance company subsidiaries, the American International Assurance Company Ltd. (AIA) and the American Life Insurance Company (ALICO),[346] the timing of which is contingent upon market conditions.[347] As discussed above, the ceiling on this facility has been reduced gradually as a result of several restructurings since September 2008, as well as certain asset sales that have already occurred, and currently stands at $35 billion, of

through 3Q09"); Moody's Investors Service, *Issuer Comment: AIG shows signs of stabilization but risks remain, says* GAO (Sept. 28, 2009) (hereinafter "AIG shows signs of stabilization but risks remain").

[344] Treasury conversations with Panel staff (Dec. 3, 2009).

[345] Treasury conversations with Panel staff (Dec. 16, 2009).

[346] With respect to the Maiden Lane facilities, FRBNY anticipates that its loans to Maiden Lane II LLC and Maiden Lane III LLC, both of which have six-year terms but may be extended at the Federal Reserve's discretion, will be repaid with the proceeds from the interest and principal payments or proceeds from the liquidation of the assets held by the facilities. Letter from Scott G. Alvarez, general counsel, Board of Governors of the Federal Reserve System, and Thomas C. Baxter, Jr., general counsel, Federal Reserve Bank of New York, to Neil Barofsky, special inspector general, Troubled Asset Relief Program (Nov. 15, 2009). FRBNY has retained BlackRock Financial Management Inc. to manage the Maiden Lane II and III asset portfolios, with the objective of maximizing long-term cash flows to pay the loans (including principal, interest, and contingent interest), while "refraining from investment actions that would disturb general financial market conditions." Federal Reserve Bank of New York, *Maiden Lane II Transactions* (online at www.newyorkfed.org/markets/maidenlane2.html); Federal Reserve Bank of New York, *Maiden Lane III Transactions* (online at www.newyorkfed.org/markets/maidenlane3.html). The Federal Reserve has indicated that it plans to hold the Maiden Lane assets until they mature or increase enough in value so as to allow the Federal Reserve to maximize its recovery through asset sales. AIG Restructuring Plan Announcement, *supra* note 311. While these steps will take time, FRBNY expects that the proceeds from the asset sales "should enable AIG to repay the New York Fed in full." House Committee on Financial Services, Testimony of William C. Dudley, president and chief executive officer of the Federal Reserve Bank of New York, *Oversight of the Federal Government's Intervention at American International Group*, 111th Cong., at 2 (Mar. 24, 2009) (hereinafter "Dudley Testimony before House Financial Services Committee"); Senate Committee on Banking, Housing, and Urban Affairs, Testimony of Donald L. Kohn, vice chairman, Board of Governors of the Federal Reserve System, *American International Group: Examining what went wrong, government intervention, and implications for future regulation,* 111th Cong., at 10 (Mar. 5, 2009) (online at banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=aa8bcdf2-f42b-4a60-b6f6-cdb045ce8141) (stating that the investment manager for FRBNY projects that the Maiden Lane II and Maiden Lane III loans "will be repaid over time with no loss to the taxpayer," even under highly stressed scenarios).

[347] Federal Reserve Board authorizes lending to AIG, *supra note* 110.

which $22 billion, including principal and interest, but net of any fees, is outstanding.[348]

Once AIG repays the Revolving Credit Facility in full and thereby reduces its leverage, Treasury expects that AIG will be able to access the capital markets on its own and consider different capital market strategies to begin repaying its obligations to Treasury.[349] As Assistant Secretary Allison stated, "[u]pon the repayment in full of its debt to the FRBNY, AIG will then focus on building value in its remaining insurance businesses, Chartis, Domestic Life and Retirement Services and American General and Valic, as well as ILFC, its aircraft leasing business, and American General, its consumer finance business."[350] Treasury has indicated, however, that among the strategies AIG may pursue to facilitate the repayment of the AIGIP/SSFI Preferred is a recapitalization pursuant to which all or a portion of them would be converted into common stock.[351] Such a recapitalization would boost AIG's capital ratios, further buttressing its ability to maintain an investment grade rating on a stand-alone basis and facilitating Treasury's exit from its investment by permitting it to sell common stock on the New York Stock Exchange as market conditions permit.[352]

The stabilization of AIG "so that it no longer poses a disruptive threat"[353] to the financial system and the economy will inevitably be a multi-year process.[354] This is especially the case given the current market conditions and continued economic uncertainty. As Ben S. Bernanke, chairman of the Board of Governors of the Federal Reserve System, testified, "[h]aving lent money to avert the risk of a global financial meltdown, we found ourselves in the uncomfortable situation of overseeing both the preservation of its value and its dismantling, a role quite different from our usual activities."[355] Chairman Bernanke further stated that "[u]sing our rights as a creditor, we have worked with AIG's new management team to begin the difficult process of winding down [AIG Financial Products] and to oversee the company's restructuring and divestiture strategy."[356]

For its part, AIG has offered some insight into how it expects to become profitable enough so that it can repay its government as-

[348] For further discussion of the terms and current status of the revolving credit facility, *see* footnote 311.

[349] Treasury conversations with Panel staff (Dec. 16, 2009); Treasury conversations with Panel staff (Dec. 3, 2009). For further discussion on Treasury's recently published financial statements which shows Treasury's view as to the expected loss amount from TARP AIGIP investments in AIG, *see* Section D.6, *infra*.

[350] Allison Testimony before House Oversight and Government Reform Committee, *supra* note 118, at 11.

[351] Treasury conversations with Panel staff (Dec. 16, 2009).

[352] Treasury conversations with Panel staff (Dec. 16, 2009); *see also* Allison Testimony before House Oversight and Government Reform Committee, *supra* note 118, at 11 (stating that "AIG and Treasury are in active, ongoing discussions with regard to strategies to allow Treasury to monetize its investment in AIG, once the FRBNY has been paid in full").

[353] Dudley Testimony before House Financial Services Committee, *supra* note 346.

[354] Treasury conversations with Panel staff (Dec. 3, 2009). Then-CEO Edward Liddy testified in May that he expects AIG to take three to five years to complete its restructuring and repay Treasury and the Federal Reserve. House Committee on Oversight and Government Reform, Testimony of Edward Liddy, chief executive officer of AIG, *AIG: Where is the Taxpayer Money Going?,* 111th Cong. (May 13, 2009) (online at oversight.house.gov/images/stories/documents/20090512165421.pdf).

[355] House Committee on Financial Services, Testimony of Ben S. Bernanke, chairman of the Board of Governors of the Federal Reserve System, *Oversight of the Federal Government's Intervention at American International Group*, 111th Cong., at 4 (Mar. 24, 2009).

[356] *Id.*

sistance. Since September 2008, the company has been focused on executing an asset disposition plan, preserving and enhancing the value of key business operations, and placing the company on a path toward future profitability.[357] AIG Chief Executive Officer Robert Benmosche states that his immediate concerns are to restore stability and profitability to the company.[358] At a town hall-style meeting for company employees held in August 2009, Mr. Benmosche stated that the company plans to rebuild businesses and will not be pressured by the federal government into selling assets at "unfavorable prices."[359] AIG owes "the U.S. government a lot of money and we are not going to be able to pay it back just by our profits," he said, and, AIG "will sell some of the company off but only at the right time at the right price."[360] With respect to the winding down of AIG Financial Products (AIGFP), the business unit whose derivative trades in part brought AIG to the brink of collapse, Mr. Benmosche has emphasized maximizing asset values rather than selling the assets with speed.[361] Furthermore, Mr. Benmosche has postponed planned sales of an investment-advisory unit and AIG's two Japanese life insurance companies, in order to build value in those assets. While the restructuring is still taking place, Mr. Benmosche's recent statements suggest that AIG is moving away from the path set by former Chief Executive Officer Edward Liddy, who planned to sell off units last year before they lost value, but then delayed those plans as deteriorating economic conditions interfered with the company's ability to engage in such sales. In AIG's view, the company has stabilized significantly from where it was a year ago, and even six months ago.[362] AIG management also believes that the current amount of U.S. government assistance is "sufficient for the restructuring process."[363]

The Trust Shares will be disposed of separately. They are held in a trust for the benefit of the United States Treasury, overseen by three independent trustees.[364] Pursuant to the terms of the Credit Facility Trust Agreement, the trustees are responsible for managing the equity stake in matters such as voting and for establishing a plan to dispose of the shares over time, but must refrain

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[357] AIG conversations with Panel staff (Dec. 11, 2009). See also American International Group, *AIG Reports Third Quarter 2009 Results* (Nov. 6, 2009) (online at www.aigcorporate.com/investors/2009_November/AIG%203Q09%20Press%20Release.pdf) (hereinafter "AIG Reports Third Quarter 2009 Results") (highlighting the progress AIG has made in its restructuring efforts). AIG's restructuring plan has four key goals:

(1) Creation of strong, more independent insurance businesses worthy of investor confidence to stabilize and protect the value of AIG's important franchise businesses.

(2) Divestment of assets and implementation of restructuring program to enable repayment of loans made by the U.S. government.

(3) Comprehensive review of AIG's cost structure to significantly reduce operating costs.

(4) Wind-down of AIG's exposure to certain financial products and derivatives trading activities to reduce excessive risk.

American International Group, Inc., *The Restructuring Plan* (online at www.aigcorporate.com/restructuring/index.html) (accessed Jan. 13, 2010).

[358] Hugh Son and Boris Cerni, *Benmosche Says He'll Rebuild Units to Repay U.S.*, Bloomberg (Aug. 20, 2009) (online at www.bloomberg.com/apps/news?pid=20601087&sid=aMclXyXbD2HA).

[359] *Id.*

[360] *Id.*

[361] *Id.;* AIG conversations with Panel staff (Dec. 11, 2009).

[362] AIG conversations with Panel staff (Dec. 11, 2009).

[363] AIG conversations with Panel staff (Dec. 11, 2009).

[364] The three independent trustees are Jill M. Considine, former chairman of the Depository Trust & Clearing Corporation; Chester B. Feldberg, former chairman of Barclays Americas; and Douglas L. Foshee, president and chief executive officer of El Paso Corporation. The Treasury Department has no control over the trust and cannot direct the trustees.

from interfering in the day-to-day management of the company.[365] The Credit Facility Trust Agreement provides that the trustees must act "in or not opposed to the best interests of Treasury."[366] The Credit Facility Trust Agreement further stipulates that the trustees cannot be Treasury or FRBNY employees.

The articulated justification for establishing a trust was to avoid conflicts of interest. The Credit Facility Trust Agreement provides, "to avoid any possible conflict with its supervisory and monetary policy functions, FRBNY does not intend to exercise any discretion or control over the voting and consent rights associated with the Trust Stock."[367] In exercising their discretion under the Credit Facility Trust Agreement, the trustees are advised, however, that FRBNY believes that AIG "being managed in a manner that will not disrupt financial market conditions, [is] consistent with maximizing the value of the Trust Stock."[368] Any proceeds from the ultimate sale of the Trust Shares will go directly to the U.S. Treasury.

While a trust structure does provide some important benefits and value, the Panel notes that there have been various criticisms raised about the AIG trust structure. As the Panel noted in its September Oversight Report, Professor J.W. Verret articulated three criticisms of the AIG trust structure in his May 2009 testimony before the House Oversight and Government Reform Committee.[369] First, he discussed how the AIG trustees are required to "manage the trust in the best interests of Treasury, rather than the U.S. taxpayers specifically."[370] Second, he believes that the trust should require the trustees to act to maximize the value for the trust beneficiaries.[371] Third, Professor Verret raised concerns that the Trust Agreement might allow trustees to benefit personally from investment opportunities that belong to AIG.[372] Some members of Congress have also raised concerns about the AIG trust structure. Representatives Darrell Issa (R–CA) and Spencer Bachus (R–AL) have sent letters to Treasury and SIGTARP calling for an audit of the AIG trust and setting out criticisms of the trust structure, including the "lack of standard fiduciary duties," the Trust's "broad

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[365] AIG Credit Facility Trust Agreement, *supra* note 313.

[366] AIG Credit Facility Trust Agreement, *supra* note 313. Note that the trust is for the benefit of the United States Treasury, not the United States Department of the Treasury. The AIG Credit Facility Trust Agreement uses both terms without explaining the distinction, leaving some question as to whether the Treasury Department is the trust's beneficiary. As noted above, the Agreement stipulates that "any property distributable to Treasury as beneficiary hereunder shall be paid to Treasury for deposit into the General Fund as miscellaneous receipts." *Id.* at § 1.01.

[367] AIG Credit Facility Trust Agreement, *supra* note 313; Dudley Testimony before House Financial Services Committee, *supra* note 346 (stating that "[i]n light of the inherent conflicts that would arise from either the U.S. government or the Federal Reserve exerting ownership control over the world's largest insurer, the Federal Reserve, with the support of the Treasury Department, directed in the loan agreement that an approximately 79.9 percent equity interest in AIG be issued to an independent trust established for the sole benefit of the United States Treasury").

[368] AIG Credit Facility Trust Agreement, *supra* note 313, at 2.0.

[369] House Oversight and Government Reform Committee, Testimony of Professor J.W. Verret, *Panel II: AIG: Where is the Taxpayer's Money Going?* (May 13, 2009) (online at oversight.house.gov/images/stories/documents/20090512175538.pdf) (hereinafter "Verret Testimony before House Oversight and Government Reform Committee"). Professor Verret is an assistant professor of law at George Mason University, and a senior scholar with the Mercatus Center. He has also served as a consultant for SIGTARP and the GAO on a corporate governance audit for TARP-recipient institutions.

[370] *Id.*

[371] *Id.*

[372] *Id.*

indemnification of the actions of the trustees," and lack of accountability on the part of the trustees.[373] Congressman Gerry Connolly (D–VA) has expressed some concern that the AIG trustees are not independent enough from the Federal Reserve, and do not have enough power relative to the Federal Reserve in exercising their duties.[374] Furthermore, Congressman Edolphus Towns (D–NY), chairman of the House Committee on Oversight and Government Reform, and Congressman John Tierney (D–MA), have both expressed concerns about the actual level of power the trustees have over AIG decisions, the degree of transparency and accountability their decisions have, and the overall lack of clarity as to what role they play.[375]

For its part, the GAO has noted that any trust raises some important efficiency and management concerns since the structure takes control of the investment out of the government's hands substantially and requires the trustees to "develop their own mechanisms to monitor the investments and analyze the data needed to assess the financial condition of the institutions or companies and decide when to divest."[376]

Additionally, tensions have arisen between AIG, trustees, and other government regulators, despite the existence of a trust.[377] Recent press reports indicating that one of the AIG trustees was contemplating whether to resign suggest the potential conflicts between trustees and other government regulators (e.g., the special master for compensation) that can arise even when a trust structure is used.

c. Analysis of Intended Exit Strategy

Earlier this year, no real exit strategy was apparent with respect to AIG. At the Panel's hearing on April 21, 2009, Secretary Geithner was unable to explain clearly the Administration's exit strategy.[378] Secretary Geithner could only point to the fact that the federal government "came into this financial crisis without a legal framework that allowed it to intervene and manage more effec-

[373] Letter from Representatives Spencer Bachus and Darrell Issa to Neil Barofsky (Aug. 31, 2009); *see also* Letter from Representatives Spencer Bachus and Darrell Issa to Secretary Timothy F. Geithner (Aug. 31, 2009).

[374] *See* House Committee on Oversight and Government Reform, Transcript Statement of Representative Connolly, *AIG: Where is the Taxpayer Money Going?,* 111th Cong. (May 13, 2009) (questioning the distinction between the role of the trustees and "those members of the Federal Reserve who sit in on" every board and committee meeting).

[375] *See* House Committee on Oversight and Government Reform, Transcript Statement of Chairman Towns, *AIG: Where is the Taxpayer Money Going?,* 111th Cong. (May 13, 2009) (stating "I'm just thinking that if you are trustees of a company that has set a record in losses, it seems to me you should have something to say—should put something somewhere. I mean, if not, you should feel extremely guilty" and also commenting that "it's not clear to me and other members here exactly what you do in terms of your role that you're playing in this"); House Committee on Oversight and Government Reform, Transcript Statement of Representative Tierney, *AIG: Where is the Taxpayer Money Going?,* 111th Cong. (May 13, 2009).

[376] U.S. Government Accountability Office, *Troubled Asset Relief Program: Status of Government Assistance Provided to AIG,* GAO–09–975, at 18 (September 2009) (online at www.gao.gov/new.items/d09975.pdf) (hereinafter "GAO Report on AIG").

[377] In recent weeks, AIG has seen the departures of some of its senior management, including its vice chairman for legal, human resources, corporate affairs, and corporate communications, and its chief compliance and regulatory officer. These employees resigned due to the reduction in base salary that was mandated by Special Master for Compensation Kenneth Feinberg.

[378] Congressional Oversight Panel, Testimony of Treasury Secretary Timothy F. Geithner (Apr. 21, 2009) (online at cop.senate.gov/documents/transcript-042109-geithner.pdf) (in response to question from Rep. Hensarling).

tively the risk posed by institutions like AIG . . . We still do not have that authority today."

While the legal framework necessary for proper resolution of a large failing financial institution still does not exist, improvements in market conditions have allowed Treasury to better articulate an exit strategy for AIG. Treasury's intent to balance taxpayer return, institutional stability and systemic stability, however, tips in favor of institutional and systemic stability, which at present are very much the same thing. Treasury believes that AIG still represents a significant systemic weakness and would be given non-investment credit ratings by the rating agencies without government support, and any exit strategy is constrained by that fact.[379] Additionally, changing circumstances mean that Treasury's exit strategy has to be adjusted on a continuous basis. While the initial plan by the Federal Reserve and Treasury was to sell off certain divisions of AIG quickly, Treasury and the Federal Reserve indicated in their March announcement that deteriorating economic conditions (and the difficulty of obtaining reasonable prices) had interfered with that objective. Their goal became reducing the size of AIG by disposing of assets once the market improves.[380] AIG has had mixed success in some of its restructuring plans, such as separating and strengthening core insurance businesses, divesting assets, reducing operating expenses, and winding down its exposure to certain financial products and derivatives trading activities in order to reduce risk. Given the complexity and extensiveness of AIG's restructuring, however, this is a process that will take several years.[381] Even some critics of the AIG bailout recognize that the U.S. government cannot end its assistance to AIG anytime soon because of the size of its assistance as well as continued economic uncertainty.[382]

With respect to timing, as with most TARP-related investments, the U.S. government has stated that it would like AIG to repay its federal assistance "as soon as practicable" (and AIG has also indicated a desire to do so as soon as possible),[383] but it seems likely that a complete disposition of Treasury's holdings in AIG will occur over several years, especially in light of the size of its stake as well as its objective to achieve "full repayment" of the government assistance that AIG has received.[384] The Panel notes that the AIG

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[379] Treasury conversations with Panel staff (Dec. 1, 2009).

[380] AIG Restructuring Plan Announcement, *supra* note 311; Participation in AIG Restructuring Plan Announcement, *supra* note 319.

[381] *See* AIG Reports Third Quarter 2009 Results, *supra* note 357 (noting that AIG's wind-down has slowed as the company expects to accomplish its restructuring plan "over a longer time frame than originally contemplated"); Treasury conversations with Panel staff (Dec. 3, 2009); Treasury conversations with Panel staff (Dec. 16, 2009).

[382] Professor Charles Calomiris, Henry Kaufman Professor of Financial Institutions at Columbia Business School, made the following statement with respect to AIG on an NPR radio broadcast in March 2009: "I've made most of my career talking about the dangers of rewarding failure in financial institutions. So it's especially ironic that I'm here on your program telling people that right now, that isn't the right answer. Yes, it doesn't feel very good, it creates bad incentives, too. . . . But right now, we have to also deal with what the cards that were dealt. And the cards that we're dealt is a financial system, the brain center of the economy, that's desperately in need of propping up. And if we don't prop it up, we're the ones who are going to not get credit. We're the ones who are going to suffer the consequences of a very depressed economy for a very long time. We're the ones who are going to lose our jobs, our homes and our retirement savings." Interview with Charles Calomiris, *Talk of the Nation,* NPR radio broadcast (Mar. 17, 2009) (online at www.npr.org/templates/transcript/transcript.php?storyId=102006900).

[383] AIG conversations with Panel staff (Dec. 11, 2009).

[384] Dudley Testimony before House Financial Services Committee, *supra* note 346, at 2. However, even Treasury believes that achieving this goal is doubtful, as its recently published finan-

intervention is somewhat unique in that it involves both Treasury and FRBNY, meaning that the actions of both Treasury and FRBNY have an impact on what the U.S. government holds and what steps might be taken in the future.

A "buy-and-hold" strategy, which appears to be the objective of Treasury and the Federal Reserve, has several advantages. First, a satisfactory return on collateralized debt obligations (CDOs) and residential mortgage-backed securities (RMBS) purchased by Maiden Lane II LLC and Maiden Lane III LLC will likely take time, given the current difficulties in obtaining reasonable prices for these types of assets.[385] Second, a long-term approach may increase AIG's ability to repay its obligations to the federal government as economic conditions continue to improve. "The slower approach to restructuring could help AIG to generate more favorable values from its business portfolio than would be the case under rushed asset sales," Moody's Investors Service has noted.[386] Third, Mr. Benmosche has cautioned that corporate earnings will likely remain subject to "continued volatility" as the company continues its restructuring process. In early March 2009, AIG announced a loss of $61.7 billion for the fourth quarter of 2008, the largest quarterly corporate loss in U.S. history. AIG only recently posted a second consecutive quarterly profit. Since AIG continues to rely heavily on the federal government for liquidity and capital, it is still too early to know whether this recent trend in earnings will continue.

While Treasury might consider selling now and realizing a loss or pursuing an orderly liquidation of AIG's businesses outside the bankruptcy process, Treasury indicated that such options do not seem feasible or practical given the company's substantial connections to various parts of the insurance and financial products sectors.[387] First, the value of the taxpayers' investment in AIG would be jeopardized substantially in a liquidation, since Treasury would receive little or no value on its preferred securities holdings; moreover, market confidence could be shaken by any such action by Treasury.[388] Second, Treasury discussed how it reached a mutual agreement with the Federal Reserve to assist AIG under a unique set of circumstances, largely due to the systemic risk concerns created by the company's substantial size and exposure to various sectors of the financial markets, including insurance and credit default swaps (CDS) and derivatives.[389] In conversations with Panel staff, Treasury staff emphasized that its exit from AIG is constrained by the impact of credit rating agency downgrades, which would trigger the posting of additional collateral.[390]

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cial statements show Treasury's estimate of the expected loss from TARP AIGIP investments in AIG. See Section D.6, *infra*.

[385] The Federal Reserve Bank of New York stated that this equity interest "has the potential to provide a substantial financial return to the American people should the $85 billion loan, as anticipated, provide AIG with the intended breathing room to execute a value-maximizing strategic plan." Federal Reserve Bank of New York, *Statement by the Federal Reserve Bank of New York Regarding AIG Transaction* (Sept. 29, 2008) (online at www.newyorkfed.org/newsevents/news/markets/2008/an080929.html).

[386] Moody's sees AIG holding its ground through 3Q09, *supra* note 343.

[387] Treasury conversations with Panel staff (Dec. 16, 2009).

[388] *Id.*

[389] *Id.*; Treasury conversations with Panel staff (Dec. 3, 2009).

[390] AIG entered into credit-default swaps with counterparties who were authorized to require AIGFP to post collateral upon the occurrence of certain events relating to the underlying CDOs, including declines in market value as well as credit rating downgrades. Treasury conversations

Continued

While most of the initial focus in the AIG intervention was on the AIGFP transactions, Treasury points out that the intervention was also driven by the positions of AIG's insurance companies.[391] Four major subsidiaries are consolidated with AIG. While each is functionally regulated by the states where it is licensed, and each state imposes its own capital requirements, Treasury noted that the subsidiaries' viability and performance are subject to the capacity to maintain investment-grade credit. To some, the notion that several insurance players could cause the system to be destabilized substantially seems unlikely, given that insurance underwriters and agencies have gotten into trouble many times before, and no major crisis has resulted. Panel staff pressed this issue with Treasury, and Treasury's response underscores how the entirety of its exit strategy with respect to AIG is based on the reaction of the credit rating agencies.[392] In Treasury's view, if the government does anything to cause a substantial credit downgrade for the AIG parent, it would result in an unraveling of the business of its subsidiaries. AIG has made efforts to sell two of its insurance subsidiaries (American International Assurance Company Ltd. (AIA), and American Life Insurance Company (ALICO)) in order to create some independence from the parent and AIGFP.[393] The credit rating agencies have indicated that if AIG were to sell off the remaining two insurance subsidiaries, such actions would substantially affect AIG's ongoing business and thereby trigger further downgrades,[394] unless the proceeds of the sales would be sufficient to pay off all of the company's debt, which is not likely.[395] While a downgrade of a parent does not necessarily result in the downgrade of a well-capitalized subsidiary, A.M. Best, a leading credit rating agency for the insurance industry, indicated to Treasury that if the parent is no longer rated investment grade, it would be very difficult to maintain an investment grade rating on a subsidiary.[396] While policyholders would likely be protected in the event of a downgrade, Treasury noted that, given that there are 130 million AIG life insurance policyholders, there would be significant interruption in the flow of insurance claim payments as a result of any such downgrade, at least for some time.[397] This would result in a

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with Panel staff (Dec. 3, 2009). A significant portion of AIGFP's Guaranteed Investment Agreements (GIAs), structured financing arrangements and financial derivative transactions included provisions that required AIGFP, "upon a downgrade of AIG's long-term debt ratings, to post collateral or, with the consent of the counterparties, assign or repay its positions or arrange a substitute guarantee of its obligations by an obligor with higher debt ratings." American International Group, *2008 Annual Report, Form 10–K,* Item 7 (online at www.aigcorporate.com/investors/annualreports_proxy.html). In addition, certain downgrades of AIG's long-term senior debt ratings (resulting from various default events, including bankruptcy due to dissolution, insolvency, appointment of a conservator, etc.) would permit either AIG or the counterparties to elect early termination of contracts. *See* 1992 ISDA section 5. (Treasury confirmed that AIG had contracts with this type of wording.)

[391] Treasury conversations with Panel staff (Dec. 16, 2009); Treasury conversations with Panel staff (Dec. 3, 2009).

[392] Treasury conversations with Panel staff (Jan. 5, 2010).

[393] Treasury conversations with Panel staff (Jan. 5, 2010). As discussed in Note 312, AIG recently decided to have a public stock offering for AIA on the Hong Kong stock exchange (which might raise as much as $20 billion).

[394] According to Treasury, such downgrades would also trigger the remaining AIGFP debt, resulting in the need to post more collateral as counterparties would terminate the Guaranteed Investment Agreements (GIAs), structured financing arrangements and financial derivative transactions.

[395] Treasury conversations with Panel staff (Jan. 5, 2010).

[396] Treasury conversations with Panel staff (Jan. 5, 2010).

[397] Treasury conversations with Panel staff (Dec. 3, 2009).

"loss of confidence among policyholders," and a possible run in the insurance industry, similar to a bank run.[398]

Furthermore, AIG remains exposed to financial products, including over $1 trillion notional value of credit-default swaps and other derivatives, according to Treasury.[399] As a result of this exposure, any credit rating downgrade would, in Treasury's view, cause serious destabilization and volatility in those markets, as counterparties liquidated their contracts and asserted their claims.[400] Additionally, Treasury noted that such circumstances could result in real discontinuity in pricing, and not just among the counterparties.[401] The Panel notes, however, that many of these contracts are partially canceling, so AIG's *net* notional exposure is much smaller than the notional value articulated by Treasury. According to the Depository Trust & Clearing Corporation, AIG's CDS gross notional outstanding and net notional outstanding were $82.4 billion and $7.4 billion, respectively, as of December 31, 2009.[402] The gross notional outstanding represents the aggregate dollar value exposure on all CDS contracts. The net notional outstanding, however, represents the maximum funds that would be transferred on outstanding credit default swaps from net sellers to net buyers were a credit event to occur on December 31, 2009.

In some ways, it is difficult to assess the progress that AIG itself is making towards restructuring because recent changes in senior management have altered the company's direction. *The Economist* has characterized AIG's strategy as "oscillat[ing] between retrenchment and rebirth, depending on who is in charge on any given day."[403] Based upon the available information, however, it seems that AIG's revised restructuring strategy, as articulated by Mr. Benmosche, has resulted in some progress in the company's path toward stabilizing and repaying at least part of its government assistance. In his recent testimony before the Panel, Secretary Geithner discussed how the company's new board and management are "working very hard and effectively" at strengthening AIG's core insurance business while reducing the AIGFP portfolio.[404]

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[398] Agency Financial Statement 2009, *supra* note 32.

[399] Treasury conversations with Panel staff (Dec. 3, 2009); Treasury conversations with Panel staff (Dec. 16, 2009).

[400] Treasury conversations with Panel staff (Dec. 3, 2009).

[401] Treasury conversations with Panel staff (Dec. 3, 2009).

[402] *See* The Depository Trust & Clearing Corporation, *Trade Information Warehouse Credit Derivatives Data Report, Table 6: Top 1000 Reference Entities (Gross and Net Notional) for the Week ending: 2010–01–01* (www.dtcc.com/products/derivserv/data_table_i.php?id=table6_current) (accessed Jan. 6, 2010). AIG's CDS notional outstanding figures include the CDS gross and net notional outstanding for American General Finance Corp. and International Lease Finance Corp., both of whom are subsidiaries of AIG Capital Corp., a subsidiary of AIG. The CDS securities for American General Finance Corp. and International Lease Finance Corp. trade under their own unique CDS tickers but are underneath the corporate AIG, Inc. umbrella and, therefore, represent CDS exposure for AIG, Inc. The CDS gross notional outstanding and net notional outstanding for these two subsidiaries comprise $38.3 billion and $3.5 billion of the total gross and net notional outstanding for AIG, Inc.

[403] *The Living Dead*, The Economist (Nov. 5, 2009) (online at www.economist.com/opinion/displaystory.cfm?story_id=14803171) (arguing that AIG is the "biggest financial zombie of all").

[404] Agency Financial Statement 2009, *supra* note 32.

FIGURE 12: NET INCOME/(LOSS) ATTRIBUTABLE TO AIG

[Dollars in millions]

	Q1 2008	Q2 2008	Q3 2008	Q4 2008	Q1 2009	Q2 2009	Q3 2009
Net Income/(Loss)	$(7,805)	$(5,357)	$(24,468)	$(61,659)	$(4,353)	$1,822	$455

As noted above and shown in Figure 12, AIG has now posted two consecutive quarterly profits. These earnings results prompted Moody's to maintain its credit ratings on AIG in early November 2009 after concluding that the company should be able to repay its Federal Reserve loans and "much or all" of Treasury's TARP investments if financial markets continue to stabilize.[405] In discussing the profits, AIG management highlights the company's retention of existing customers as well as its ability to attract new customers.[406] Through October 31, 2009, AIG had entered into agreements to sell or complete the sale of operations and assets that are expected to generate roughly $5.6 billion in proceeds that will, upon closing, be used to repay outstanding borrowings and reduce the amount of the FRBNY revolving credit facility.[407] There are also some indications that AIG has garnered success in selling fixed annuities to bank customers and that more insurance customers are keeping their policies with AIG, both of which might provide some positive news for the company's future. On the other hand, the Panel cannot determine if this is due to good business practices, or simply a result of government involvement. This uncertainty emphasizes once again the difficulty the U.S. government faces in backing out of this involvement.

The Panel notes, however, that it is still too early to reach conclusions about the effectiveness of AIG's restructuring, and that the company continues to face steep obstacles in its restructuring efforts and path toward profitability. AIG's restructuring plan still relies heavily on government assistance, and it will take more than two profitable earnings quarters for the company to stabilize and be able to repay the entirety of its government support. As the GAO noted recently, "[t]he sustainability of any positive trends of AIG's operations and repayment efforts is not yet clear. The government's ability to recoup the federal assistance money depends on the "long-term health of AIG, its sales of certain businesses, and the maturation or sales of assets in the Maiden Lanes, among other factors."[408] In a recent interview, Mr. Benmosche stated that the company remains too large and unwieldy. "I feel strongly that AIG is too big today—it is extremely complex to manage and we need to make sure it's more transparent, that it's smaller, and that we can make it on our own," he said.[409] As noted above, AIG has made some preliminary progress with respect to its commitment to split off two sizeable foreign life insurance units, which it said previously would be broken off before the end of 2009. AIG's assets,

[405] *See* Moody's sees AIG holding its ground through 3Q09, *supra* note 343.

[406] AIG conversations with Panel staff (Dec. 11, 2009).

[407] AIG Reports Third Quarter 2009 Results, *supra* note 357; American International Group, *SEC Form 10–Q, Third Quarter 2009* (online at www.aigcorporate.com/investors/2009_November/2517447_17501T04_CNB.pdf) (hereinafter "AIG SEC Form 10–Q").

[408] GAO Report on AIG, *supra* note 376, at 51.

[409] Serena Ng, *AIG Chief: Key Staff Suffer Financially*, Wall Street Journal (Dec. 15, 2009) (online at online.wsj.com/article/SB10001424052748703954904574596501071391332.html).

many of which are derivative contracts tied to mortgage debt, could again lose value, or the company could be forced to take losses as it sells them off. Another issue of some concern is AIG's ability to refinance debt obligations as they come due in coming years. The AIG parent company and two of its business units face significant maturities in the near term,[410] and whether AIG has the capacity to refinance these debt obligations remains to be seen. As it writes down the value of sold-off assets, AIG's ability to achieve a long run of profitable quarters will be impacted. For example, as a result of its recently completed debt-for-equity swap involving its two life insurance subsidiaries with FRBNY, AIG will take a $5.7 billion restructuring charge in the fourth quarter of 2009, which will likely offset any profits AIG has made in this same period. It is also unclear at this time whether and to what extent AIG will be able to access the capital markets, a necessary step before it can repay its AIGIP/SSFI assistance, and whether AIG will be able to maintain its single "A" credit rating or face further downgrades. In addition, much of the recent improvement in AIG's financial condition can be reasonably attributed to the substantial Treasury and Federal Reserve assistance that AIG has received since late 2008.[411]

The most troublesome part of AIG remains AIGFP.[412] As of September 30, 2009, the notional amount of the AIGFP derivatives portfolio had been reduced by 28 percent from December 2008, with a 13 percent reduction in the third quarter of 2009 alone, but Maiden Lane III had not eliminated AIGFP's exposure to credit default swaps.[413] In discussions with Panel staff, Treasury expressed confidence that the entire AIGFP will be unwound by the end of 2010.[414] However, a recent AIG filing with the SEC suggests that it remains unclear whether AIG will need to post additional collateral if credit markets experience continued deterioration and, hence, whether it will be exposed to further losses as well as risks for a much longer period of time.[415] Given the continued economic uncertainty, AIGFP is unable to predict accurately when it will be able to retire its credit default swap portfolio in full.

The Panel notes the steps the government has taken to address AIG's systemic risk concerns and prevent it from facing imminent collapse again, including a significant amount of information shar-

[410] American International Group, *2008 Annual Report, Form 10–K*, at 274–75 (online at phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9Mjg0NHxDaGlsZElEPS0xfFR5cGU9Mw==&t=1) (detailing aggregate annual maturities of long-term debt obligations (based on final maturity dates); AIG conversations with Panel staff (Dec. 16, 2009).

[411] *See* Moody's sees AIG holding its ground through 3Q09, *supra* note 343; AIG shows signs of stabilization but risks remain, *supra* note 343 (noting that the U.S. government has continued to serve as AIG's primary liquidity and capital source and that the "restructuring plan still relies heavily on government support." In addition, Moody's Investors Service emphasizes that its current ratings on AIG "reflect [its] understanding that the government is committed to working with the firm to maintain its ability to meet obligations as they come due throughout the restructuring process"); *see also* GAO Report on AIG, *supra* note 376, at 43–51.

[412] The Panel notes that SIGTARP issued a recent audit discussing the government's intervention in AIG and the controversy over AIG counterparty payments and why they were paid at par value. See SIGTARP, *Audit: Factors Affecting Efforts to Limit Payments to AIG Counterparties*, at 25 (Nov. 17, 2009) (online at www.sigtarp.gov/reports/audit/2009/Factors_Affecting_Efforts_to_Limit_Payments_to_AIG_Counterparties.pdf).

[413] *See* AIG Reports Third Quarter 2009 Results, *supra* note 357; *see also* AIG SEC Form 10–Q, *supra* note 407.

[414] Treasury conversations with Panel staff (Dec. 16, 2009); Allison Testimony before House Oversight and Government Reform Committee, *supra* note 118, at 11.

[415] *See* AIG SEC Form 10–Q, *supra* note 407.

ing between Treasury and FRBNY personnel with respect to the monitoring of AIG's restructuring process.[416] These steps by themselves do not mean, however, that the government's exit will come quickly or that the decision to intervene in AIG will prove to be a profitable one. As discussed above, there are significant obstacles to the company's restructuring process, and Treasury's most recent estimates are that some significant portion of those funds will never be recovered.[417] Treasury appears not, however, to have been seeking to maximize profits in this intervention.[418]

Treasury and the Federal Reserve have taken extraordinary steps to keep AIG from facing bankruptcy. As discussed above, the government's exit strategy has to be adjusted on a continuous basis due to changing circumstances, meaning that AIG's restructuring is an iterative process. While neither AIG management nor Treasury believes that additional assistance is necessary at this time, Treasury and FRBNY continue to monitor the company's restructuring process and financial condition closely.[419] Treasury remains cognizant of the fact, however, that it will be difficult for the company "to prosper under [the U.S. government's] majority ownership," and Treasury expressed the view that the U.S. government would rather make an orderly exit out of AIG "than [make] a lot of money on it."[420]

7. Chrysler and GM

a. Acquisition of Assets and Current Value

The government's holdings in Chrysler and General Motors (GM) derive from a sequence of events that started in late 2008, described more fully in the Panel's September report.[421] Facing a crippling lack of access to the credit markets due to the global financial crisis, Chrysler and GM appealed to Congress for assistance. The government eventually provided assistance under a new TARP initiative, the Automobile Industry Financing Program (AIFP). Chrysler and GM received bridge loans of $4 billion and $19.4 billion,[422] respectively.[423]

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[416] Treasury conversations with Panel staff (Dec. 16, 2009).

[417] In its recently issued TARP financial statements for the year ended September 30, 2009, Treasury noted that the prospect for full repayment from the AIGP is doubtful. Unlike its banking investments, for which it expects to make money, Treasury does not have the same level of confidence with respect to its efforts to stabilize AIG. As of September 30, 2009, Treasury reports that AIGIP will result in a net cost to the taxpayers of $30.427 billion. As Secretary Geithner stated in his recent testimony before the Panel, "[t]here is a significant likelihood we will not be repaid from our investments in AIG." COP December Geithner Hearing Transcript, *supra* note 210. Assistant Secretary Allison confirmed the likelihood of losses on AIG, "[b]ased on current valuations," in his recent testimony before the House Oversight and Government Reform Committee. Allison Testimony Transcript, *supra* note 135.

[418] Treasury conversations with Panel staff (Dec. 16, 2009).

[419] Treasury conversations with Panel staff (Dec. 16, 2009); AIG conversations with Panel staff (Dec. 11, 2009); Allison Testimony Transcript, *supra* note 135 (noting that Treasury "believe[s] that the investments [it] made should be adequate").

[420] Treasury conversations with Panel staff (Dec. 16, 2009); *see also* Allison Testimony Transcript, *supra* note 135 (noting that "[t]he TARP investments were not made to make money but to help avert a collapse of our financial system").

[421] *See* COP September Oversight Report *supra* note 108, at 7–23.

[422] Treasury invested an initial amount of $13.4 billion in December 2008, and had loaned an additional $6 billion to GM by June 2009. *See* Agency Financial Statement 2009, *supra* note 32, at 34.

[423] For the terms of the loans, *see generally* 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) (hereinafter "Loan and Security Agreement [GM]"); U.S. Department of the Treasury, Loan and Security Agreement [Chrysler]

The loans were extended to Chrysler and GM under terms and conditions specified in separate loan and security agreements. Under the initial agreements, the Bush Administration required each company to demonstrate its ability to achieve "financial viability," which was defined as "positive net value, taking into account all current and future costs," and the ability to "fully repay the government loan." [424] In February 2009, both companies submitted plans for achieving financial viability, which were reviewed by officials in the Administration.

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.[425] The Administration concluded that GM's financial viability plan relied on overly optimistic assumptions about the company and future economic developments.[426]

Ultimately, both companies entered bankruptcy and, with debtor-in-possession financing provided by the federal government,[427] underwent significant restructuring. In the GM bankruptcy, some of the debt owed to the U.S. government was converted into equity. All told, U.S. taxpayers expended $49.9 billion of TARP funds in conjunction with GM's bankruptcy and the subsequent creation of what is called New GM.[428] The Chrysler transactions expended $12.8 billion of TARP funding. Today, the U.S. government owns:

- 10 percent of the common equity of Chrysler;
- $7.1 billion in debt securities of Chrysler; [429]
- 60.8 percent of the common equity of GM;
- $5.7 billion in debt securities of GM; [430] and
- $2.1 billion in GM preferred stock, paying a dividend of nine percent.[431]

The following table shows the government's current holdings and the amounts expended to acquire those holdings:

(Dec. 31, 2008) (online at www.financialstability.gov/docs/agreements/Chysler__12312008.pdf) (hereinafter "Loan and Security Agreement [Chrysler]").

[424] 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.

[425] 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).

[426] 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).

[427] Treasury provided a total of $8.5 billion in working capital and exit financing to facilitate Chrysler's Chapter 11 restructuring. U.S. Department of the Treasury, *AIFP Outlays for COP* (Aug. 18, 2009). It provided a total of approximately $30.1 billion of financing to support GM's Chapter 11 restructuring. *See also* Allison Testimony before House Oversight and Government Reform Committee, *supra* note 118, at 4.

[428] COP September Oversight Report, *supra* note 108, at 54.

[429] The $7.1 billion debt security consists of a $6.6 billion new commitment and $0.5 billion in assumed debt. As of December 31, 2009, Chrysler has drawn approximately $4.6 billion. *See* Agency Financial Statement 2009, *supra* note 32, at 35.

[430] As of December 31, 2009, the outstanding principal balance is $5.7 billion. *See* Agency Financial Statement 2009, *supra* note 32, at 34; *see also* U.S. Department of the Treasury, *Treasury Receives First Quarterly Repayment from General Motors* (Dec. 18, 2009) (online at treasury.gov/press/releases/tg456.htm) (hereinafter "Treasury Receives First Quarterly Repayment from GM").

[431] Agency Financial Statement 2009, *supra* note 32, at 34–35; *see also* Allison Testimony before House Oversight and Government Reform Committee, *supra* note 118, at 5.

FIGURE 13: GOVERNMENT HOLDINGS IN CHRYSLER AND GM [432]

Asset	Number/Principal Amount [433]	Acquisition Cost	Aggregate Value as of 9/30/09
Chrysler:			
Common Stock (Class A)	[434] 96,461		
Floating Rate Notes	[435] $7,142,000,000		
Total		[436] $12,810,284,222	
GM:			
Preferred Stock	[434 437] 3,898,305		
Common Stock	[434 438] 304,131,356		
Floating Rate Notes	$5,711,864,407		
Total		[439] $49,860,624,198	
Total for All Assets			[440] 42,300,000,000

[432] In December 2009, SIGTARP released a report on the use of TARP funds for GM, Chrysler, GMAC, Chrysler Financial Services, the Hartford Financial Services Group and Lincoln National Corporation. According to the report, GM used the $49.5 billion it received to pay operating costs, aid in the wind-down of old GM, settle derivative positions, fund foreign subsidiaries, and provide a loan to GM Canada. By November 18, 2009, Chrysler had used $10.5 billion of the total $12.5 billion in Treasury funds, primarily for operating costs. *See* SIGTARP, *Additional Insight on Use of Troubled Asset Relief Program Funds,* at 5–6 (Dec. 10, 2009) (online at www.sigtarp.gov/reports/audit/2009/Additional_Insight_on_Use_of_Troubled_Asset_Relief_Program_Funds.pdf). In addition, also in December 2009, the OFS released the Agency Financial Report for the year ending September 30, 2009. The report discusses the automotive industry financing program and associated programs, as well as the valuation methodology that OFS uses to account for the investments. *See* Agency Financial Statement 2009, *supra* note 32, at 33–36 and 53.
[433] This table only lists the government's holdings in Chrysler Group LLC and General Motors Holdings LLC, the ''new'' car companies as detailed in the Panel's September report. *See* COP September Oversight Report, *supra* note 108, at 60–63. The government also holds claims in Chrysler Holding LLC and Motors Liquidation Company, the ''old'' car companies, which are currently in the process of being liquidated in bankruptcy. *See* TARP Transactions Report for Period Ending December 30, 2009, *supra* note 166. These claims will be administered by the bankruptcy court and it is unlikely that the government will be repaid. *See* COP September Oversight Report, *supra* note 108.
[434] Treasury conversations with Panel Staff (Dec. 3, 2009). This number represents numbers of shares of stock, rather than dollar values.
[435] The $7.1 billion amount consists of a $6.6 billion new commitment and $0.5 billion in assumed debt. As of December 31, 2009, Chrysler has drawn approximately $4.6 billion. *See* Agency Financial Statement 2009, *supra* note 32, at 35.
[436] This figure represents the total amount of funds provided to Chrysler through the AIFP. It does not reflect the $280 million repayment made by Chrysler on July 10, 2009 or the $2.4 billion in Treasury commitments to Chrysler that were unused and de-obligated. *See* COP September Oversight Report, *supra* note 108, at 60.
[437] Treasury conversations with Panel Staff (Dec. 3, 2009). This number represents numbers of shares of stock, rather than dollar values.
[438] Treasury conversations with Panel Staff (Dec. 3, 2009).
[439] This figure represents the total amount of funds provided to General Motors through the AIFP. It does not reflect the $361 million repayment made by GM on July 10, 2009, or the $1 billion repayment made in December 2009. *See* COP September Oversight Report, *supra* note 108, at 62–63; *see also* Treasury Receives First Quarterly Repayment from GM, *supra* note 430.
[440] Agency Financial Statement 2009, *supra* note 32, at 17.

Treasury's holdings in the automotive companies cannot be ascribed a definitive value. As an initial matter, following bankruptcy proceedings, the "good" assets in GM and Chrysler are now held by private companies, sometimes referred to as New GM and New Chrysler, and there is at present no market for either the common or the preferred shares. Accordingly, there is no trading data on which to base a valuation. The companies are reorganizing their varying properties—intellectual, physical, and human capital—increasing the uncertainty of valuation. Further, in addition to the difficulty in valuing the shares of private companies (much less those in such flux as GM and Chrysler), valuation incorporates many assumptions, such as market risk and projected cash flows. Experts will use different methodologies and professional judgment to formulate these assumptions and, thus, their results may vary. The TARP financial statements reflect expected losses of $30.4 billion from GM and Chrysler as of September 30, 2009.[441] Office of Management and Budget (OMB) and Congressional Budget Office (CBO) valuations of the taxpayer subsidy rate in automotive industry have produced varying results.[442] Nevertheless, both OMB's

[441] *See* Agency Financial Statement 2009, *supra* note 32, at 18.
[442] The OMB calculated separate subsidy rates for TARP investment debt and equity transactions at 49 percent and 65 percent, respectively, while the CBO estimated an aggregate credit subsidy rate for all TARP automotive industry support programs of 73 percent. *See* COP September Oversight Report, *supra* note 108, at 55–56. *See generally* Office of Management and Budget, *The President's Budget for Fiscal Year 2010,* at 983 (May 2009) (online at www.whitehouse.gov/omb/budget/fy2010/assets/tre.pdf); Congressional Budget Office, *The Trou-*

and CBO's subsidy estimates imply there is a high likelihood the initial TARP financing to GM and Chrysler will not be repaid.[443]

b. Disposal of Assets and Recovery of Expended Amounts

As discussed above, it is unlikely that the taxpayers will recover the whole of their TARP expenditure in the automobile companies.[444] The money that can be recovered will come in two forms. First, both companies are indebted to the government. They must make enough money to pay principal and interest on that debt. Second, the government owns equity in both companies. Treasury must sell that equity in order to realize the taxpayers' investment. Repaying the debt merely depends on the company staying solvent long enough to make payments. Getting a return on equity investment depends on the company actually doing well enough for its stock price to increase: that is more directly linked to good corporate strategies. The companies' strategies are, therefore, discussed below in the context of the equity investment.

i. Debt

The complex events leading to Treasury's loans to GM and Chrysler have resulted in a variety of debts outstanding, with different borrowers, terms, and maturity periods.[445] The initial loan and securities agreements between Treasury and Old GM and Treasury and Old Chrysler have substantially similar terms.[446] Each agreement stipulates that the respective company may obtain financing from time to time, on an as-needed basis, and sets forth a process for each company to request such funding. For both Old Chrysler and Old GM, Treasury loans made under the applicable agreements accrue interest at the London Interbank Offered Rate (LIBOR) plus 3 percent,[447] subject to increase upon nonpayment or default to the ordinary interest rate plus another 5 percent.[448] These loans are secured by a lien on and security interest in all the respective company's assets, including, for example, cash and cash equivalents, intellectual property rights and its corresponding

bled Asset Relief Program: Report on Transactions Through June 17, 2009 (June 2009) (online at www.cbo.gov/ftpdocs/100xx/doc10056/06-29-TARP.pdf).

[443] *See* COP September Oversight Report, *supra* note 108, at 55–56.

[444] Further, in recent testimony, Assistant Secretary for Financial Stability Herbert Allison stated that the losses from the disbursements to AIG and the auto companies were likely to be $60 billion. *See* Allison Testimony Transcript, *supra* note 135.

[445] *See generally* U.S. Department of the Treasury, *Auto Industry Financing Program* (online at www.financialstability.gov/roadtostability/autoprogram.html) (updated Jan. 7, 2010).

[446] *See generally* Loan and Security Agreement [Chrysler], *supra* note 423.

[447] U.S. Department of the Treasury, *Warrant Agreement Between General Motors Corporation and the U.S. Department of the Treasury,* Appendix A, at 1–5 (Dec. 2008) (online at www.financialstability.gov/docs/ContractsAgreements/GMagreement.pdf) (hereinafter "Warrant Agreement Between GM and Treasury"); Loan and Security Agreement [Chrysler], *supra* note 423, at Appendix A. By way of comparison, in October 2008, the Prime Rate (the rate at which banks make short term-loans to businesses) was 4.56 percent, while the one-month LIBOR was 2.58 percent at the end of October 2008, and had been 3.24 percent a week earlier. *See* Board of Governors of the Federal Reserve System, Bank Prime Loan (Frequency: Monthly) (online at www.federalreserve.gov/Releases/H15/data/Monthly/H15__PRIME__NA.txt) (accessed Jan. 4, 2010); *Market Data Center, Money Rates,* Wall Street Journal (Oct. 31, 2008) (online at online.wsj.com/mdc/public/page/2__3020-moneyrate-20081031.html?mod=mdc__pastcalendar). It is difficult, however, to evaluate the rates given to the automobile companies against other loans given the extraordinary nature of the circumstances and the credit crunch.

[448] Warrant Agreement Between GM and Treasury, *supra* note 447, at 17; Loan and Security Agreement [Chrysler], *supra* note 423, at 17.

royalties, and all other tangible and intangible property.[449] Subsequent credit agreements between Treasury and GM and Treasury and Chrysler provide for an interest rate that resets each quarter to the greater of three-month LIBOR or the floor (2 percent), plus a percentage that differs depending on the company and, in Chrysler's case, the tranche involved. The interest rates may be determined by reference to a variety of interest rate markers and provide for an increased rate in the event of default.[450]

Absent an event of default, GM's loans mature on July 10, 2015.[451] The credit agreement between Treasury and GM provides for quarterly mandatory prepayments of $1 billion from existing escrow amounts in addition to the obligation for such funds to be applied to repay the loan by June 30, 2010, unless extended. Absent an event of default, a portion of Chrysler's loans mature in December 2011, with the balance becoming due in June 2017.[452] However, in the event of default, any loans to either GM or Chrysler would become immediately due and payable.[453] Treasury may transfer any or all of its rights under the debt instruments at any time. Chrysler and GM, however, may only transfer their rights and obligations with the prior written consent of Treasury.[454]

In testimony before the Panel in July, Senior Advisor to the Secretary of the Treasury Ron Bloom, now also senior counselor on manufacturing policy,[455] expressed reservations about the likelihood of taxpayers recouping the entirety of their investment in Chrysler and GM: "[U]nder certain assumptions, GM may be able to pay off a high percentage of the total funds advanced by the taxpayers. Less optimistic, and in Treasury's view more likely, scenarios involve a reasonable probability of repayment of substantially all of the government funding for new GM and new Chrysler, and much lower recoveries for the initial loans." [456] As of the end

[449] Warrant Agreement Between GM and Treasury, *supra* note 447, at 29–30; Loan and Security Agreement [Chrysler], *supra* note 423, at 29–30.

[450] Specifically, the interest rate may switch from the three-month Eurodollar Rate to the Alternate Base Rate (the higher of the Prime Rate announced by JPMorgan Chase Bank or the federal funds rate plus 50 basis points). In an event of default, the interest rate for both companies resets to the then-applicable interest rate plus 2 percent. *See* U.S. Department of the Treasury, *Second Amended and Restated Secured Credit Agreement among General Motors Co., the Guarantors, and the United States Department of the Treasury,* at section 2 (Aug. 12, 2009) (online at www.financialstability.gov/docs/AIFP/Binder1%20Second%20AR%20Credit%20Agreement%20and%201-4%20Amendments%2011-23-09.pdf) (hereinafter "Second Amended and Restated Credit Agreement"); *First Lien Credit Agreement among New Carco Acquisition LLC and the Lenders Party Thereto Dated as of June 10, 2009,* at section 2 (online at www.financialstability.gov/docs/AIFP/4.%20Newco%20Credit%20Agreement.PDF). *See also* COP September Oversight Report, *supra* note 108, at 66.

[451] *See* Second Amended and Restated Credit Agreement, *supra* note 450, at section 2. The original loans to Old GM mature on December 30, 2011. *See* Warrant Agreement Between GM and Treasury, *supra* note 447, at 1.

[452] *See* Allison Testimony before House Oversight and Government Reform Committee, *supra* note 118, at 12.

[453] *See* Warrant Agreement Between GM and Treasury, *supra* note 447, at 2.

[454] *See* Warrant Agreement Between GM and Treasury, *supra* note 447, at 66; Loan and Security Agreement [Chrysler], *supra* note 423.

[455] White House, *President Obama Names Ron Bloom Senior Counselor for Manufacturing Policy* (Sept. 7, 2009) (online at www.whitehouse.gov/the_press_office/President-Obama-Names-Ron-Bloom-Senior-Counselor-for-Manufacturing-Policy/).

[456] Congressional Oversight Panel, Transcript Testimony of Ron Bloom, Senior Advisor to the Secretary of the Treasury and Senior Counselor on Manufacturing Policy, *Field Hearing: Oversight of TARP Assistance to the Automobile Industry,* 111th Cong. (July 27, 2009) (online at cop.senate.gov/documents/transcript-072709-detroithearing.pdf) (hereinafter "Ron Bloom Transcript Testimony").

of 2009, Treasury has stated that it does not believe that there has been any material change to this assumption.

For its part, Chrysler has expressed confidence that it will "make good on the public's investment as the economy begins to recover and financing becomes available to dealers and consumers." As Jan Bertsch, a senior vice president of Chrysler, explained in her testimony at the Panel's July hearing: "Our debt to the U.S. Treasury is due in several different tranches. One would be in 2011, again in 2016, and 2017. Our goal would definitely be, if possible, to pay that back early. Part of the reason is the interest cost to the company is not immaterial, and so based on the interest rates that we are paying, I think that it would be one of our definite goals to pay that back early. But we see no issue in paying it back on time, certainly." [457]

On December 1, 2009, GM replaced then-CEO Fritz Henderson with Edward Whitacre,[458] who has since said that GM is considering repaying the (now) $5.7 billion it owes the government under the secured notes through a lump-sum payment,[459] and has stated that GM will repay by June 2010.[460] It should be noted, however, that GM is not yet making any profits, and the payment will come from an escrow account established as part of the bankruptcy reorganization,[461] so that GM could not, strictly speaking, be said to be earning money to pay the taxpayer.[462]

ii. Equity

The Treasury auto team expects that both companies will eventually access the equity capital markets through IPOs,[463] and as a result, successful IPOs will form the basis for the recovery of the taxpayers' money. This strategy hinges directly on the ability of the two companies to restructure and become profitable. At the mo-

[457] Congressional Oversight Panel, Transcript Testimony of Jan Bertsch, Chrysler Senior Vice President and Treasurer, *Field Hearing: Oversight of TARP Assistance to the Automobile Industry,* 111th Cong., at 82 (July 27, 2009).

[458] *See* General Motors, *Statement Attributed to Chairman Ed Whitacre* (Dec. 1, 2009) (online at media.gm.com/content/media/us/en/news/news__detail.brand__gm.html/content/Pages/news/us/en/2009/Dec/1201__GM__Fritz).

[459] *See* General Motors, *GM CEO and Chairman Ed Whitacre: GM Leaders Expected to Show Quick Results* (Dec. 9, 2009) (online at media.gm.com/content/media/us/en/news/news__detail.brand__gm.html/content/Pages/news/us/en/2009/Dec/1209__webchat). GM has since repaid $1 billion of the sums outstanding. *See* Treasury Receives First Quarterly Repayment from GM, *supra* note 430.

[460] *See* General Motors, *Statement Attributed to Chairman and Chief Executive Officer Ed Whitacre* (Dec. 18, 2009) (online at media.gm.com/content/media/us/en/news/news__detail.brand__gm.html/content/Pages/news/us/en/2009/Dec/1218__repayment).

[461] Proceeds in the amount of $16.4 billion from the $30.1 billion debtor-in-possession facility were deposited in escrow and will be distributed to GM at its request if the following conditions are met: (1) the representations and warranties GM made in the loan documents are true and correct in all material respects on the date of the request; (2) GM is not in default on the date of the request taking into consideration the amount of the withdrawal request; and (3) the United States Department of the Treasury (UST), in its sole discretion, approves the amount and intended use of the requested disbursement. U.S. Securities and Exchange Commission, *General Motors Co. Form 8–K* (Sept. 2, 2009) (online at www.sec.gov/Archives/edgar/data/1467858/000119312509220534/0001193125-09-220534-index.htm) (hereinafter "General Motors Co. Form 8–K").

[462] General Motors Co. Form 8–K, *supra* note 461; Allison Testimony before House Oversight and Government Reform Committee, *supra* note 118, at 12. In December, 2009, GM made the first of its quarterly payments to Treasury. *See* Treasury Receives First Quarterly Repayment from GM, *supra* note 430.

[463] *See* COP September Oversight Report, *supra* note 108, at 68–70. Chrysler and GM will require initial public offerings in order to become publicly-traded and access the capital markets. As part of the bankruptcy proceeding, both Chrysler and GM sold the majority of their assets to private companies. These companies are not public: they are neither SEC-registrants nor traded on any exchange.

ment, in a still-constrained credit market, and with the two companies facing pressure to rebuild themselves and under the perceived threat of political interference,[464] it is unclear whether either company in its current form could access the banks or the capital markets in the amounts and on the terms that they would require. Since the public offering of these companies is the primary method for recovery of taxpayers' money, delays in or hindrances to accessing the capital markets will prolong Treasury's involvement as a shareholder, leading to greater uncertainty, both for the companies and for Treasury.

Following the completion of a successful IPO, the Treasury auto team has made clear that it intends to dispose of Treasury's ownership stakes in Chrysler and GM "as soon as is practicable." At least with respect to GM, where Treasury holds 60.8 percent of the company, Treasury does not expect to sell its entire stake in the IPO.[465] The Stockholders Agreement calls for Treasury to use reasonable best efforts to effect an IPO by July 10, 2010.[466] In its Shareholder's Agreement, Chrysler has agreed to file a shelf registration statement with the SEC either six months after an IPO or on January 1, 2013, whichever is earlier.[467]

The Treasury auto team has not ruled out other ways of exiting ownership of these companies and returning them to private hands, but options such as selling Treasury's stake to private equity investors seem unlikely at present.[468] Treasury's stake in Chrysler is small enough that Treasury believes that it could exit ownership of Chrysler promptly upon Chrysler's filing of a shelf registration statement. As noted above, Treasury's stake in GM is sufficiently large that it would be extremely difficult for Treasury either to find a buyer or buyers, and it is not clear whether significant sales would have a destabilizing effect on GM or on the markets. Treasury has stated, however, that when it is able to sell, it should do so in a transparent and open manner so as to avoid additional destabilization.[469]

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[464] *See* COP September Oversight Report, *supra* note 108, at 68–69. Pursuant to its operating agreement, GM will attempt to make a reasonable best efforts IPO by July 10, 2010. *See* Allison Testimony before House Oversight and Government Reform Committee, *supra* note 118, at 12.

[465] *See* Allison Testimony before House Oversight and Government Reform Committee, *supra* note 118, at 12.

[466] *Stockholders Agreement by and among General Motors Company, United States Department of the Treasury, 7176384 Canada Inc., and UAW Retiree Medical Benefits Trust*, at 8 (July 10, 2009) (online at www.sec.gov/Archives/edgar/data/1467858/000119312509150199/dex101.htm) (hereinafter "GM Stockholders Agreement"); *see also* Agency Financial Statement 2009, *supra* note 32, at 44.

[467] Under the terms of the Chrysler Shareholders Agreement, Treasury can require Chrysler to file a registration statement under the Securities Act of 1933 (a "demand registration"); in the case of an IPO, such demand notice can only be delivered by either (a) one or more holders holding 10 percent or more of the equity securities, or (b) both Treasury and Canada. *Shareholders Agreement Among Fiat Newco, United States Department of the Treasury, UAW Retiree Medical Benefits Trust, Canada Development Investment Corporation, and the Other Members Party Hereto*, at section 3.2(a)(i) (filed May 12, 2009) *In Re* Chrysler LLC, S.D.N.Y. (No. 09 B 50002 (AJG)) (online at www.chryslerrestructuring.com/). Treasury cannot seek more than one demand registration in any 12-month period, and cannot request more than five. *Id*., at section 3.2(a)(ii).

[468] At a July 29, 2009 briefing with Panel staff, Treasury and Task Force staff indicated that, at least at that point, no private equity investor has come along with demonstrated interest in investing in these companies, and as of the end of 2009, this remains unchanged. Treasury conversations with Panel staff (Dec. 22, 2009). *See generally* Section D.7(c), *infra*.

There are also several pre-IPO contractual limitations on the public sale of Treasury's ownership stakes in GM that are set out in the Stockholders Agreement. *See* GM Stockholders Agreement, *supra* note 466, at 8–9.

[469] Treasury conversations with Panel staff (Dec. 22, 2009).

In making the decision—or decisions—to sell the equity stakes that it holds in the automotive companies, Treasury will have to balance the desire to exit as soon as practicable, as articulated by the President and the head of the Treasury auto team,[470] with the need to maximize the return or minimize the loss to taxpayers, as dictated by EESA.[471] Maximizing returns may, however, argue for holding the investments for longer than Treasury would otherwise prefer, bringing these two goals into conflict. It is not easy to time the markets, and Treasury cannot force Chrysler's board, at least, to engage in an IPO. Until the companies go public through the IPO process, Treasury's primary and perhaps only option is to sell its stake privately, which, as discussed above, remains an unlikely event, although of the two, it would be more likely that Treasury could sell the Chrysler stake privately. Once the companies become public companies subject to SEC reporting requirements, Treasury's options would be somewhat broader. Subject to certain conditions, Treasury could sell large stakes in SEC-registered secondary offerings.[472] Treasury could also sell smaller amounts of shares into the public markets.[473]

Until it exits ownership of Chrysler and GM, Treasury will continue to be a substantial shareholder of these companies; however, Treasury does not intend to take the activist role commonly associated with large private shareholders.[474] Mr. Bloom, who was appointed to lead the Treasury auto team, has stated that President Obama gave the Task Force two directives regarding its approach to the automotive restructurings. First, the Task Force was to avoid intervening in the day-to-day corporate management of GM and Chrysler, and instead act as "a potential investor of taxpayer resources" with the goal of promoting profitable companies that contribute to economic growth without taxpayer support.[475] Second, the Task Force was to "behave in a commercial manner."[476] The Panel noted the tension between these dual roles in its September oversight report. President Obama has stated that each company's

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[470] *See* White House, *Remarks by the President on General Motors Restructuring* (June 1, 2009) (online at www.whitehouse.gov/the__press__office/Remarks-by-the-President-on-General-Motors-Restructuring/) (hereinafter "Remarks by the President on GM") ("In short, our goal is to get GM back on its feet, take a hands-off approach, and get out quickly."); *see also* COP September Oversight Report, *supra* note 108, at 69.

[471] *See* 12 U.S.C. § 5213.

[472] *See* Allison Testimony before House Oversight and Government Reform Committee, *supra* note 118, supplemented by Treasury conversations with Panel staff (Dec. 22, 2009).

[473] Shareholders that are "affiliates" of a company (in general, those with a significant stake in the voting equity of the company, or the right to a board seat) may sell their shares in the public markets without registration of the transaction with the SEC. SEC rules impose volume, timing, and other restrictions on such sales. 17 CFR § 230.144 (2009). Any such sales by the government are likely to have a significant impact on the securities market, which may suspect a signal to the market with respect to the specific companies, the auto industries, or the economy in general. For this reason (and the general difficulty in timing the market discussed above), holding these equity stakes in a trust, discussed in more detail below, might help to manage the taxpayers' stake more efficiently and maximize returns.

[474] *See* Allison Testimony before House Oversight and Government Reform Committee, *supra* note 118, at 5.

[475] *See* Congressional Oversight Panel, Written Testimony of Ron Bloom, Senior Advisor to the Secretary of the Treasury and Senior Counselor on Manufacturing Policy, *Field Hearing: Oversight of TARP Assistance to the Automobile Industry*, 111th Cong. (July 27, 2009) (online at cop.senate.gov/documents/testimony-072709-bloom.pdf) (hereinafter "Ron Bloom Written Testimony").

[476] *See* Senate Committee on Banking, Housing, and Urban Affairs, Testimony of Senior Advisor at the U.S. Department of the Treasury Ron Bloom, *The State of the Domestic Automobile Industry: Impact of Federal Assistance*, 111th Cong. (June 10, 2009) (online at banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore__id=40341601-355c-4e6f-b67f-b9707ac88e32).

board of directors and management team are responsible for achieving financial and operational restructuring as well as cultural changes at GM and Chrysler.[477]

Testifying before the Panel, Mr. Bloom reiterated that while the government has a partial ownership stake in these companies, the Task Force should manage its stake in a "hands off" manner, voting only on core governance issues such as the selection of directors and other major corporate actions.[478] Characterizing the Administration as a "reluctant shareholder" in GM and Chrysler, Mr. Bloom also testified that Treasury would work with a "firm conviction to manage that investment commercially" and dispose of equity stakes "as soon as practicable."[479] Further, the GM Shareholders' Agreement provides that after GM's IPO, Treasury will only vote on certain matters, including elections to the board, certain major transactions, such as merger or dissolution, and matters in which Treasury must vote its shares in order for the shareholders to take action. In the latter case, Treasury will vote its shares in the same proportion (for, against, or abstain) as the other shares are voted.[480]

While the Administration's stated purpose is not to involve the federal government in daily business decisions, Treasury cannot entirely abrogate its responsibilities as a shareholder. Even if Treasury restricts its participation to "core governance," it must reasonably and responsibly establish its interpretation of "core governance." As an example, given the ongoing and sweeping changes at both companies, a management succession plan—which SEC staff has recently described as one of a board's key functions—is critical.[481] If Treasury has not clearly established a policy for its involvement in management succession plans, it should do so promptly.

Treasury has been directed and intends to make minimal interventions in management, as well as shareholder decisions. Overall, Treasury has expressed a firm commitment to its limited role. In conversations with Panel staff, the Treasury auto team indicated that they would, at most, share their opinions about strategy with the management of the auto companies. The management of the auto companies, however, is entirely responsible for setting strategy, and may ignore Treasury's opinions as they please. A "hands off" approach, however, may not provide the influence necessary to achieve the cultural changes most likely to lead to sustained viability for Chrysler and GM. If the government maintains the role of a disinterested shareholder, it may be difficult to protect taxpayer interests in these companies. On the other hand, it may be similarly detrimental to taxpayer interests if Treasury is an involved shareholder, as in this role Treasury arguably suffers from inher-

[477] *See* Remarks by the President on GM, *supra* note 470; *see also* Ron Bloom Written Testimony, *supra* note 472.

[478] *See* Ron Bloom Written Testimony, *supra* note 472; *see also* COP September Oversight Report, *supra* note 108, at 82–83.

[479] Ron Bloom Written Testimony, *supra* note 472. *See also* Allison Testimony before House Oversight and Government Reform Committee, *supra* note 118, at 5.

[480] *See* Allison Testimony before House Oversight and Government Reform Committee, *supra* note 118, at 6.

[481] *See* Division of Corporation Finance, *Securities and Exchange Commission, Shareholder Proposals*, Staff Legal Bulletin No. 14E (CF) (Oct. 27, 2009) (online at www.sec.gov/interps/legal/cfslb14e.htm).

ent conflicts of interest, politics, lack of knowledge, and lack of competence.

Treasury's position is that the government, as shareholder, distorts the market in such a way that the auto companies—and accordingly the taxpayers—will ultimately reap greater benefit from a passive government shareholder. Where a typical shareholder can be assumed to seek profit maximization, Treasury is concerned that any shareholder activism on its part will be perceived through a political rather than commercial lens. Treasury believes this would harm the market as a whole in addition to harming the auto companies. Under this model, private shareholders, faced with a large shareholder that acts with multiple, possibly political motivations, would be more reluctant to invest in the company, delaying Treasury's exit and the return of the company to private hands, and overall reducing the value of Treasury's investment.[482] It is difficult to determine which of these approaches would cause more or less harm to the markets in general or to the auto companies in particular. It is also possible that the passive approach promotes market stability in general at the expense of the taxpayers' specific investment in the auto companies.

To mitigate the potential conflicts of interest inherent in government ownership of Chrysler and GM shares, the Panel recommended in September that Treasury consider placing its Chrysler and GM shares in an independent trust that would be insulated from political pressure and government interference.[483] At a hearing on October 22, 2009, however, Assistant Secretary Allison questioned whether an independent trust would be an efficient use of taxpayer funds given the requisite "administrative infrastructure" that would be involved.[484] Treasury also has expressed concern that a trust might be inconsistent with its supervisory obligations under EESA. In February 2009, however, Secretary Geithner discussed the possibility of putting assets from the TARP, as then-constituted in the Capital Assistance Program, in a Financial Stability Trust.[485] The Capital Assistance Program ultimately closed without making any investments, and therefore no assets were ever placed in the Financial Stability Trust.[486]

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[482] *See* Allison Testimony before House Oversight and Government Reform Committee, *supra* note 118; Treasury conversations with Panel staff (Dec. 22, 2009). On the other hand, although Treasury is concerned that its involvement may depress stock price, absent Treasury's and the U.S. Government's intervention, the liquidated companies' stock would have no value at all.

[483] *See* COP September Oversight Report, *supra* note 108, at 114. In addition, Senator Warner and Senator Corker have proposed the TARP Recipient Ownership Trust Act of 2009, which would move any government private company shareholding over 20 percent into a trust with instructions to liquidate the stakes by the end of 2011. *See* Sen. Bob Corker, *Corker, Warner Introduce TARP Recipient Ownership Trust Act of 2009* (June 17, 2009) (online at corker.senate.gov/public/index.cfm?FuseAction=NewsRoom.NewsReleases&ContentRecord__id=efcc93cf-0189-87f7-0c26-fb49c985a43f).

[484] *See* Congressional Oversight Panel, Transcript Testimony of Treasury Assistant Secretary for Financial Stability Herbert M. Allison, Jr., *COP Hearing with Assistant Treasury Secretary Herbert M. Allison, Jr.*, at 63 (Oct. 22, 2009).

[485] U.S. Department of the Treasury, *Secretary Geithner Introduces Financial Stability Plan* (Feb. 10, 2009) (www.treas.gov/press/releases/tg18.htm) (hereinafter "Secretary Geithner Introduces Financial Stability Plan").

[486] 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").

As part of its efforts to increase profitability, on November 4, 2009, Chrysler unveiled its five-year business plan.[487] Under this plan, the current Chairman of the Board, Robert Kidder, states that Chrysler's top priority will be to create a compelling brand and product offering. In addition, Chrysler will leverage its alliance with Italian automaker Fiat, manage its supply chain to match customer demand and production, strengthen its dealer network, cut fixed costs, develop its new MOPAR brand, build a strong team and high performance culture, and adopt a financial plan that aims to recapitalize the company. In conversations with Panel staff, Chrysler maintained that it is happy with its progress in merging with Fiat, and believes that it is creating a more efficient company. Its product mix will include more fuel-efficient cars, and it believes it is making progress in reducing the time-to-market for newer products. Chrysler is also sensitive to the need to act quickly, and believes that it has brought greater focus to its product offerings.[488]

GM also issued a five-year plan,[489] which includes consolidating facilities, streamlining brands and dealer networks, creating "fewer, better" vehicles, developing technologies to increase fuel efficiency, hybrids, advanced propulsion, and addressing unprofitable foreign operations. On November 16, 2009, GM stated that its focus is currently on "top line performance" and gaining market share by offering "performance and value" to customers.[490] In subsequent conversations with Panel staff, GM stated that it believes that it has made good progress on initiatives designed to increase its competitiveness, including: building plants that can switch between products; developing a more versatile product mix, with more small cars; building its four core brands and attempting to divest other brands; and creating strategic alliances in overseas markets. GM believes that the restructured business will be simpler and much easier to manage as a result.[491]

Treasury has stated that the new companies are, in capital structure alone, fundamentally quite different from their prior incarnations. In addition to manufacturing changes and product shifts, the restructured companies lack the debt that dogged old Chrysler and old GM. They have lower overhead and a lower break-even point. They compete in a smaller market and have simplified obligations to fewer debt and equity holders. Treasury believes that these differences significantly distinguish the current auto companies from their predecessors, and will help them to become profitable.[492]

c. Analysis of Intended Exit Strategy

The crisis that beset Chrysler and GM was a long time coming, even if its severity was unprecedented. As President Obama ob-

[487] *See generally* Chrysler Group, *Our Plan Presentation* (Nov. 4, 2009) (online at www.chryslergroupllc.com/business/?redir=cllc).

[488] Chrysler conversations with Panel staff (Dec. 16, 2009).

[489] *See generally* General Motors Corporation, *2009–2014 Restructuring Plan* (Feb. 17, 2009) (online at www.financialstability.gov/docs/AIFP/GMRestructuringPlan.pdf).

[490] General Motors Corporation, *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).

[491] GM conversations with Panel staff (Dec. 15, 2009).

[492] Allison Testimony before House Oversight and Government Reform Committee, *supra* note 118, at 5; Treasury conversations with Panel staff (Dec. 22, 2009).

served in his speech on the GM bankruptcy, the crisis resulted from a long series of poor business decisions, large legacy costs, and failure to address a changing market.[493] It is to be hoped that the near-liquidation of these companies will impress upon their respective managements and employees the need to be more responsive to changes in markets, commodity prices, and consumer preferences. Both Chrysler and GM were resting upon a very long period of market dominance, and failed to respond promptly when it was revealed that their influence had waned and their competitors were more nimble and modern, both culturally and technologically. High labor costs—from wages, benefits, and rigid work rules—further hampered GM's and Chrysler's competitiveness.[494] Compounding the difficulty, the auto industry overall suffers from a long time-to-market, relatively high fixed and variable costs, and substantial infrastructure needs, which make it difficult for even a flexible and adaptive company to move quickly. Reports that GM is restructuring its bureaucracy are encouraging,[495] although substantial additional changes will be needed for both companies to again become profitable and permit Treasury to divest its holdings.

As discussed above, Treasury owns equity in and holds debt of both Chrysler and GM. While repayments on the debt and successful IPOs are both dependent on revitalized companies, Treasury will likely hold the equity stakes for longer than the debt will remain outstanding. The equity stakes, accordingly, are of greater concern in a discussion of exit. Further, it is Treasury's GM holding that poses the most difficulty: Treasury's stake in Chrysler is small enough that Treasury could sell it shortly after a Chrysler IPO or to a third-party buyer.[496] The size of the GM holding therefore creates unique circumstances: In the absence of buyers for a block sale or sales, in all probability, Treasury will sell its stake into the public market, and it probably cannot sell its entire stake simultaneously. Although it continues to evaluate the best methods for divesting its holdings in the GM equity, Treasury currently takes the position that transparency—in the form of successive registered follow-on offerings—will best serve the markets and the taxpayers' investment in the auto companies.[497] If, by contrast, Treasury were to sell its stake at less predictable or less transparent intervals, Treasury believes that potential investors might be concerned about unpredictable pressure on the stock price from Treasury's sales. Any such sales, however, must follow the IPO, and likely will be subject to a lock-up as well. Treasury therefore probably cannot sell even the larger part, much less all, of its equity stake until years in the future.

It is unusual for any company to have a majority shareholder as passive as Treasury intends to be. This stance, especially with respect to Treasury's GM holding, may result in no other entity's

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[493] *See* Remarks by the President on GM, *supra* note 470; *see also* COP September Oversight Report, *supra* note 108, at 107–110.

[494] House Select Committee on Global Warming, Testimony of Professor Peter Morici, *The Energy Independence Implications of the Auto Bailout Proposal,* 110th Cong., at 2 (Dec. 9, 2008) (online at www.globalwarming.house.gov/tools/3q08materials/files/0068.pdf).

[495] Treasury conversations with Panel staff (Dec. 22, 2009).

[496] Allison Testimony before House Oversight and Government Reform Committee, *supra* note 118.

[497] Allison Testimony before House Oversight and Government Reform Committee, *supra* note 118; Treasury conversations with Panel staff (Dec. 22, 2009).

being able to play the traditional majority shareholder role, and create a governance vacuum. This concern will intensify as the auto companies return to being publicly traded companies. The Panel's September report suggested that Treasury consider holding its auto company shares in a trust, to which Treasury has responded with a variety of concerns, from administrative costs to statutory obligations. In addition to these concerns, establishing a trust to hold the shares might: slow Treasury's exit; prolong its involvement in the market; and make future interventions more palatable, any or all of which could set an inappropriate precedent. However, particularly with respect to the GM stake, it may be some time before Treasury is able to divest itself of its holdings. GM will therefore have a deliberately disinterested and passive majority shareholder for the foreseeable future, which may hamper its ability to again become viable and may affect the value that the capital markets place on it. This being the case, the Panel believes that Treasury should continue to contemplate whether it should place the automobile company shares, particularly the GM shares, in a trust. In an earlier incarnation of the TARP, Treasury had contemplated creating a trust for its financial sector investments.[498] Treasury should revisit the discussions surrounding the Financial Stability Trust to help determine whether any of the considerations in operation at that time might now be applicable to the automobile company shares. If Treasury is of the opinion that a trust is unnecessary at present, it should reconsider this position at the time an IPO is being planned.[499]

The uncertainty surrounding the long-term prospects for these investments, of course, raises additional issues. Investments without clear time frames for exit—if any—pose particularly difficult questions about Treasury's involvement in a commercial enterprise. Even if Treasury believes that the taxpayers' best interest is served by its "hands-off" approach, it must nonetheless perform rigorous diligence of its ongoing investment in search of good divestment windows. If, instead, Treasury later determines that it should take a more interventionist role, it must still find the appropriate balance between serving the taxpayers' need and the significant problems posed by involving Treasury in management. In any case, however, Treasury should not exit either company without establishing that it has a reasonable plan for long-term viability. The alternative, as discussed below, would be to reinstitute the full-scale liquidation avoided through commitment of TARP funds.

The Panel is hopeful that both Chrysler and GM will return to profitability in short order, making Treasury's continued involvement unnecessary. The Panel also appreciates the auto task force's difficulty in balancing its role as a shareholder with its obligations to the taxpayers and its decided reluctance to become actively involved in management. That said, while there are many ways in which Treasury differs from a shareholder in the ordinary course, one in particular is relevant to our discussion: what Treasury

[498] Secretary Geithner Introduces Financial Stability Plan, *supra* note 485.

[499] Other unconventional measures that Treasury might consider would include replacing its common stock with a class of limited shares, and, drawing from private equity traditions, breaking its holding into six or more blocks and having private managers manage those holdings, actively exercising the governance rights that accompany the shares.

should do if and when it determines that it has made a "bad investment." A typical shareholder may decide that he or she no longer wishes to hold a given investment, and may sell, generally without much effect on the market. If, however, the automotive companies prove unlikely to become profitable again, even if far in the future, Treasury cannot simply sell and write off its investment. And if Treasury sees no possibility of a sale, then in the best interests of the taxpayers, Treasury may need to contemplate its only remaining means of exit—an orderly wind-down of the relevant company. Not only can this never be a casual decision, but it must also involve deep and careful consideration of the effect on all parties concerned—taxpayers, investors, suppliers, car owners, and industrial workers, among others.

The consequences of liquidating one or both of these companies, even if far into the future and in an orderly fashion, would likely still be significant for the economy.[500] The Panel is hopeful that the global financial crisis that precipitated the TARP will not be repeated, and that if it is, the industries that require rescue will be more robust. If there is a similar crisis, or if after some period of time, one or both of GM and Chrysler appear unlikely to ever become profitable again, Treasury will face a difficult choice. Treasury should have procedures for the continuing evaluation of its investment in the automotive industry. This report discusses these procedures in the context of divestment windows. These procedures should be formulated with an awareness that Treasury may need to consider exit even though the subject company or companies cannot continue without Treasury's support. The Panel hopes that no such action will ever be necessary, but believes that in order for Treasury to have a comprehensive understanding of its role as an investor, it must internally take note of this possibility. That said, publication of precise metrics or timelines may be inadvisable, both because they could limit Treasury's discretion and could negatively affect the companies. Treasury, at present, takes the view that the auto companies will not be ripe for long-term evaluation until after any IPO. While it is reasonable to look to the IPOs as a more concrete point at which to assess the auto companies, it is also appropriate for Treasury to consider, if not plan for, the longer term.[501]

8. GMAC

Since the results of the stress tests were announced in early May,[502] nine of the 10 bank holding companies that were identified as needing to raise additional capital have met or exceeded their capital raising requirements without government assistance.[503] GMAC, which was unable to raise sufficient outside capital to meet the capital buffer established by the stress tests, originally set at

[500] *See* COP September Oversight Report, *supra* note 108, at 7–23.

[501] The Panel understands that Treasury intends to begin a formal evaluation of its investment in the automobile companies shortly.

[502] Treasury Announces Restructuring of Commitment To GMAC, *supra* note 170; COP June Oversight Report, *supra* note 175, at 41.

[503] Agency Financial Statement 2009, *supra* note 32, at 25.

$11.5 billion, is the only participant to seek additional TARP funds from Treasury.[504]

At the conclusion of the stress tests in May 2009,[505] Treasury made a "down payment" of $7.5 billion but acknowledged that GMAC would need additional capital support.[506] On December 30, 2009, Treasury provided GMAC with $3.8 billion in new capital.[507] This amount was $1.8 billion less than the remaining $5.6 billion shortfall on the capital buffer calculated in May by the Federal Reserve under the stress tests.[508] According to Treasury, the reduced size of the capital injection was due to "less disruption" than anticipated in the GM and Chrysler restructurings.[509] The Panel is not aware of the stress tests being recalculated for any other bank that participated in them, although it must be noted that GMAC is the only participant that failed to meet the stress tests' November 2009 deadline for raising additional capital.

The additional funds were provided in the form of $2.54 billion in Trust Preferred Securities (TruPs) and $1.25 billion in Mandatory Convertible Preferred Stock (MCP).[510] Treasury also received warrants to purchase $127 million of TruPs and $63 million of MCP, which it exercised upon closing.[511] At the same time, Treas-

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[504] Prior to the December 2009 capital injection, Treasury owned $13.1 billion in preferred shares in GMAC, and 35 percent of GMAC's common equity. Of this $13.1 billion, $5.25 billion was acquired in December 2008 when Treasury purchased $5 billion in preferred equity and received warrants for an additional $250 million in preferred equity. Treasury then acquired an additional $7.875 billion in May 2009 when it purchased $7.5 billion of convertible preferred shares and received warrants for an additional $375 million. Also, on May 29, 2009, Treasury exercised its option to exchange a $884 million loan for the ownership interest that GM had purchased, amounting to about 35 percent of the common membership interests in GMAC. OFS FY09 Financial Statements, *supra* note 133, at 62, 74.

[505] At the conclusion of the stress tests in May, the Federal Reserve announced that GMAC required an additional $11.5 billion in capital, $9.1 billion of which had to be in the form of fresh capital (as opposed to conversions). Treasury conversations with Panel staff (Jan. 8, 2010); Treasury Announces Restructuring of Commitment To GMAC, *supra* note 170.

[506] Of this $7.5 billion, $3.5 billion was used to add to GMAC's required capital buffer, and $4 billion was used to support new financing for Chrysler dealers and customers. Treasury conversations with Panel staff (Jan. 8, 2010). The term sheet for this investment stated that Treasury would invest "up to $5.6 billion" at a later date.

Treasury stated that it decided to "stage" its investments because it believed that the GM and Chrysler bankruptcy proceedings might be less disruptive, and faster, than anticipated and because it wanted to give a new GMAC management team the opportunity to develop its own strategy for raising capital. Treasury conversations with Panel staff (Jan. 8, 2010). Less disruptive bankruptcy proceedings would have the effect of lowering GMAC's capital needs because the value of the GM and Chrysler automobiles financed by GMAC and forming a large part of its collateral, would be higher with GM and Chrysler standing behind their warranties. *Id.; see also* Treasury Announces Restructuring of Commitment To GMAC, *supra* note 170; OFS FY09 Financial Statements, *supra* note 133, at 62 ("GMAC is in discussions with the Treasury-OFS regarding additional financing to complete GMAC's post-SCAP capital needs up to the amount of $5.6 billion, as previously discussed in May").

[507] Treasury Announces Restructuring of Commitment To GMAC, *supra* note 170. The transaction closed and was funded on December 30, 2009. Treasury conversations with Panel staff (Jan. 6, 2010). Treasury stated that it timed the transaction to close in fiscal year 2009 in order to "clean up" GMAC's balance sheet. Treasury conversations with Panel staff (Jan. 8, 2010).

[508] Treasury Announces Restructuring of Commitment To GMAC, *supra* note 170; Treasury Announcement Regarding the CAP, *supra* note 486 ("[GMAC's] capital need is expected to be lower than anticipated at the time the SCAP results were announced"); U.S. Department of the Treasury, *Questions for the Record for U.S. Department of the Treasury Assistant Secretary Herbert M. Allison Jr.,* at 9 (Oct. 22, 2009) (online at cop.senate.gov/documents/testimony-102209-allison-qfr.pdf) (hereinafter "Questions for the Record for Secretary Allison"); OFS FY09 Financial Statements, *supra* note 133, at 62 ("GMAC is in discussions with the Treasury-OFS regarding additional financing to complete GMAC's post-SCAP capital needs up to the amount of $5.6 billion, as previously discussed in May"). A *Wall Street Journal* story in late October stated that the capital injection would be between $2.8 billion and $5.6 billion. Dan Fitzpatrick and Damian Paletta, *GMAC Asks for Fresh Lifeline*, Wall Street Journal (Oct. 19, 2009) (online at online.wsj.com/article/SB125668489932511683.html?mod=djemalertNEWS).

[509] Treasury Announces Restructuring of Commitment To GMAC, *supra* note 170.

[510] Treasury Announces Restructuring of Commitment To GMAC, *supra* note 170.

[511] Treasury Announces Restructuring of Commitment To GMAC, *supra* note 170.

ury converted $5.25 billion of its preferred securities to MCPs (which have a more advantageous conversion rate) and converted $3 billion of its MCPs to common stock, increasing its ownership stake from 35 percent to 56 percent.[512] Treasury also took the opportunity to recut the terms of some of its existing securities, including the conversion terms. With its enlarged ownership stake, Treasury has the right to appoint four directors to GMAC's board of directors.[513] In total, Treasury now holds $2.67 billion in TruPs and $11.4 billion in MCPs.

The additional capital was provided under the AIFP, rather than under the Capital Assistance Program (CAP), which was established to provide capital to financial institutions in connection with the stress tests.[514] Treasury stated that it used the AIFP because its previous capital injections had been through the AIFP and because of the relationship between GMAC and the automotive industry.[515] The terms of the securities issued under the AIFP are also more advantageous to Treasury.

GMAC intends to seek financing in the credit markets during 2010, and if it is able to access the equity markets, then Treasury will be able to start unwinding its position. Treasury's large MCP position makes it likely that it will convert the MCPs and sell common stock in the market after an eventual IPO, although a private sale cannot be ruled out.[516] In either case, Treasury's goal is to "dispose of the government's interests as soon as practicable consistent with EESA goals."[517] Treasury intends to sell its interests in a timely and orderly manner that "minimizes financial market and economic impact," under what it determines to be appropriate market conditions.[518]

In answers to questions posed by members of the Panel, Assistant Secretary Allison suggested that Treasury's assistance to GMAC has provided a "reliable source of financing to both auto dealers and customers seeking to buy cars," helped "stabilize our auto financing market," and contributed "to the overall economic recovery."[519] GMAC is a source of retail and wholesale financing for both GM and Chrysler.[520] Treasury has stated that if it refused to support GMAC after providing assistance to GM and Chrysler, it would undermine its own investments in the automotive companies. Treasury has also stated that denying support to GMAC in December 2009 would have placed Treasury's previous investments

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[512] Treasury Announces Restructuring of Commitment To GMAC, *supra* note 170.

[513] Treasury Announces Restructuring of Commitment To GMAC, *supra* note 170. The increase in ownership stake from 35 percent to 56 percent gave Treasury the right to appoint two additional directors.

[514] *Id.; see also* Congressional Oversight Panel, *December Oversight Report: Taking Stock: What Has the Troubled Asset Relief Program Achieved?,* at 20 (Dec. 9, 2009) (online at cop.senate.gov/documents/cop-120909-report.pdf) (hereinafter "COP December Oversight Report"). Although Treasury provided the funds through the AIFP, it stated that it was "acting on its previously announced commitment to provide capital to GMAC as identified in May as a result of the Supervisory Capital Assessment Program (SCAP)." Treasury Announces Restructuring of Commitment To GMAC, *supra* note 170.

[515] Treasury conversations with Panel staff (Jan. 8, 2010).

[516] Agency Financial Statement 2009, *supra* note 32, at 102; Treasury conversations with Panel staff (Jan. 8, 2010).

[517] Agency Financial Statement 2009, *supra* note 32, at 44.

[518] Agency Financial Statement 2009, *supra* note 32, at 40.

[519] Questions for the Record for Secretary Allison, *supra* note 508, at 9; *see also* COP December Oversight Report, *supra* note 514, at 71.

[520] Treasury conversations with Panel staff (Jan. 8, 2010).

at risk, and that refusing assistance after promising it in May would have had a detrimental effect on market confidence.[521]

In spite of Assistant Secretary Allison's general statements about the reasons for providing additional support to GMAC, Treasury has not yet articulated a specific and convincing reason to support the company. Treasury's most recent announcement of assistance states only that its "actions fulfill Treasury's commitments made in May to GMAC in a manner which protects taxpayers to the greatest extent possible." [522] It has never stated that a GMAC failure would result in substantial negative consequences for the national economy. If Treasury has made such a determination, then it should say so publicly. It does not appear that the support has been made on the merits of the investment, particularly given GMAC's recent statements that it anticipates reporting fourth quarter 2009 losses of approximately $5 billion.[523] Treasury has not indicated whether it will be open to providing additional financing to GMAC in the future.

Moreover, GMAC has received different treatment from all other financial institutions that were subject to the stress tests. Unlike other institutions, it was subjected to additional stress tests after the initial stress test results were released in May, and unlike other institutions, its capital buffer requirements were revised in light of this second round of tests. GMAC was the only institution that was allowed to benefit from post-May improvements in its financial position and in related sectors of the economy. In the face of criticism about the merits of saving GMAC, Treasury owes the public a more detailed and convincing explanation not only of its rationale for providing substantial assistance to GMAC, but also of its rationale for treating GMAC differently than other stress-tested institutions.

9. PPIP

Treasury has committed up to $30 billion to be invested in the Public-Private Investment Program (PPIP), a TARP initiative pairing Treasury with private investors to purchase mortgage-backed securities as a means of jump-starting that market back into active trading. Treasury announced the PPIP on March 23, 2009, as part of its efforts to repair balance sheets distorted by toxic assets and increase credit availability in the financial system.[524] Although the PPIP, when announced, included both a legacy loans program and a legacy securities program, the legacy loan program has been postponed for the present.[525] Because the loan program has not been implemented, this report will address only the securities program.

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[521] Treasury conversations with Panel staff (Jan. 8, 2010).

[522] Treasury Announces Restructuring of Commitment To GMAC, *supra* note 170.

[523] GMAC Financial Services, *2009 Fourth Quarter Strategic Actions* (Jan. 5, 2009) (online at phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MjY1MzIxN3xDaGlsZElEPTM2MzQ5M3xUeXBlPTI=&t=1); Samuel Spies, *GMAC Expects to Report Q4 Loss of about $5B,* SNL Financial (Jan. 5, 2010).

[524] 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).

[525] "Legacy securities" are defined as "Troubled real estate-related securities (residential mortgage-backed securities or commercial mortgage-backed securities), and other asset-backed securities lingering on institutions' balance sheets because their value could not be determined." Treasury Decoder, *supra* note 148.

The PPIP was designed to draw private capital into the legacy securities market by creating public-private investment funds financed by private investors, whose capital contributions are matched dollar-for-dollar by Treasury using TARP funds. The funds may also obtain debt financing from Treasury equal to the full value of the fund's capital investments.[526] The funds, called PPIFs, are managed by fund managers who have been selected by Treasury through an application process. According to Treasury, those who were ultimately selected were chosen based on a combination of the following criteria:

1. Demonstrated capacity to raise a minimum amount of private sector capital;
2. Demonstrated experience investing in targeted asset classes, including through performance track records;
3. A minimum amount (market value) of the targeted asset classes currently under management;
4. Demonstrated operational capacity to manage the investments in a manner consistent with Treasury's stated investment objectives while also protecting taxpayers; and
5. Headquartered in the United States (although the ultimate parent company need not be headquartered in the United States).[527]

Treasury ultimately selected nine funds, all of which have succeeded in raising the private capital necessary to qualify as fund managers under the program.[528] As of December 31, 2009, Treasury has committed approximately $30 billion in eight funds.[529] Of the $30 billion invested under PPIP, $19.9 billion was committed as senior debt and $9.9 billion as equity.[530] Treasury received notes in exchange for its loans, with the "same duration as the underlying fund."[531]

The PPIFs are structured as limited partnerships, with the Fund Manager serving as General Partner and Treasury, along with the other private investors, serving as Limited Partners. Under the terms of the partnership agreements, the General Partners have broad authority for the "management, operation and policy of the Partnership," which is "vested exclusively in the General Partner."[532] Concerns have been expressed over Treasury's apparent lack of control over the funds and the funds' lack of transparency

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[526] This financing may include TALF financing, as described in Section D.10, *infra*.

[527] U.S. Department of the Treasury, *Guidelines for the Legacy Securities Public-Private Investment Program* (accessed Jan. 6, 2010) (online at www.financialstability.gov/docs/ProgramGuidelinesS-PPIP.pdf).

[528] One fund was recently frozen under the Key Man provision of the partnership agreement creating the fund due to the departure of the person named in that provision from the fund.

[529] TARP Transactions Report for Period Ending December 30, 2009, *supra* note 166, at 19.

[530] These amounts represent Treasury's total commitment and not the actual amount disbursed. *Id.*

[531] *See* U.S. Department of the Treasury, *Public-Private Investment Program: $500 Billion to $1 Trillion Plan to Purchase Legacy Assets* (online at www.treas.gov/press/releases/reports/ppip—whitepaper—032309.pdf) (accessed Jan. 12, 2010). This expiration term will apply unless the note is accelerated in the event of default or the fund is dissolved earlier. *See, e.g.,* U.S. Department of the Treasury, *Loan Agreement* (online at www.financialstability.gov/docs/Loan%20Agreement%20(redacted)%20-%20AB.PDF) (accessed Jan. 12, 2010).

[532] *Amended and Restated Limited Partnership Agreement for AllianceBernstein Legacy Securities Master Fund, L.P.,* at 25 (online at www.financialstability.gov/docs/AB%20Complete%20LPA%20(redacted).pdf). The partnership agreements for the remaining PPIFs contain identical language.

regarding their trading activities.[533] Although the agreements require the General Partners to obtain Treasury approval for certain actions, these actions are limited and generally involve the PPIFs venturing beyond the prescribed terms of the program by, for example, purchasing assets other than those designated as "eligible assets" under the terms of the program. Obviously, as partner in the funds, Treasury has the right and ability to counsel the General Partners regarding investment strategy, but there is no provision in the agreements to provide Treasury with the ability to manage the assets directly or to dictate the General Partners' management of the assets. Treasury has yet to implement any measures to address these concerns.

Under the agreements, each fund is able to conduct business in the legacy securities markets until the eighth anniversary of its inception, subject to a two-year extension with Treasury's consent, unless the fund is terminated earlier by the General Partner.[534] Thus, the funds will be terminated and dissolved no later than 2020.[535] After outstanding debt is repaid, any remaining funds will be divided equally between Treasury (on account of its equity investment) and the private investor.

As of the date of this report, neither Treasury nor the funds have disclosed the nature of the PPIFs' investments.

While Treasury will have no direct role in selling the assets held by the PPIFs, and therefore will not need as detailed an exit strategy as other programs will require, OFS will continue to have a responsibility to monitor the Fund Managers and the funds' investments.

10. TALF

Another small TARP program, the Term Asset-Backed Securities Loan Facility (TALF), will require very little action to facilitate a complete exit. FRBNY created the TALF in response to "near-complete halt" of the asset-backed securities (ABS) market in October 2008.[536] Under the TALF, FRBNY provides non-recourse, three- to five-year loans to eligible borrowers who pledge qualifying ABS or commercial mortgage-backed securities.[537] FRBNY receives month-

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[533] *See* COP August Oversight Report, *supra* note 65; SIGTARP, *Quarterly Report to Congress,* at 171 (July 21, 2009) (online at www.sigtarp.gov/reports/congress/2009/July2009_Quarterly_Report_to_Congress.pdf) (expressing concern over the lack of transparency in the PPIFs' trading activities and holdings and requesting that Treasury take measures to address these concerns).

[534] U.S. Department of the Treasury, *Public-Private Investment Program* (online at www.financialstability.gov/roadtostability/publicprivatefund.html) (accessed Dec. 31, 2009) (providing redacted versions of every executed partnership agreement between Treasury and the private investor in establishing PPIFs).

[535] Before Treasury and the private investor are paid on behalf of their capital investments, the PPIF must first repay loans plus principle, if any, under TALF. As previously discussed in this Section and Section D.9 *supra,* Treasury may also receive a portion of this debt repayment as a result of its financing of TALF's SPV.

[536] *See* Federal Reserve Bank of New York, *Term Asset-Backed Securities Loan Facility: Frequently Asked Questions* (online at www.newyorkfed.org/markets/talf_faq.html) (hereinafter "TALF Frequently Asked Questions") (accessed Jan. 12, 2010) ("The asset-backed securities (ABS) market has been under strain for some months. This strain accelerated in the third quarter of 2008 and the market came to a near-complete halt in October").

[537] In addition to other criteria, an "eligible borrower" must be a "U.S. company," as defined by FRBNY. *See generally* TALF Terms and Conditions, *supra* note 27. "Eligible collateral" includes ABS that have a long-term AAA credit rating and are backed by one or more of the following classes of securities: auto loans, student loans, credit card loans, equipment loans, floorplan loans, insurance premium finance loans, small business loans fully guaranteed as to principal and interest by the U.S. Small Business Association, receivables related to residential

ly interest payments on these loans.[538] As of December 31, 2009, TALF loan requests totaled approximately $61 billion.[539] Unless FRBNY grants an extension,[540] the TALF will no longer make new loans after March 31, 2010 for loans collateralized by ABS, and after June 30, 2010 for loans collateralized by commercial mortgage-backed securities.[541]

Treasury has currently committed up to $20 billion in TARP funds under the TALF.[542] This amount is incrementally funded and, as of September 30, 2009, Treasury has only disbursed $100 million under the program.[543] In exchange for any amount disbursed, Treasury will receive a promissory note bearing interest at LIBOR plus 3 percent.[544] Pursuant to an agreement to subordinate its debt, Treasury's loan will be repaid only after FRBNY's loans, if any, are paid in full with interest.[545] This program is administered by FRBNY, and Treasury has limited discretion regarding its management.

Because a TALF loan is non-recourse,[546] if the borrower defaults, FRBNY cannot take action against the borrower. Instead, FRBNY takes ownership of the collateral. In turn, FRBNY sells the collateral to TALF, LLC,[547] a special purpose vehicle (SPV) formed to facilitate this program. The SPV purchases the recovered collateral from FRBNY at a price equal to the defaulted TALF loan amount, plus accrued unpaid interest and fees.[548] As of December 31, 2009, no TALF loans have defaulted, and the SPV contains only $100 million of Treasury's seed funding.[549]

Treasury's $20 billion commitment to the TALF is to provide the initial funding of this SPV.[550] To the extent the SPV purchases as-

mortgage servicing advances (servicing advance receivables), or commercial mortgage loans. *See generally id.*

[538] *See generally* TALF Terms and Conditions, *supra* note 27.

[539] Federal Reserve Bank of New York, *Term Asset-Backed Securities Loan Facility: CMBS* (online at www.newyorkfed.org/markets/CMBS_recent_operations.html) (accessed Jan. 12, 2010) (hereinafter "FRBNY CMBS Recent Operations"); Federal Reserve Bank of New York, *Term Asset-Backed Securities Loan Facility: non-CMBS* (online at www.newyorkfed.org/markets/talf_operations.html) (accessed Jan. 12, 2010) (hereinafter "FRBNY non-CMBS Recent Operations").

[540] TALF has already been granted one extension, which authorized this program to continue beyond December 31, 2009, the original termination date. Board of Governors of the Federal Reserve System, *Federal Reserve and Treasury Department Announce Extension to Term Asset-Backed Securities Loan Facility* (TALF) (Aug. 17, 2009) (online at www.federalreserve.gov/newsevents/press/monetary/20090817a.htm).

[541] TALF Terms and Conditions, *supra* note 27.

[542] TARP Transactions Report for Period Ending December 30, 2009, *supra* note 166.

[543] Agency Financial Statement 2009, *supra* note 32.

[544] U.S. Department of the Treasury, *Credit Agreement among TALF LLC as Borrower, FEDERAL RESERVE BANK OF NEW YORK, as Controlling Party, FEDERAL RESERVE BANK OF NEW YORK, as the Senior Lender and UNITED STATES DEPARTMENT OF THE TREASURY, as the Subordinated Lender* at 12 (Mar. 3, 2009) (online at www.financialstability.gov/docs/SPV-Credit-Agt.pdf) (hereinafter "TALF Credit Agreement").

[545] TALF Credit Agreement, *supra* note 544. FRBNY's loans, if any, are secured by a first priority lien on all assets of the SPV. *See* U.S. Department of the Treasury, *Security and Intercreditor Agreement among TALF LLC, as borrower, FEDERAL RESERVE BANK OF NEW YORK, as Senior Lender, UNITED STATES DEPARTMENT OF THE TREASURY, as Subordinated Lender, FEDERAL RESERVE BANK OF NEW YORK, as Controlling Party, and THE BANK OF NEW YORK MELLON, as Collateral Agent* (Mar. 3, 2009) (online at www.financialstability.gov/docs/SPV-Sec-Agt.pdf).

[546] "The TALF loan is non-recourse except for breaches of representations, warranties, and covenants, as further specified in the MLSA." TALF Frequently Asked Questions, *supra* note 536.

[547] TARP Transactions Report for Period Ending December 30, 2009, *supra* note 166.

[548] TALF Terms and Conditions, *supra* note 27.

[549] Agency Financial Statement 2009, *supra* note 32, at 53.

[550] TALF Terms and Conditions, *supra* note 27.

sets exceeding $20 billion, FRBNY will loan the SPV the additional funding. As mentioned above, FRBNY's loan to the SPV, if any, will be senior to Treasury's loan. To the extent there are any assets remaining in the SPV after both FRBNY and Treasury have been repaid, those assets will be shared equally between FRBNY and Treasury.[551]

Loans extended by Treasury and FRBNY to the SPV are due on the 10th anniversary of the credit agreement, subject to extension by FRBNY upon receipt of Treasury's consent.[552] Treasury has informed Panel staff that if an ABS sold to the SPV is underwater, the SPV will hold the asset until it appreciates in value before disposing of it, thereby increasing the likelihood of Treasury being repaid in full and with interest.[553] While potentially maximizing taxpayer returns, this exit strategy may also have the effect of prolonging the winding down process and therefore Treasury's involvement in the market. Moreover, it will be the SPV created by FRBNY that will manage any assets it holds.[554] Consequently, within the 10-year period after the execution of the credit agreement, Treasury has little to no control over when its loan will be repaid.

11. Small Business Programs

a. Programs

Treasury has yet to acquire any assets under its small business initiatives, but it has committed $15 billion in TARP funds out of the $35 billion it has allocated toward supporting small businesses so far, to potentially do so.[555] Treasury's small business initiatives are three-pronged: $20 billion pledged as credit protection under the TALF, $15 billion directed to the purchase of Small Business Administration (SBA)-guaranteed securities, and a still-evolving initiative to provide capital assistance to small banks in return for commitments to lend to small businesses.[556] As relates to the first two initiatives, Treasury may directly acquire assets should it elect to purchase SBA-guaranteed securities, but it will not receive assets from its TALF credit protection pledge.[557] It is still unclear what assets, if any, Treasury may receive from its latest initiative.

[551] Board of Governors of the Federal Reserve System, *Term Asset-Backed Securities Loan Facility (TALF) Terms and Conditions* (online at www.federalreserve.gov/newsevents/press/monetary/monetary20081125a1.pdf) (hereinafter "TALF Terms and Conditions").

[552] Assuming the agreement closed in 2009, FRBNY and Treasury loans would become due in 2019. The credit agreement is considered "closed" upon the satisfaction or waiver of certain preconditions stipulated therein. TALF Credit Agreement, *supra* note 544.

[553] Treasury conversations with Panel staff (June 24, 2009).

[554] Assuming the agreement closed in 2009, FRBNY and Treasury loans would become due in 2019. The credit agreement is considered "closed" upon the satisfaction or waiver of certain preconditions stipulated therein. TALF Credit Agreement, *supra* note 544.

[555] U.S. Department of the Treasury, *Fact Sheet: Unlocking Credit for Small Businesses* (Oct. 19, 2009) (online at www.financialstability.gov/roadtostability/unlockingCreditforSmallBusinesses.html) (hereinafter "Small Business Fact Sheet").

[556] Small Business Fact Sheet, *supra* note 555. *Cf.* U.S. Department of the Treasury, *Consumer & Business Lending Initiative* (July 17, 2009) (online at www.financialstability.gov/roadtostability/lendinginitiative.html) (hereinafter "Consumer & Business Lending Initiative"); *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 New Small Business Efforts").

[557] Small Business Fact Sheet, *supra* note 555; *see* TALF Terms and Conditions, *supra* note 551 (accessed Jan. 12, 2010).

Under the TALF, as noted above, Treasury provides up to $20 billion of TARP funds as a credit backstop against first losses on FRBNY's overall $200 billion program commitment.[558] At present, approximately $62 billion in TALF loans have been requested.[559] For Treasury's backstop to be fully depleted, and for FRBNY to incur any loan losses subsequently, posted collateral would need to decline in value by more than one-third.

Another of Treasury's small business initiatives calls for the purchase of up to $15 billion in securities backed by SBA loans: the government-guaranteed portion of SBA 7(a) loans and the non-government-guaranteed first-lien mortgage loans affiliated with the SBA's 504 loan program.[560] Although an active secondary market traditionally allowed commercial lenders to sell the government-guaranteed portion of their 7(a) loans, providing lenders with new capital and allowing them to offer additional loans, beginning last fall, the secondary market for SBA-guaranteed securities froze.[561] Unable to shed the risk from their books, commercial lenders significantly curtailed their lending activities.[562] Treasury enacted this initiative in March 2009 to "jumpstart credit markets for small businesses."[563]

Under the initiative, Treasury hired Earnest Partners, an independent investment manager with SBA-guaranteed loan experience, to guide its efforts to buy the securities.[564] Unlike the TALF, Treasury's program to purchase SBA-guaranteed securities does not utilize private-sector pricing. Rather, Treasury may purchase securities directly from "pool assemblers" and banks.[565] According to Treasury's implementation documents, "Treasury and its invest-

[558] Consumer & Business Lending Initiative, *supra* note 556.

[559] This figure includes both CMBS and non-CMBS loans requested as of December 3, 2009. *See* FRBNY CMBS Recent Operations, *supra* note 539; FRBNY non-CMBS Recent Operations, *supra* note 539.

[560] Small Business Fact Sheet, *supra* note 555. Under its 7(a) Loan Program, the Small Business Administration (SBA) guarantees a portion of qualified loans made and administered by commercial lenders. The SBA does not make 7(a) loans, nor fully guarantee them—the lender and SBA share the risk that a borrower will not fully repay the loan. U.S. Small Business Administration, *SBA Programs Office* (online at www.sba.gov/financialassistance/borrowers/guaranteed/7alp/index.html) (accessed Nov. 24, 2009).

[561] From 2006 through 2008, between 40 and 45 percent of the SBA guaranteed portion of 7(a) loans were sold into the secondary market. *See* 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); Congressional Oversight Panel, *May Oversight Report: Reviving Lending to Small Businesses and Families and the Impact of the TALF,* at 52 (May 7, 2009) (online at cop.senate.gov/documents/cop-050709-report.pdf) (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).

[562] Small Business Fact Sheet, *supra* note 555.

[563] Small Business Fact Sheet, *supra* note 555.

[564] 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%20 be%20posted.pdf) (updated Nov. 12, 2009); *See* SIGTARP, *Quarterly Report to Congress,* at 112 (Apr. 21, 2009) (online at www.sigtarp.gov/reports/congress/2009/April2009_Quarterly_Report_to_Congress.pdf).

[565] 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. 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 on Implementation").

ment manager will analyze the current and historical prices for these securities" in order to "identify opportunities to purchase the securities at reasonable prices."[566] 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."[567]

Treasury has $3 billion apportioned for its direct purchase program, and despite stating 7(a) and 504 purchases would begin by May 2009, Treasury has not yet made any purchases under the program.[568] A rejuvenated secondary market for SBA loans, as Treasury previously noted, has tempered the need for an earlier start to the program.[569] If Treasury does engage in direct purchases, it plans to either sell the securities to private investors or pursue a buy-and-hold strategy, depending on market conditions.[570]

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 low-cost capital to community banks to be used in small business lending.[571] 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 CPP. These small banks will be able to receive capital totaling up to 2 percent of their risk weighted assets.[572] For community development financial institutions that can document that 60 percent of their small business lending targets low income communities or underserved populations,[573] this dividend rate will be only two percent. As currently conceived,[574] 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.[575] Further implementing details for this program have not been announced as of the release of this report.

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[566] *Id.*
[567] *Id.*
[568] 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); Unlocking Credit for Small Businesses: FAQ on Implementation, *supra* note 565.
[569] Between May and October, the total volume of loans settled from lenders to broker averaged $344 million, exceeding pre-crisis levels. By comparison, in January total volume was $85.9 million. U.S. Department of the Treasury, *SBA Host Small Business Financing Forum* (Nov. 18, 2009) (online at www.financialstability.gov/latest/tg—11182009.html) (hereinafter "SBA Host Small Business Financing Forum"). *See also* Unlocking Credit for Small Businesses: FAQ on Implementation, *supra* note 565.
[570] SBA Host Small Business Financing Forum, *supra* note 569.
[571] 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 New Small Business Efforts, *supra* note 556.
[572] *See id.*
[573] Community development financial institutions, which are certified by the federal government, provide loans to underserved communities.
[574] *See* President Obama Announces New Small Business Efforts, *supra* note 556.
[575] *See id.*

b. Future Considerations

Small businesses continue to experience an inability to access credit.[576] Treasury has indicated that measures to "get credit to small businesses" will be a key driver in Treasury's economic recovery strategy.[577] At the Panel's December hearing, Secretary Geithner stated that new TARP investments would be limited to "housing, small business, and securitization markets that facilitate consumer and small business loans." [578] In the process of doing so, the Secretary noted, Treasury is "reserving funds for additional efforts to facilitate small business lending." [579]

Treasury, in coordination with the SBA, held a Small Business Financing Forum on November 18, 2009, convening "entrepreneurs, small business owners, lenders, policymakers and regulators to assess additional ways to spur small business growth." [580] Secretary Geithner delivered a summary of participant views and recommendations to President Obama on December 3, 2009.

As of the date of this report, it is still unclear which proposals, if any, the Administration is considering, and Treasury has not allocated additional TARP funds to support new small business initiatives beyond those discussed above.[581] It is possible, however, that small business initiatives will result in Treasury's acquisition of additional assets. As Secretary Geithner noted at the Panel's December hearing, small banks have been reluctant to participate in Treasury's recent low-cost-capital initiative for fear of being stigmatized or having operating conditions attached.[582] Because community bank lending is tied to small business growth, which often feeds job creation, Treasury's success in tailoring its small business programs to facilitate such lending will be essential to the success of Treasury's adapted TARP strategy.

Moving forward, as other TARP programs wind down, Treasury should be transparent about its eventual exit plans for programs that are not yet under way.

E. Unwinding TARP Expenditure Programs

Some of Treasury's TARP initiatives will neither generate fees, nor acquire assets with the potential to increase in value. These initiatives constitute non-recoverable expenditures from the TARP, whereby Treasury can only realize monetary losses on these programs. To date, this exposure relates solely to Treasury's mortgage foreclosure mitigation efforts, including disbursements or potential disbursements, made under Treasury's HAMP initiative and its subprograms, but may also apply to the small business initiatives

[576] *See* U.S. Department of the Treasury, *Report to the President Small Business Financing Forum* (Dec. 3, 2009 (online at www.financialstability.gov/docs/Small%20Business%20Financing%20Forum%20Report%20FINAL.PDF) (hereinafter "Report to the President Small Business Financing Forum").

[577] Agency Financial Statement 2009, *supra* note 32.

[578] *Id.*

[579] *Id.*

[580] *See* Report to the President Small Business Financing Forum, *supra* note 576.

[581] Senator Mark Warner has also offered a proposal calling for the reallocation of up to $40 billion in unused TARP funds to create a small business loan fund. Participating regional and community banks would be required to contribute up to $10 billion and assume first-dollar losses on the loans. On October 21, 2009, Senator Warner sent President Obama a letter signed by 32 Senate colleagues seeking Administration backing for the proposal. Letter from Senator Mark R. Warner to President Barack Obama (Oct. 21, 2009).

[582] *See* Agency Financial Statement 2009, *supra* note 32.

discussed above.[583] HAMP is the largest of the Making Home Affordable programs and presents the most exposure for monetary losses. As Secretary Geithner noted of HAMP at the Panel's December 10, 2009 hearing, "expenditures through [HAMP] were never intended to generate revenue." [584] Rather, HAMP "was created to help mitigate foreclosure for responsible but at-risk homeowners." [585]

1. HAMP

Under HAMP, Treasury allocated up to $50 billion from the TARP to modify private-label mortgages. To prevent foreclosures, Treasury shares the cost of reducing monthly payments on certain delinquent loans and provides targeted incentives to borrowers, investors, and servicers that participate in the program.[586] Treasury currently estimates it will spend $48.756 billion for private-label loans under HAMP. Of the initial $50 billion allocation, $1.244 billion will never be obligated due to the fact that TARP authority was reduced by this amount under the Helping Families Save their Home Act. Treasury has currently obligated $35.5 billion of the amount, reflecting Treasury's legal commitments to 102 servicers as of December 31, 2009.[587] Due to HAMP's payment structure, including delayed payments and a long disbursement cycle, only a fraction of TARP funds have been paid out to date.[588]

HAMP provides lenders/investors with cost-share payments for up to five years for half the cost of reducing a borrower's payment from 38 percent to 31 percent of the borrower's gross monthly income.[589] Investors must pay for reducing the borrower's payment down to the 38 percent threshold before they are able to benefit from the cost-share incentive.[590]

HAMP also provides targeted incentive payments for first- and second-lien mortgage modifications. On first-lien mortgages, targeted incentives include an up-front payment of $1,000 to the servicer for each successful modification following the completion of the borrower's trial period, and "pay for success" fees of up to $1,000 annually for three years if the borrower remains current.[591] Additional one-time incentives include $500 to servicers and $1,500 to investors if loans are successfully modified for distressed bor-

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[583] In keeping with the scope of this report, this section examines only Treasury's monetary exposure related to its mortgage foreclosure mitigation programs. For an in-depth assessment of Treasury's mortgage foreclosure mitigation efforts, see the Panel's October 2009 report. *See* 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.pdf) (hereinafter "COP October Oversight Report"); *see also* COP December Oversight Report, *supra* note 514.

[584] Agency Financial Statement 2009, *supra* note 32.

[585] *Id.*; OFS FY09 Financial Statements, *supra* note 133, at 3. ("In particular, the $50 billion Home Affordable Modification Program or 'HAMP,' is not designed to recoup money spent on loan modifications to keep people in their homes.")

[586] 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) (hereinafter "MHA Program Description").

[587] TARP Transactions Report for Period Ending December 30, 2009, *supra* note 166.

[588] OFS FY09 Financial Statements, *supra* note 133. (Treasury's FY 2009 net cost of operations of $41.6 billion includes the estimated net cost related to loans, equity investments, and asset guarantees. Due to its program structure, the $50 billion HAMP has delayed payments as well as a long disbursement cycle so the FY 2009 amounts include only $2 million in cost.)

[589] MHA Program Description, *supra* note 586.

[590] MHA Program Description, *supra* note 586.

[591] MHA Program Description, *supra* note 586.

rowers who are current but are in danger of imminent default.[592] Homeowners also earn up to $1,000 towards principal balance reduction annually for five years contingent on their remaining current with payments.[593] Treasury estimates that up to 50 percent of at-risk mortgages have second liens.[594] In order to address second lien debts, such as home equity lines of credit or second mortgages, HAMP encourages servicers to contact second lien holders and negotiate the extinguishment of the second lien.[595] Servicers are eligible to receive payments of $500 per second lien modification, as well as success payments of $250 per year for three years, provided the modified first loan remains current.[596] Borrowers also receive success payments for participating of $250 per year for up to five years that are used to pay down the principal on the first lien.[597]

Treasury utilizes mortgage servicers to carry out the process of modifying mortgages. In exchange for agreeing to follow Treasury's standardized guidelines and process, participating servicers are eligible for the various program incentive payments. Under the Servicer Participation Agreements, Treasury has authorized each participating servicer to modify mortgages through December 31, 2012. Because mortgages will continue to be modified past the October 2010 expiration of TARP, it is important to consider how various aspects of the program will function.

HAMP modifications begin with a three-month trial modification period for eligible borrowers, although the maximum trial period was recently extended to allow borrowers additional time to provide necessary documentation. After three months of successful payments at the modified rate and provision of full supporting documentation, the modification becomes permanent. December 31, 2012 will be the last date upon which servicers can commence a new trial modification. Under current program guidelines, the last date for a possible conversion to permanent status is May 1, 2013.

Presuming a HAMP modification remains current, incentive payments will extend into the future for five years after the trial modification converts to permanent status, long past the scheduled expiration of the TARP. Based on the final date for a modification to become permanent, servicer incentive payments could continue until May 1, 2016, and borrower incentive payments could continue until May 1, 2018. Following the expiration of TARP and following the expiration of servicers' authority to continue making new modifications, scheduled payments will continue to be made by Fannie Mae, Treasury's financial agent, as they are currently. HAMP payments are made to servicers monthly via wire transfer in a consoli-

[592] Imminent default determinations are made by servicers based on the borrower's financial condition in light of hardship as well as the condition of and circumstances affecting the property securing the mortgage. U.S. Department of the Treasury, *Supplemental Documentation—Frequently Asked Questions Home Affordable Modification Program* (Nov. 12, 2009) (online at www.hmpadmin.com/portal/docs/hamp_servicer/hampfaqs.pdf) (hereinafter "Supplemental Documentation for HAMP").

[593] MHA Program Description, *supra* note 586.

[594] U.S. Department of the Treasury, *Making Home Affordable: Program Update* (Apr. 28, 2009) (online at www.financialstability.gov/docs/042809SecondLienFactSheet.pdf) (hereinafter "Making Home Affordable: Program Update").

[595] *Id.*

[596] *Id.*

[597] *Id.*

dated manner.[598] Payments are remitted to servicers either for themselves or on behalf of borrowers and investors.[599] Servicers apply payments made to borrowers directly to reducing the principal of the borrower's mortgage.[600] Cost-share payments to investors/security holders accrue monthly as of the completed modification, not from the start of the trial period. Servicers are responsible for delivering these payments to the appropriate investors/security holders.[601]

Treasury anticipates that HAMP expenses will increase significantly over time, "as more modifications of mortgage payments are finalized between mortgage servicers and borrowers, resulting in increased incentive payments."[602] As more money flows, the need for strong oversight becomes even more important. Freddie Mac serves as Treasury's compliance agent and monitors servicer payments to ensure the proper remittance of funds to investors/security holders and the proper application of funds to borrowers' accounts.[603] Freddie Mac will continue in this role after the expiration of the TARP.

Payments under HAMP are contingent on borrowers remaining in "good standing." A borrower loses good standing when an amount equal to three full monthly payments is due and unpaid on the last day of the third month in which payments were due. If this occurs, good standing cannot be restored, and the borrower permanently loses eligibility to receive further incentives and reimbursements under HAMP. A borrower who fails a HAMP modification is not eligible for another HAMP offer, even if the borrower fully cures the delinquency. However, the servicer is obligated to work with the borrower to attempt to cure their delinquency. If a cure cannot be reached, the servicer must consider the borrower for "any other home retention loss mitigation options that may be available." If those options are unsuccessful, a short sale or deed-in-lieu must be considered.[604] Notwithstanding any future changes Treasury may make to the program, provisions addressing troubled modifications and redefaults will not change following the expiration of the TARP or the cessation of additional modifications.

The October 2010 expiration of TARP will have one notable effect on the foreclosure mitigation programs by freezing the maximum number of modifications, even though the program will continue to operate. The funds available to pay servicer, borrower, and investor payments are capped based upon each servicer's Servicer Participation Agreement.[605] Treasury established the amount in each servicer's initial program participation cap by "estimating the number of HAMP modifications expected to be performed by each

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[598] Monthly incentive payments are distributed on a consolidated basis, rather than by individual loan. Supplemental Documentation for HAMP, *supra* note 592, at 25.

[599] Fannie Mae provides loan-level accounting for the incentives. *Id.*

[600] Making Home Affordable: Program Update, *supra* note 594.

[601] Treasury is not providing guidance on how those funds are to be passed through to security holders of securitization trusts.

[602] See Agency Financial Statement 2009, *supra* note 32 ("We need to continue to find ways to help mitigate foreclosures for responsible homeowners . . .").

[603] Supplemental Documentation for HAMP, *supra* note 592, at 25.

[604] Supplemental Documentation for HAMP, *supra* note 592, at 25.

[605] U.S. Department of the Treasury, *Supplemental Directive 09–01 Introduction of the Home Affordable Modification Program,* at 23 (online at www.hmpadmin.com/portal/docs/hamp__servicer/sd0901.pdf) (hereinafter "Supplemental Directive for HAMP").

servicer during the term of the HAMP."[606] Once a servicer's cap is reached, a servicer cannot "enter into any agreements with borrowers intended to result in new loan modifications, and no payments will be made with respect to any new loan modifications."[607] Treasury, at its sole discretion, can adjust a servicer's cap based on an updated estimate of the number of HAMP modifications the servicer is expected to perform.[608] For example, the total initial allocation to servicers was $23.6 billion, but the various allocations have been increased by a total of $11.9 billion to the current cap of $35.5 billion. However, Treasury will only commit funds to servicers until TARP's October 2010 expiration.[609] This means that after October 3, 2010, the maximum amount each servicer is authorized to modify under HAMP will be locked into place, and Treasury can no longer increase a servicer's cap, only decrease it, through the end of the program.

2. Future Considerations

Moving forward, Treasury has stated that its focus will remain on foreclosure mitigation as a key part of its new TARP commitment strategy.[610] The prospect of future initiatives raises important questions about future expenditures, timetables, management, supervision and enforcement, in addition to Treasury's relationship to servicers and borrowers going forward. At this time, Treasury has not announced any changes to the foreclosure mitigation programs on these points. Further, as noted in the Panel's October 2009 report, the foreclosure problem is far from abating, and with rising unemployment, widespread deep negative equity, and recasts on payment-option adjustable rate mortgages and interest-only mortgages increasing in volume, there is no immediate sign of a resolution to the foreclosure crisis in sight.[611] While Treasury has structured the Servicer Participation Agreements to allow servicers to modify mortgages through 2012, it is unclear that Treasury would have the authority to introduce any new foreclosure initiatives or make changes to existing programs past the October 2010 expiration of the TARP. Therefore, should Treasury intend to make changes to address these matters, the changes would need to be implemented relatively soon.

Treasury identified its key challenges related to HAMP going forward as three-fold: To reach more eligible borrowers, to help borrowers convert more modifications from trial to permanent, and to increase transparency to assure the public that the program is helping homeowners as intended.[612] Of these objectives, borrower

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[606] *Id.*
[607] *Id.*
[608] *Id.*
[609] U.S. Department of the Treasury, *Making Home Affordable Borrower Frequently Asked Questions,* at 11 (July 16, 2009) (online at www.financialstability.gov/docs/borrower__qa.pdf).
[610] *See* Agency Financial Statement 2009, *supra* note 32; Sec. Geithner Written Testimony, *supra* note 32, at 5 ("Second, we must fulfill EESA's mandate to preserve home ownership, stimulate liquidity for small businesses, and promote jobs and economic growth. To do so, we will limit new commitments in 2010 to three areas. We will continue to mitigate foreclosure for responsible American homeowners as we take the steps necessary to stabilize our housing market").
[611] *See* COP October Oversight Report, *supra* note 583.
[612] House Financial Services Committee, Written Testimony of Assistant Secretary Herbert Allison, *The Private Sector and Government Response to the Mortgage Foreclosure Crisis* 111th

Continued

conversions is the "central focus."[613] HAMP was not designed to address foreclosures caused by unemployment, which now appears to be a central cause of nonpayment. Testifying before the House Financial Services Committee in December, Assistant Secretary Allison stated:

> While our key focus is on helping as many borrowers as quickly as possible under the current program, Treasury recognizes that unemployment presents unique challenges and is still actively reviewing various ideas and suggestions in order to improve implementation and effectiveness of the program in this area.[614]

Finally, as Treasury winds down the foreclosure mitigation programs under the TARP, it must be cognizant of the intersection of these programs with other non-TARP programs and initiatives, which may also be unwound or changed. For example, the Federal Reserve's monetary policy has produced low interest rates, which have stimulated greater demand for mortgage financed home purchases by lowering the cost of capital, and federal government support for the GSEs and the private label mortgage backed securities market has also contributed to liquidity and thus lowered the costs of mortgage capital. This level of support cannot continue indefinitely, however, and as long as foreclosures and real estate owned inventory flood the housing market and contribute to an oversupply of housing stock for sale, there will be strong downward pressure on home prices.

F. What Remains and What Additional Assets Might Be Acquired?

Set forth above in Sections D and E is a summary of the TARP initiatives that are open and closed to new expenditures. As of December 30, 2009, $65.5 billion of TARP funds have been committed and not used and $336.2 billion of TARP funds remains uncommitted.[615] On December 10, 2009, Secretary Geithner announced that Treasury will continue to wind down programs put in place to address the crisis. During the fourth quarter of 2009, the CPP ended. New TARP commitments in 2010 will be in three areas:

- Continuing foreclosure mitigation;[616]
- Providing capital to small and community banks and reserve funds to facilitate small business lending;[617] and
- Increasing commitment to the TALF.[618]

In addition, if passed, the following proposed legislation includes several provisions that would impact the TARP.

H.R. 4173, the *Wall Street Reform and Consumer Protection Act of 2009*, passed the House of Representatives on December 11, 2009 by a vote of 223 to 202.[619] The bill includes a series of measures

Cong. (Dec. 8, 2009) (online at www.house.gov/apps/list/hearing/financialsvcs__dem/herb__allison.pdf).

[613] *Id.*

[614] *Id.*

[615] *See* Figure 22.

[616] For further discussion, *see* Section E, *infra*.

[617] For further discussion, *see* Section D.11, *infra*.

[618] For further discussion, *see* Section D.10, *infra*.

[619] *Wall Street Reform and Consumer Protection Act of 2009*, H.R. 4173, 111th Cong. (2009).

that would comprehensively reform the U.S. financial regulatory structure. In addition, the bill includes the following TARP provisions:

- The bill would reduce the maximum allowable amount outstanding under TARP by $20.8 billion and use the money to offset the excess costs of the bill.[620]
- An amendment offered by Rep. Barney Frank (D–MA), adopted by a vote of 240 to 182, would authorize Treasury to transfer $3 billion in funds available under EESA to the Department of Housing and Urban Development (HUD) to provide emergency low-interest loans to unemployed homeowners in need of assistance in making mortgage payments and $1 billion to HUD's Neighborhood Stabilization Program to assist states and local governments with the redevelopment of abandoned and foreclosed homes.[621]
- Section 134 of EESA states that should TARP realize a net loss, "the President shall submit a legislative proposal that recoups from the financial industry an amount equal to the shortfall in order to ensure that the Troubled Asset Relief Program does not add to the deficit or national debt." An amendment offered by Rep. Gary Peters (D–MI), adopted by a vote of 225–198, would authorize the FDIC to make assessments on large financial institutions to compensate for any such TARP shortfall.[622]

The Senate Committee on Banking, Housing & Urban Affairs expects to mark up its version of this bill at the end of January 2010.

H.R. 2847, *Jobs for Main Street Act of 2010*, passed the House of Representatives on December 16, 2009, by a vote of 217 to 212.[623] The bill, which originated as the FY 2010 Commerce-Justice-Science appropriations bill, authorizes $154 billion for job creation and the extension of unemployment benefits. The bill would reduce the maximum amount outstanding under the TARP by $150 billion and redirect $75 billion to create new jobs through infrastructure projects ($48.3 billion) and prevent layoffs of state and local employees ($26.7 billion).[624] The remaining $79 billion in spending, not funded through the TARP, would pay for the extension of unemployment benefits and health insurance aid for the jobless, measures that were included in the $787 billion economic

[620] Congressional Budget Office, *Cost Estimate of H.R. 4173, Wall Street Reform and Consumer Protection Act of 2009* (Dec. 9, 2009) (online at www.cbo.gov/ftpdocs/108xx/doc10844/hr4173asreported.pdf).

[621] Representative Barney Frank, Wall Street Reform and Consumer Protection Act of 2009, Congressional Record Vol. 155, No. 186: p. H14663–14664 (Dec. 10, 2009) (online at frwebgate.access.gpo.gov/cgi-bin/getpage.cgi?position=all&page=H14663&dbname=2009_record).

[622] Rep. Gary Peters, Amendment to the Wall Street Reform and Consumer Protection Act of 2009, Congressional Record, H14748–14750 (Dec. 11, 2009) (online at www.congress.gov/cgi-lis/query/D?r111:1:./temp/r111kAWb3J::).

[623] *Jobs for Main Street Act*, H.R. 2847, 111th Cong. (2009).

[624] In its March 2009 baseline projection, the Congressional Budget Office (CBO) estimated that Treasury would use all of the spending authority available under the TARP. That baseline was adopted as the Congress' budget resolution baseline for scorekeeping purposes and is used by CBO for estimating the budgetary impact of legislation until the Congress adopts a new baseline for scorekeeping purposes. Using the March baseline's estimated average subsidy of 50 percent for the use of uncommitted TARP authority, the bill's proposed reduction in authority of $150 billion would result in outlay savings of $75 billion which would be redirected toward job creation initiatives.

stimulus package (Pub. L. 111–5) earlier this year. The Senate is expected to act on this bill in January 2010.[625]

G. Unwinding Implicit Guarantees in a Post-TARP World

There are two kinds of tools available to counteract the effects of implicit guarantees.[626] One is to regulate the institutions that are the beneficiaries of such risks in order to minimize the impact of the guarantees. The second is to create a credible system in which such institutions could be liquidated or otherwise reorganized so that failure is a real possibility.[627] The options may work alone or in concert. In the following section, this report lays out several options that have been discussed by various commentators, and describes legislative proposals by Congress and the current Administration. The Panel does not take a position as to whether any of these options are advisable; the sole purpose in describing the options available is to provide a brief survey of current thought on this issue.

1. Regulatory Options

The regulatory options most often discussed at present include the following broad categories:

a. Limitations on Size

One school of thought holds that size alone is a threat to the system.[628] The proponents of this theory point out that just four of the 8,100 or so U.S. banks control nearly 40 percent of the deposits in the U.S. banking system,[629] that as of September 30, 2009, the four

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[625] Geof Koss, *House-Passed Jobs Measure Will Wait*, CQ Weekly (Dec. 28, 2009).

[626] It is important to note that implicit guarantees from government subsidization or sponsorship exist in numerous markets. For example, before the mortgage crisis, Government Sponsored Enterprises (GSEs) such as Fannie Mae were thought to be shielded from aggregate credit risks by implicit government backing, allowing them to take on debt at rates below those paid by private institutions. *See* Karsten Jeske & Dirk Kreuger, *Housing and the Macroeconomy: The Role of Implicit Guarantees for Government-Sponsored Enterprises*, Federal Reserve Bank of Atlanta Working Paper 2005–15 (Aug. 2005) (online at papers.ssrn.com/sol3/papers.cfm?abstract_id=811004). Some economists have argued that such implicit guarantees contributed to the mortgage crisis. *See* Vernon L. Smith, *The Clinton Housing Bubble*, Wall Street Journal (Dec. 18, 2007) (online at online.wsj.com/article/SB119794091743935595.html). This report, however, addresses the effects of TARP and its aftermath and so is limited in scope to the concerns created by the implicit guarantee to large financial institutions.

[627] The Panel made a number of recommendations on this topic in its special report on regulatory reform. Congressional Oversight Panel, *Modernizing the American Financial Regulatory System: Recommendations for Improving Oversight, Protecting Consumers, and Ensuring Stability* (Jan. 29, 2009) (online at cop.senate.gov/reports/library/report-012909-cop.cfm).

[628] This seems to be the belief in Europe. Several large, struggling financial institutions have instead been forced to sell off business units, leaving the parent companies smaller but, ostensibly, stronger. Most notably, Royal Bank of Scotland PLC in the UK, ABN Amro in the Netherlands, and Dexia SA in Belgium have all recently announced planned sell-offs. *See* The Royal Bank of Scotland, *RBS Announces Successful Sale of RBS Asset Management Fund Management Assets* (Jan. 8, 2010) (online at www.rbs.com/media/news/press-releases/2010-press-releases/2010-01-08-asset-finance-sale.ashx) (quoting the RBS Group's CFO, Bruce Van Suan as saying "This transaction represents another step in our plan to restructure RBS around its core customer franchises"); Ministry of Finance of the Netherlands, *Government Clears the Way for Integration of ABN Amro and Fortis Bank Netherlands* (Nov. 19, 2009) (online at www.minfin.nl/english/News/Newsreleases/2009/11/Government_clears_the_way_for_integration_of_ABN_AMRO_and_Fortis_Bank_Nederland) (citing letter from Dutch Minister of Finance to the Dutch Lower House of Parliament stating that "the hiving off of business units is necessary"); Dexia, *Societe General and Dexia Complete the Credit du Nord Transaction* (Dec. 11, 2009) (online at www.dexia.com/docs/2009/2009_news/20091210_credit_nord_UK.pdf) (noting that Dexia's divestiture of its 20 percent stake in Credit du Nord is part of the Dexia Group's restructuring plan).

[629] These banks are Citigroup, Bank of America, Wells Fargo, and JPMorgan.

largest banks held 37.9 percent of all domestic assets,[630] and that a collapse of any one of them could bring down the banking system, if not large portions of the economy.[631] While JPMorgan Chase CEO Jamie Dimon argues that a regulatory system could be created to deal with the failure of very large banks, as the FDIC deals with failed commercial banks,[632] the "just too big" school points out that the FDIC system is predicated on the existence of bigger banks that can take over the assets of failed commercial banks, and that no entity exists that can take over a failed very large bank, except the U.S. government.[633] Among the proponents of this argument is former Federal Reserve Chairman Alan Greenspan, who maintains that the solution to the too big to fail problem will require "radical things," such as the forced break-up of very large banks, just as Standard Oil was broken up in 1911.[634] Without such action, Mr. Greenspan believes the implicit subsidy provided to very large firms will result in "a moribund group of obsolescent institutions, which will be a big drain on the savings of this society."[635] David Moss, the John G. McLean Professor of Business Administration at Harvard Business School, suggests an alternative solution to the too big to fail problem in which federal officials identify financial institutions whose failure would pose a systemic threat to the broader financial system and submit such institutions to increased oversight and mandatory federal insurance.[636]

Others have suggested imposing limitations that prohibit banks getting to a specified size. For example, Simon Johnson, Professor of Global Economics and Management at the MIT Sloan School of Management, has suggested that capping assets under management at a single financial institution at $100 billion may permit such institutions to pass easily through the bankruptcy system, obviating the need for bailouts.[637]

Those in favor of retaining very large banks say there is a need within the global economy for large banks capable of lending billions of dollars at a time. Gerald Corrigan, a managing director of

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[630] Specifically, four banks accounted for 37.9 percent of the assets of all insured U.S.-chartered commercial banks with assets of at least $300 million. *See* Board of Governors of the Federal Reserve System, *Large Commercial Banks* (online at www.federalreserve.gov/releases/lbr).

[631] *See, e.g.,* Joint Economic Committee, Written Testimony of Joseph Stiglitz, Professor, Columbia University, *Too Big to Fail or Too Big to Save? Examining the Systemic Threats of Large Financial Institutions*, 111th Cong., at 2–3 (Apr. 21, 2009) (online at jec.senate.gov/index.cfm?FuseAction=Files.View&FileStore‘id=6b50b609-89fa-4ddf-a799-2963b31d6f86).

[632] Jamie Dimon, *No More Too Big To Fail'*, Washington Post (Nov. 13, 2009) (online at www.washingtonpost.com/wp-dyn/content/article/2009/11/12/AR2009111209924.html).

[633] *See, e.g.,* Joint Economic Committee, Written Testimony of Thomas M. Hoenig, President, Federal Reserve Bank of Kansas City, Too Big to Fail or *Too Big to Save? Examining the Systemic Threats of Large Financial Institutions*, 111th Cong., at 23–24 (Apr. 21, 2009) (online at jec.senate.gov/index.cfm?FuseAction=Files.View&FileStore__id__5335d2cb-895a-4075-8db8-a8b71e27f933).

[634] Alan Greenspan, *C. Peter McColough Series on International Economics: The Global Financial Crisis: Causes and Consequences*, Council on Foreign Relations (Oct. 15, 2009) (online at www.cfr.org/publication/20417/c__peter__mccolough__series__on__international__economics.html) (hereinafter "Greenspan on the Causes of the Crisis").

[635] *Id.*

[636] David Moss, *An Ounce of Prevention: The Power of Public Risk Management in Stabilizing the Financial System*, Harvard Business School Working Paper No. 09–087 (Rev. Jan. 27, 2009) (online at www.hbs.edu/research/pdf/09-087.pdf) (hereinafter "David Moss An Ounce of Prevention").

[637] House Financial Services Committee, Written Testimony of Simon Johnson, Ronald A. Kurtz Professor of Entrepreneurship, MIT's Sloan School of Management, *Systemic Risk: Are Some Institutions too Big to Fail, and if so, What Should We Do About It?,* 111th Cong. (July 21, 2009) (online at www.house.gov/apps/list/hearing/financialsvcs__dem/simon__johnson.pdf) (hereinafter "Johnson Testimony on Systemic Risk").

Goldman Sachs & Co., has remarked that it is the size of large financial institutions "that allows [them] to meet the financing needs of large corporations—to say nothing of the financing needs of sovereign governments."[638] And while one commentator has noted that "[t]he presumption . . . that big meant diversified and sophisticated and, therefore, less risky . . . proved false," nonetheless, "the size of many of our financial institutions, despite its role in bringing on the crisis, has also greatly benefited the U.S. economy" by "enabl[ing] our big financial firms to compete against others in Europe and Asia" and that "[s]hould we fragment and constrain the system and cap the size of banks, it would undoubtedly limit the competitive level of service, breadth of products, and speed of execution," leading clients to "turn to foreign banks that don't face the same restrictions."[639]

Martin Baily and Robert Litan of the Brookings Institution have made the same argument, testifying before a Senate committee that "[w]e need very large financial institutions given the scale of the global capital markets, and, of necessity, some of these may be 'too big to fail' because of systemic risks. For U.S. institutions to operate in global capital markets, they will need to be large."[640] Messrs. Baily and Litan further argued that punishing banks for becoming "too" successful will also have a negative impact on the willingness of financial institutions to compete with each other.[641]

Opponents of the view that the global market demands very large banks state that the need for a loan of $8 billion can be met by eight smaller banks each lending $1 billion. They further argue that these banks would compete against each other to provide the best loan terms, improving market efficiency over the current scenario in which a handful of banks provide all of the capital.[642] Such an arrangement would also spread out the risk so that the majority of large transactions would not rest on a small number of very large banks.[643] One commentator has argued that large corporations do not typically use one megabank to complete a significant transaction, but that up to 11 such large banks may be necessary.[644] To the extent that a company operates in multiple countries, this commentator argues, the company is likely to select the best bank for its needs in each country or region, rather than rely-

[638] E. Gerald Corrigan, *Containing Too Big to Fail,* Remarks at The Charles F. Dolan Lecture Series, Fairfield University (Nov. 10, 2009) (online at www.fairfield.edu/documents/academic/dsb_corrigan_remarks_09.pdf).

[639] Mortimer Zuckerman, *Finding the Right Fix for "Too Big to Fail,"* Wall Street Journal (Nov. 25, 2009) (online at online.wsj.com/article/SB10001424052748704888404574550570805868530.html).

[640] Senate Committee on Banking, Housing and Urban Affairs, Testimony of Martin Neil Baily and Robert E. Litan, *Regulating and Resolving Institutions Considered "Too Big to Fail,"* 111th Cong. (May 6, 2009) (online at banking.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=7d66a948-69e4-407e-a895-04cec6a4f541) (hereinafter "Bailey and Litan Testimony").

[641] Bailey and Litan Testimony, *supra* note 640.

[642] *Cf.* Johnson Testimony on Systemic Risk, *supra* note 637 (Dr. Johnson argues that "breaking up our largest banks would likely increase (rather than reduce) the availability of low-cost financial intermediation services"). Ilan Moscovitz and Morgan Housel, *It's Time to End "Too Big To Fail,"* The Motley Fool (Nov. 13, 2009) (online at www.fool.com/investing/general/2009/11/13/its-time-to-end-too-big-to-fail.aspx) (hereinafter "It's Time to End 'Too Big To Fail'").

[643] It's Time to End "Too Big To Fail", *supra* note 642.

[644] James Kwak, *Who Needs Big Banks,* The Baseline Scenario (Oct. 12, 2009) (online at baselinescenario.com/2009/10/12/who-needs-big-banks/) (hereinafter "Who Needs Big Banks").

ing on one-stop-shopping for its banking, countering the argument that multinational companies need multinational banks.[645]

b. Limitations on Activities

Some commentators have advocated for the reinstatement of the provisions of the Glass-Steagall Act, repealed in 1999, which precluded banks from acting as both investment banks and depository institutions. Notably, in May 2009, Congressman Maurice Hinchey (D–NY), with the support of fellow House members John Tierney (D–MA), Jay Inslee (D–WA), John Conyers (D–MI), and Peter DeFazio (D–OR), proposed an amendment that would reinstate those provisions. In announcing the amendment, Representative Hinchey stated that the repeal had created banks that provided "one stop shopping" with the result that "these banks were empowered to make large bets with depositors' money and money they didn't really have. When many of those bets, particularly in the housing sector, didn't pan out, the whole deck of cards came crumbling down and U.S. taxpayers had to come to the rescue."[646] Senators John McCain (R–AZ) and Maria Cantwell (D–WA) have recently introduced a bill in the Senate to prohibit certain affiliations between commercial and investment banks.[647]

Paul Volcker, the former chairman of the Federal Reserve and current chairman of the President's Economic Recovery Advisory Board, has also recommended reinstating a barrier between commercial and investment banks that, while not a full return to Glass-Steagall as it previously existed, would be functionally similar to the barrier that existed under certain repealed sections of that act. Mr. Volcker has proposed breaking up the largest banks into investment houses and commercial banks, with government assistance available only to the commercial banks.[648] The commercial banks would take deposits, make loans, and trade securities for their customers, but not for themselves. These banks would be eligible for government assistance if they were to falter. The investment banks, on the other hand, would be free to engage in riskier behavior because they would be buying and selling their own securities, but they would not be rescued if they were poised to fail. According to Mr. Volcker, regulation is insufficient without separating commercial banks from investment banks. "The [commercial] banks," he has stated, "are there to serve the public, and that is what they should concentrate on. These other activities create conflicts of interest. They create risks, and if you try to control the risks with supervision, that just creates friction and difficulties."[649]

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[645] *Id.*

[646] Office of Representative Maurice Hinchey, *Hinchey to Introduce Amendment to Reinstate Glass-Steagall Act to Break Up MegaBanks that Caused Financial Crisis* (Dec. 7, 2009) (online at www.house.gov/apps/list/press/ny22_hinchey/morenews/120709glassstegallamendment.html).

[647] Banking Integrity Act of 2009, S. 2886, 111th Cong. (2009).

[648] Charlie Rose, *Paul Volcker: The Lion Lets Loose,* BusinessWeek (Dec. 30, 2009) (online at www.businessweek.com/magazine/content/10_02/b4162011026995.htm) (interview of Mr. Volcker in which Mr. Volcker explained his vision of the type of reform needed); *see also* Louis Uchitelle, *Volcker Fails to Sell a Bank Strategy,* New York Times (Oct. 21, 2009) (online at www.nytimes.com/2009/10/21/business/21volcker.html?_r=1) (hereinafter "Volcker Fails to Sell a Bank Strategy") (quoting statements by Mr. Volcker on the same subject).

[649] This position is not far from the "break-up-the-banks" position advocated by Alan Greenspan. Greenspan, however, seems opposed to reinstating Glass-Steagall at this juncture. Volcker Fails to Sell a Bank Strategy, *supra* note 648. While similar in their desire to divide up the

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In response to these arguments, some commentators have stated that the repealed portions of Glass-Steagall have had little impact on the way traditional banks conduct their business, and that reinstating these portions would have implications in the international sphere while doing nothing to prevent another crisis.[650] These commentators note that commercial banks have suffered because of their investment decisions with respect to mortgages, and other types of traditional lending—activities permitted under Glass-Steagall. The repeal of portions of Glass-Steagall permitted banks to engage in underwriting and dealing in securities, but these commentators note, those activities have not caused banks to fail. Instead, they argue, it was overinvestment in mortgage backed securities that led to the crisis, a phenomenon that would not have been prevented by Glass-Steagall.[651] Former chairman of the law firm Sullivan & Cromwell H. Rodgin Cohen recently stated, "If you look at what happened, with or without Glass-Steagall, it would have made no difference."[652] Mr. Cohen and others point out that both Bear Stearns and Lehman brothers were pure investment banks, and so would not have been affected by the Glass-Steagall prohibition on joint investment-commercial banks.[653] Opponents of the Act's revival also argue that the Act was in place during the savings and loan crisis of the 1980s, yet did not prevent that crisis.[654] Furthermore, according to economist Mark Zandi, reinstating those portions of Glass-Steagall and "breaking up the banking system's mammoth institutions would be too wrenching and would put U.S. institutions at a distinct competitive disadvantage vis-à-vis their large global competitors" who do not have such restrictions.[655]

c. Increased Regulatory Oversight

Another school of thought holds that large institutions that pose a systemic risk will and must exist, and that the best solution is to increase regulation of these institutions proportionately to the risk that they pose.[656] Certain legislative proposals put forward in

banks, the rationale behind the two positions is not fully aligned. The Greenspan position holds that the size of the banks themselves creates the risk, while Volcker's position holds that it is the inherent conflict within the banks that causes commercial banks to engage in risky behavior befitting investment banks. Other commentators suggest simply spinning off the banks' proprietary trading activities. *See* Roger Ehrenberg, *Rethinking the Wall Street Business Model (Part 1)* (Nov. 21, 2009) (online at www.informationarbitrage.com/2009/11/rethinking-the-wall-street-business-model.html).

[650] *See,* e.g., Peter Wallison, *Did the "Repeal" of Glass-Steagall Have Any Role in the Financial Crisis? Not Guilty. Not Even Close,* Networks Financial Institute (Nov. 2009) (online at papers.ssrn.com/sol3/papers.cfm?abstract_id=1507803) (hereinafter "Wallison Paper on Glass-Steagall"); Robert Pozen, Stop Pining for Glass-Steagall, Forbes.com (Oct. 5, 2009) (online at www.forbes.com/forbes/2009/1005/opinions-glass-steagall-on-my-mind.html).

[651] *See, e.g.,* Wallison Paper on Glass-Steagall, *supra* note 650.

[652] Alison Vekshin & James Sterngold, *Reviving Glass-Steagall Means "War" on Wall Street,* BusinessWeek (Dec. 27, 2009) (online at www.businessweek.com/investor/content/dec2009/pi20091228_523550.htm) (hereinafter "'War' on Wall Street").

[653] "War" on Wall Street, *supra* note 652.

[654] *Would Reinstatement of Glass-Steagall Improve Banking?,* American Banking News (Jan. 4, 2010) (online at www.americanbankingnews.com/2010/01/04/would-reinstatement-of-glass-steagall-improve-banking/).

[655] House Financial Services Committee, Written Testimony of Mark Zandi, chief economist and co-founder of Moody's Economy.com, *Systemic Risk: Are Some Institutions too Big to Fail, and if so, What Should We Do About It?,* 111th Cong. (July 21, 2009) (online at www.house.gov/apps/list/hearing/financialsvcs_dem/zandi.pdf).

[656] *See, e.g.,* Paul Krugman, *Too Big to Fail FAIL,* The New York Times (June 18, 2009) (online at krugman.blogs.nytimes.com/2009/06/18/too-big-to-fail-fail) (noting that systemic risk is not a new concept and was a concern at least as of the Latin debt crisis in 1982. The solution,

the House and Senate, and by the current Administration, hew closely to this line. Under key provisions of these proposals, systemic risk would be managed through either new or newly empowered government entities and increased supervision and regulation of financial institutions.[657] These proposals are discussed in detail in Section G.4 below.

Some have argued that increased regulation would only exacerbate the current problem of implicit guarantees by highlighting the firms that require additional oversight, thus marking them as too big to fail. Kevin Hassett of the American Enterprise Institute has remarked that "[o]nce there is a public list of firms that are too big to fail, they will have an enormous competitive advantage . . . [s]ince government is backstopping them, they will be able to borrow at lower interest rates[.]"[658] SEC Commissioner Elisse Walter has similarly testified that under proposed legislation creating a council to monitor financial risk, "a real risk remains that market participants will favor large interconnected firms, particularly those identified as systemically important, over smaller firms of equivalent creditworthiness, because of the belief that the government will step in and support such an institution, its bondholders, or counterparties in times of crisis."[659] Others have observed that if interconnectedness results in systemic risk that must be regulated, there is no reason to stop at financial institutions; any large, interconnected business must be similarly regulated—or there is no need for such regulation because interconnectedness is not inherently risky.[660] There is the additional difficulty of identifying potentially risky behavior in time to avert a financial crisis. In light of the failure of many to predict the current crisis, the question arises of what level of competence is required for an economist to predict accurately which institutions will pose a threat to our financial system.[661]

d. Charging Too Big To Fail Institutions Insurance Fees or Taxes

Banks that are considered too big to fail receive the benefit of an implicit taxpayer subsidy, since their cost of funding does not adequately reflect the potential costs of their rescue. Some of the reform proposals suggest that institutions that are found to pose systemic risks be assessed financial contributions for the risk they

he states, is to "[r]egulate and supervise, then rescue if necessary; there's no way to make this [financial system] automatic").

[657] U.S. Department of the Treasury, *Financial Regulatory Reform: A New Foundation,* at 10–19 (June 17, 2009) (online at www.financialstability.gov/docs/regs/FinalReport__web.pdf).

[658] Kevin Hassett, *Obama's Too-Big-to-Fail Plan Is Too Dumb to Pass*, American Enterprise Institute for Public Policy Research (Sept. 28, 2009) (online at www.aei.org/article/101075).

[659] House Committee on Agriculture, Written Testimony of Securities and Exchange Commissioner Elisse Walter, *Review of Financial Stability Improvement Act*, 111th Cong. (Nov. 17, 2009) (online at agriculture.house.gov/testimony/111/h111709/Walter.pdf).

[660] *See* Hal Scott, *Do We Really Need a Systemic Regulator*?, Wall Street Journal (Dec. 10, 2009) (online at online.wsj.com/article/SB10001424052748704342404574577870952276300.html).

[661] One method of valuing risk that has been proposed in the past is to track the spread between the yield on a Treasury bond and on an institution's own subordinated debt with a similar maturity date. The rationale is that the spread should reflect the increased yield to balance the increased risk presented by the institution. This notion has been challenged, however, by data analysis that shows a lack of correlation between risk and yield spreads. C.N.V. Krishnan et al., *Monitoring and Controlling Bank Risk: Does Risky Debt Help*?, The Journal of Finance (Feb. 2005); Diana Hancock and Myron L. Kwast, *Using Subordinated Debt to Monitor Bank Holding Companies: Is It Feasible*?, The Federal Reserve Board of Governors (Apr. 27, 2001) (online at www.federalreserve.gov/Pubs/FEDS/2001/200122/200122pap.pdf).

pose, either before or after any failure occurs. A proposal introduced by House Financial Services Committee Chairman Barney Frank would create an insurance fund within the FDIC similar to that available to insure bank deposits to be used to "extend credit to or guarantee obligations of solvent insured depository institutions or other solvent companies that are predominantly engaged in activities that are financial in nature, if necessary to prevent financial instability during times of severe economic distress[.]" [662] This insurance would be funded by assessments on "large financial companies" under terms in the Administration's proposed regulatory reform legislation that would enable the FDIC to impose "risk-based assessments on bank holding companies based on their total liabilities." [663]

At least one commentator has noted a flaw in this proposal. According to economist Dean Baker, because the fee is to be assessed only after a bank faces failure, either the necessary funds are unlikely to be available, or other banks are unlikely to be willing to make such payments.[664] Whether the former or the latter scenario applies, he writes, depends on whether the failing bank has gotten into trouble by doing what everyone else was doing—in which case all the other banks would be in just as much trouble and unable to pay—or it was doing some unusual, risky thing—in which case all the other banks would be unwilling to underwrite the failing bank's imprudence. David Moss of the Harvard Business School has proposed, among other options, a system of federal capital insurance under which systemically significant institutions would be publicly identified and then required to pay into a federal insurance fund on a regular basis.[665] Premiums, as for any insurance plan, would be keyed to the level of risk the insured posed, and payments on claims would be limited to a pre-set amount.[666] Mr. Moss also believes that in the event of a failure, the federal government should not bail out or prop up the failing company, but should take the company over and restructure, sell, or liquidate it.[667] Such measures, he believes, would result in a system where no institution is too big to fail.

Another option may be a so-called Tobin tax, named after the late economist James Tobin, which would impose a tax on cross-currency financial transactions. While a Tobin tax has been most often proposed as a means of funding projects for the public good, today's proponents envisage it as an emergency fund to be used to support a faltering financial system. The most prominent proponent of the tax has been British Prime Minister Gordon Brown, who reportedly raised the issue of creating such a tax during the

[662] Financial Stability Improvement Act of 2009, H.R. 3996, § 1109(a) (2009).

[663] Resolution Authority for Large, Interconnected Financial Companies Act of 2009, 1209(o)(1) (2009). The House bill actually states that the assessments are to be made under 1609(o) of the Administration's proposal. No such section of that proposal exists while 1209(o) appears to include the provision to which the House bill intended to refer.

[664] Dean Baker, *Breaking Up the Banks is Hard to Do*, The Guardian (Nov. 2, 2009) (online at www.guardian.co.uk/commentisfree/cifamerica/2009/nov/02/banking-regulation-us-congress/print).

[665] David Moss An Ounce of Prevention, *supra* note 636.

[666] David Moss An Ounce of Prevention, *supra* note 636.

[667] David Moss An Ounce of Prevention, *supra* note 636.

November 2009 meeting of the finance ministers of the G–20.[668] Secretary Geithner reportedly rejected the idea during the same meeting.[669] Opponents of the tax argue that the presence of such an emergency fund may perpetuate moral hazard as institutions begin to rely on the presence of the fund to backstop major losses.[670]

e. Other Regulatory Options

Messrs. Baily and Litan, whose views on the need for large banks are discussed above, argue that while the government should not break up large banks, it should take steps to ensure that any large-scale growth is "organic," based on the banks' own success, and not the result of a merger. To this end, they argue, the government should review proposed mergers to prevent those that would create an institution that might pose a systemic risk.[671]

2. Liquidation and Reorganization

The impact of implicit guarantees can also be substantially reduced if there are credible ways to liquidate or reorganize failing businesses. In effect, if there are ways to permit such businesses to fail, then they are no longer too big to fail. Several options are under discussion.

a. "Living Wills"

There are many advocates of "living wills," contingency plans creating a systematic regime under which an institution that posed a systemic risk would be wound down, which also entails the institution reorganizing itself so that the plan can be effected in a crisis.[672] Advocates argue that the existence of such plans would avoid the shockwaves that the disorderly collapse of Lehman Brothers caused and AIG threatened, but it is possible that the very act of creating such plans might bring unexpected risks to the attention of management in time for them to be addressed.[673] Living wills could be used in conjunction with several of the other regulatory approaches being considered.

However, even commentators generally in favor of this concept note that living wills are an incomplete tool without ensuring separation among an institution's component parts. This separation can take place along activity lines, where systemically critical functions must have ring-fencing capable of protecting them during the unwinding pursuant to the living will.[674] The international com-

[668] *Gordon Brown's Global Tax Trap*, Wall Street Journal (Nov. 13, 2009) (online at online.wsj.com/article/SB10001424052748704576204574531211500981726.html#printMode) (hereinafter "Gordon Brown's Global Tax Trap").

[669] Gordon Brown's Global Tax Trap, *supra* note 668.

[670] Gordon Brown's Global Tax Trap, *supra* note 668.

[671] Bailey and Litan Testimony, *supra* note 640.

[672] Among the proponents for such contingency plans are members of the House and Senate and the President, who have included variations on this idea in their financial reform bills. *See* Section G.4, *infra*.

[673] One related proposal would have banks issue contingent convertible bonds, long-term debt that would be convertible to equity upon a triggering event, providing the bank with access to capital. A "living will" would be required in the event the new equity was insufficient to meet the bank's needs. *See, e.g.*, the description in Section G.4(c) below of the bill that has been proposed in the Senate, which incorporates this proposal.

[674] Senate Committee on Banking, Housing, and Urban Affairs, Written Testimony of Vincent Reinhart, Resident Scholar, American Enterprise Institute, *Establishing a Framework for Sys-*

Continued

plexities of large, interconnected firms also may require that ring-fencing or other separation by national operating units accompany living wills.[675] The absence of ring-fencing controls, along either functional or national lines, means that an institution might collapse more tidily but not necessarily that the government will permit it to do so; until the government does, the moral hazard remains.[676]

b. Resolution Authority

The problem with very large institutions, according to some, is not that they are too big to fail, but that the proper structures do not exist to enable their orderly failure.[677] The Administration has also proposed legislation granting the government resolution authority for systemically significant institutions that fall outside of the FDIC's existing resolution regime for commercial banks. Under the proposed legislation, resolution authority would be available to the Secretary of the Treasury upon determination, with positive recommendations from the Federal Reserve and the appropriate federal regulators, and in consultation with the President, that "the financial institution in question is in danger of becoming insolvent . . . its insolvency would have serious adverse effects on economic conditions or financial stability in the United States; and . . . taking emergency action . . . would avoid or mitigate these adverse effects." [678] A similar proposal has been drafted by the House.

In the Senate, Senators Bob Corker (R–TN) and Mark Warner (D–VA) have introduced legislation that would vest resolution authority in the FDIC. This authority would extend only to depository institutions and their holding companies, affiliates, and subsidiaries and would be available only when the FDIC determined that a receivership was preferable to a resolution under Chapter 11 bankruptcy.[679] Other Republican lawmakers, rejecting the view that the federal government should determine which institutions should receive government intervention in the event of failure, have instead proposed improving the bankruptcy system to enable it to process huge, complex bankruptcies such as AIG's might have been.[680] A bill proposed in the House would amend the current

temic Risk Regulation, 111th Cong., at 9–10 (July 23, 2009) (online at banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=c00a4670-8edd-4a6e-947f-09afb555fa4d).

[675] David G. Mayes, *Banking Crisis Resolution Policy—Different Country Experiences*, Norges Bank Staff Memo, at 58–61 (2009) (online at www.norges-bank.no/upload/77285/staff_memo_09_10.pdf).

[676] *See, e.g., Death Warmed Up*, The Economist (Oct. 1, 2009) (online at www.economist.com/businessfinance/displaystory.cfm?story_id=14558456).

[677] According to Professor Charles Calomiris of the Columbia Business School, bankruptcy law as it currently exists does not contemplate allowing "large, complex financial institutions to enter bankruptcy, or receivership in the case of banks, because there is no orderly means for transferring control of assets and operations, including the completion of complex transactions with many counterparties perhaps in scores of countries via thousands of affiliates." Charles Calomiris, *In the World of Banks, Bigger Can be Better*, Wall Street Journal (Oct. 19, 2009) (online at online.wsj.com/article/SB10001424052748704500604574483222678425130.html). The solution, Mr. Calomiris believes, lies in constructing a system that would enable such a bankruptcy. As discussed below, various legislative proposals include provisions to address just this concern.

[678] U.S. Department of the Treasury, *Treasury Proposes Legislation for Resolution Authority* (Mar. 25, 2009) (online at www.financialstability.gov/latest/tg70.html).

[679] Resolution Reform Act of 2009, S. 1540, 111th Congress (2009).

[680] The current bankruptcy system has been criticized as being ill-equipped to handle a bankruptcy such as AIG's. Professor Stephen Lubben of Seton Hall Law School, for example, has noted that the 2005 expansion of sections of the Bankruptcy Code that provide a "safe harbor" for the type of swap agreements at issue in AIG's decline have exacerbated this problem. Ste-

bankruptcy code to enable the orderly liquidation or reorganization of non-bank financial institutions as a means of forestalling the need for future bail-outs.[681] These bills are discussed in greater detail below.

c. Chapter 11

Some commentators have argued that Chapter 11 bankruptcy principles should play a role in the extension of taxpayer money to "bail out" private businesses. Of these commentators, some propose the increased use of prepackaged bankruptcy filings (commonly referred to as "pre-packs") before the government provides assistance,[682] some favor ordinary bankruptcy filings in which the debtor's operations come under court supervision and shareholders are wiped out,[683] and others propose implementing Chapter 11-like measures without the business actually filing a petition with the bankruptcy court.[684] Any of these measures may help to unwind implicit government guarantees by holding businesses and investors accountable for their actions.

In a Chapter 11 reorganization, a troubled company restructures its business to emerge as viable and profitable.[685] To this end, under certain circumstances the business may wipe out existing shareholder classes, renegotiate the terms or balances on its debt, exchange preexisting debt for equity in the new business, replace management, and undo fraudulent transfers or preferences.[686]

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phen Lubben, *Repeal the Safe Harbors*, Seton Hall Public Law Research Paper No. 1497040(Nov. 1, 2009). One of the key functions of bankruptcy law is to freeze the debtor estate, prohibiting any payments out of the debtor's assets, until the entire estate and all claims on it have been sorted out and preferences established. The safe harbor provisions exempt certain types of agreements from this freeze and permit payment. Because the swap agreements fit into the safe harbor provision, AIG's trouble triggered what Professor Lubben describes as a "run" on the institution as CDS counterparties insisted on payment. Professor Lubben has therefore called for a repeal of the safe harbor provision as a way to prevent a future situation like AIG's. In contrast, Professor Edward R. Morrison of Columbia Law School has argued that the Bankruptcy Code is inadequate to protect the economy from failing systemically significant institutions, and a systemic risk regulator with the power to monitor and rescue institutions should be created. Edward R. Morrison, *Is the Bankruptcy Code an Adequate Mechanism for Resolving the Distress of Systemically Important Institutions?*, Temple Law Review (forthcoming) (available online at papers.ssrn.com/sol3/papers.cfm?abstract_id=1529802).

[681] Consumer Protection and Regulatory Enhancement Act, H.R. 3310, 111th Congress (2009).

[682] *See, e.g.*, Edward I. Altman and Thomas Philippon, *Where Should the Bailout Stop?,* in *Restoring Financial Stability,* at 355–61 (Viral V. Acharya and Matthew Richardson, eds., 2009).

[683] *See, e.g.,* Jennifer Chamberlain, *The Big Three: Bailout or Bankruptcy?,* Illinois Business Law Journal (Mar. 7, 2009) (online at www.law.uiuc.edu/bljournal/post/2009/03/07/The-Big-Three-Bailout-or-Bankruptcy.aspx); Paul Ingrassia, *The Case for Chapter 11,* Portfolio (Nov. 9, 2008) (online at www.portfolio.com/news-markets/national-news/portfolio/2008/11/09/Can-Bankruptcy-Save-US-Carmakers/).

[684] *See, e.g.,* Global Economic Symposium, *The Global Polity: The Future of Global Financial Governance,* at 4 (Sept. 2009) (online at www.global-economic-symposium.org/ges-2008-09/ges-2009/downloads/session-handouts/the-global-polity/the-future-of-global-financial-governance_2009).

[685] *See generally* COP September Oversight Report, *supra note* 108, at 40 (providing an in depth discussion of business restructuring under bankruptcy law).

[686] A "fraudulent transfer" is a transfer for less-than-reasonably equivalent value made while insolvent. A "preference" is an unusual payment to one creditor that prevents other creditors from receiving a pro rata share of the assets. Professor Randy Picker, *Bailouts and Phantom Bankruptcies,* The University of Chicago Law School Faculty Blog (Sept. 23, 2008) (online at uchicagolaw.typepad.com/faculty/2008/09/bailouts-and-ph.html) (hereinafter "Bailouts and Phantom Bankruptcies").

Under these avoiding powers, creditors may be able to force outgoing executives to repay their bonuses, thereby returning capital to the business. *See* Jesse Fried, *Uncle Sam Should Claw Back Wall Street Bonuses,* Harvard Law School Forum on Corporate Governance and Financial Regulation (Oct. 4, 2008) (online at blogs.law.harvard.edu/corpgov/2008/10/04/uncle-sam-should-claw-back-wall-street-bonuses) (hereinafter "Uncle Sam Should Claw Back Wall Street Bonuses").

Often those who provide financing to the debtor are given liens at a higher priority than existing creditors and shareholders.[687]

Congress amended the Bankruptcy Code in 2005 to exempt a broad range of financial assets from bankruptcy rules.[688] Swaps, repurchase agreements, securities contracts, and other financial products were exempted from the automatic stay that normally prevents creditors from seizing a debtor's assets after the filing of a bankruptcy petition. Companies holding substantial financial assets may therefore find bankruptcy a less attractive way to resolve financial distress, since creditors could continue to collect on some contracts. Critics of the exemptions have argued that they hinder the bankruptcy system's ability to distribute property in an orderly and equitable manner.[689] Under the current rules, some creditors may collect on their debts while others are stayed. This creates an incentive for parties seeking to bypass the bankruptcy process to structure contracts as swaps, securities contracts, or other exempt categories of assets.

If Congress required a bankruptcy filing as a prerequisite to receiving assistance, the petition could be a regular bankruptcy or a pre-pack. Pre-packs are Chapter 11 bankruptcies where the plans of reorganization are prepared in advance of filing petitions with the bankruptcy court. Pre-packs are formulated after negotiations and with the cooperation of creditors and other invested parties. Most of the legal issues litigated in the bankruptcy process are resolved as part of this out-of-court negotiation. This reduces the time and cost spent in the actual bankruptcy process. The sooner the restructuring under Chapter 11 is completed, the sooner the company can return focus to its core operations.[690]

Commentators who propose pre-packs as a solution to reorganize large businesses hope to take advantage of the debtor's rights under Chapter 11 at this reduced cost to the business. They propose that the government should make the extension of "bailout" funds contingent upon the distressed business filing a pre-pack with the bankruptcy court.[691] In doing so, shareholders could be wiped out, creditors could take a haircut, misappropriated funds could be returned to the business, and incompetent management could be replaced. These repercussions would add to a business's incentive to steer itself away from the brink of disaster, and would incentivize commercial creditors to pressure businesses to take fewer risks. The same incentives could be created by mandating a regular bankruptcy filing, and there is disagreement regarding the cost savings associated with pre-packs.[692] In either case, it could be

[687] *See* COP September Oversight Report *supra* note 108, at 40–48 (discussing priority of claims and general principles of bankruptcy law).

[688] *See* 11 U.S.C. §§ 555–56, 559–61.

[689] *See, e.g.,* House Judiciary Committee, Subcommittee on Commercial and Administrative Law, Written Testimony of Professor Jay Lawrence Westbrook, *Exemption of Financial Assets from Bankruptcy* (Sept. 26, 2008) (online at www.judiciary.house.gov/hearings/pdf/Westbrook080926.pdf).

[690] Some of these pre-pack reorganizations are extremely large, but can nevertheless be accomplished in less than two months. *See* COP September Oversight Report, *supra* note 108, at 40 (discussing pre-packs under Chapter 11).

[691] Jim Kuhnhenn, *Bailout With a Price: Chapter 11 Bankruptcy*, Associated Press (Nov. 20, 2008) (online at seattletimes.nwsource.com/html/businesstechnology/2008412177_apmeltdownbankruptcy.html).

[692] Pre-packs may prove infeasible in the case of systemic failures, in which case regular filings may be the only form of bankruptcy relief available to debtors.

argued that the bankruptcy requirement may counterbalance any market distortion that arises from implicit guarantees, while allowing the government to intervene to save systemically important institutions. Other commentators argue the same result is possible without actually utilizing the bankruptcy court.[693] Instead of filing a pre-pack, the government could make any taxpayer bailout contingent upon successful out-of-court negotiations between the distressed business and the invested parties. Thus, if the business wants public funding, it must wipe out its shareholders, get its creditors to agree to take a haircut, and replace its management. This would have the same effect as filing a pre-pack—i.e., holding managers and investors accountable for their actions and incentivizing prudent decision making. Moreover, this approach would also serve to wind down the government's implicit guarantee.

3. International Aspects of Reform

Federal Reserve Board Governor Daniel Tarullo recently remarked on the need for a resolution plan to contemplate the specific issues confronting a failing international institution. "Some of those [insolvency] regimes may be substantively inconsistent with one another, or may not account for the special characteristics of a large international firm," he noted.[694] He further remarked that "an effective international regime would . . . likely require agreement on how to share the losses and possible special assistance associated with a global firm's insolvencies." Such "satisfyingly clean and comprehensive solutions to the international difficulties occasioned by such insolvency," he believes, however, "are not within sight." Professor Simon Johnson of the MIT Sloan School of Management has expressed similar concerns. Writing about last summer's G–8 summit, he noted the lack of progress on "any kind of international agreement that would be the essential complement to a national legal authority (for example, in the United States or Europe), by providing a framework for 'resolving' the failure of a major financial institution with cross-border assets and liabilities[.]"[695] The tension between the need for such an international regulatory scheme and the difficulty of creating one, even just for the European markets, was outlined by the deputy director of the Monetary and Capital Markets Department of the International Monetary Fund, Jan Brockmeijer, in his remarks at a conference in Belgium this summer: "on the one hand, cross-border integration of European financial markets is desirable," he stated. "But . . . at the same time, financial supervision remains fundamentally a national responsibility."[696]

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[693] *See, e.g.*, Bailouts and Phantom Bankruptcies, *supra* note 108; Uncle Sam Should Claw Back Wall Street Bonuses, *supra* note 686; Robert Reich, *The Real Difference Between Bankruptcy and Bailout*, Robert Reich's Blog (Nov. 11, 2008) (online at robertreich.blogspot.com/2008/11/real-difference-between-bankruptcy-and.html).

[694] Federal Reserve Board of Governors, Speech by Daniel Tarullo, *Supervising and Resolving Large Financial Institutions* (Nov. 10, 2009) (online at www.federalreserve.gov/newsevents/speech/tarullo20091110a.htm).

[695] Simon Johnson, *What the G–8 Won't Achieve*, The New York Times (July 9, 2009) (online at economix.blogs.nytimes.com/2009/07/09/what-the-g-8-wont-achieve/).

[696] Jan Brockmeijer, *Lessons of the Crisis for EU Financial Supervisory Policy*, Remarks at the IMF-Bruegel-National Bank of Belgium Conference After the Storm: The Future Face of Eu-

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The Basel Committee's more modest approach suggests ring-fencing during periods of considerable financial distress. Such an approach would enable host countries to shore up institutions operating within their domestic borders. To do so, changes to existing laws would need to allow for this particular framework to complement domestic regulatory aims. The approach would protect the pertinent functions of the failing institution, but not the institution itself. As a result, such efforts would limit financial contagion and lessen the likelihood of moral hazard.[697]

4. Proposed Legislation

Legislative proposals from the Administration and both houses of Congress have drawn from many of the proposals discussed above.

a. Administration's Proposal

Under a legislative proposal put forward by the current Administration, new government entities would provide "robust" supervision of the financial services sector. The proposed government entities include a Financial Services Oversight Council, a Consumer Financial Protection Agency, and a National Bank Supervisor. The Council would "identify emerging risks" and "advise the Federal Reserve on the identification of firms whose failure could pose a threat to financial stability due to their combination of size, leverage, and interconnectedness."[698] The Consumer Financial Protection Agency would "protect consumers of credit, savings, payment, and other consumer financial products and services, and to regulate providers of such products and services," in part to minimize aggregation of risk.[699] The National Bank Supervisor would "conduct prudential supervision and regulation of all federally chartered depository institutions, and all federal branches and agencies of foreign banks."[700] The proposal also includes the creation of various offices within Treasury to improve oversight of systemically significant institutions.

The Administration's proposal also contemplates increased oversight of institutions that may pose a systemic risk, dubbed "Tier 1 financial holding companies," and a greater concern for how individual firms may impact the overall economy. Tier 1 FHCs would be subject to stricter and more conservative regulations regarding capital levels and liquidity requirements,[701] and might be subject to standards and guidelines for executive compensation that aim to align employees' interests with those of long-term shareholders and prevent incentives for excessive risk-taking. These firms would also

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rope's Financial System (Mar. 24, 2009) (online at www.imf.org/external/np/seminars/eng/2009/eurfin/pdf/brockm.pdf).

[697] Basel Committee on Banking Supervision, *Report and Recommendations of the Cross-border Bank Resolution Group* (Sept. 2009) (online at www.bis.org/publ/bcbs162.pdf) (hereinafter "Basel Committee Report").

[698] U.S. Department of the Treasury, *Financial Regulatory Reform: A New Foundation,* Summary of Recommendations (online at www.financialstability.gov/docs/regs/FinalReport__web.pdf) (accessed Jan. 13, 2010).

[699] *Id.*

[700] *Id.*

[701] Contingent capital bonds (commonly referred to as "CoCo bonds" or "CoCos") would be one method a Tier 1 FHC could use to meet these more stringent requirements. CoCo bonds refer to debt that may be converted to common equity when the issuer is under distress. This conversion occurs automatically upon triggering one or more contingencies (e.g., Tier 1 capital level falls below specific threshold, market price contingency, etc.). As a result, the issuer is instantly given a capital boost and is saved from having to raise fresh capital at high interest rates.

be regulated with a macroeconomic view, taking into consideration the effects that actions by the company might impose on the wider economy. Finally, a Tier 1 FHC would be required to implement a plan for an orderly winding down if the firm were to face insolvency.

b. House Legislation

The Wall Street Reform and Consumer Protection Act passed the House of Representatives on December 11, 2009, by a vote of 223–202.[702] The bill, which was introduced on December 2 by Financial Services Committee Chairman Barney Frank (D–MA), incorporates provisions from nine separate bills reported by the Financial Services, Energy and Commerce, and Agriculture committees. The bill, H.R. 4173, would create an inter-agency oversight council charged with identifying large, complex financial companies that pose a systemic risk to financial stability and economic growth. These firms would be subject to heightened oversight, prudential regulation, and reporting and disclosure requirements. The bill would also establish an orderly process for resolving large, failing financial firms whose problems could not be addressed by a stricter regulatory regime or the bankruptcy process.

H.R. 4173 would establish a council of federal regulators, the Financial Services Oversight Council ("the Council"), to monitor the financial system and regulate any financial company whose material financial distress could pose a threat to financial stability or whose scope, size, scale, concentration, interconnectedness, or mix of activities could pose a threat to economic stability.[703] After consultation with a financial company's regulator and upon a majority vote of the Council members, the Council would be empowered to place stricter regulatory standards on such company. This designation would subject a company that was not already subject to the Bank Holding Company Act of 1956 (Pub. L. 84–511), to certain provisions of the Act, which the Federal Reserve is responsible for enforcing, as if the company were a financial holding company. The Federal Reserve, as agent for the Council and in coordination with appropriate supervisors, would be responsible for implementing and enforcing heightened prudential standards. The heightened standards imposed by the Federal Reserve would have to include:

- Risk-based and size-based capital requirements;[704]
- Leverage limits;
- Liquidity requirements;
- Concentration requirements;
- Prompt corrective action requirements;
- Resolution plan requirements; and

[702] CQ House Actions Reports, No. 111–22 (Dec. 7, 2009) (describing the bill); CQ House Actions Reports, No. 111–20 (Dec. 14, 2009) (describing the vote).

[703] Voting members of the council would include the secretary of the Treasury; the chair of the Federal Reserve; Comptroller of the Currency; chair of the Securities and Exchange Commission; chair of the Commodity Futures Trading Commission; director of the Federal Housing Financing Agency; chair of the National Credit Union Administration; and an appointed state insurance commission and state-banking supervisor would serve on the council for up to two years in a non-voting capacity.

[704] When calculating new capital requirements, the Federal Reserve would have to take into account the company's off-balance sheet exposure, including financial derivatives obligations. Companies subject to stricter prudential standards would be limited to a debt-to-equity ratio of 15 to 1.

- Risk management requirements.

In addition to restrictions stipulated by the bill, the Federal Reserve, as agent for the Council, also would have authority to prohibit a firm from engaging in any credit transaction or disbursal of capital it deemed a detriment to financial stability. Senior management of undercapitalized institutions would be subject to dismissal, and the Federal Reserve could require the submission of quarterly stress tests from troubled companies. All financial companies subject to stricter regulatory standards would be required to submit to the Federal Reserve and FDIC plans for an orderly and rapid dissolution in the event of a severe financial crisis.

If, after the company were subjected to stricter regulatory standards, it continued to pose a grave threat to financial stability of the economy, the Council could take several additional steps to limit the danger posed by the company. The Council could modify the existing prudential standards, impose conditions on certain activities, limit mergers and acquisitions, and restrict the company's ability to offer certain financial products. As a last resort, the Council, with concurrence by the Secretary of the Treasury or the President, could require a company to sell, divest, or otherwise transfer business units, branches, assets, or off-balance sheet items to unaffiliated companies.

H.R. 4173 would also grant to the FDIC the authority to dissolve systemically important financial firms that are in default or in danger of default. The new mechanism would empower the FDIC—separate and apart from its authority to liquidate banks—to take over and either wind down or act as a receiver for large, complex financial institutions that are in default or in danger of default, and whose failure would threaten the financial system. The FDIC would have the authority to make loans to a failing firm, guarantee the obligations of a failing firm to its creditors, acquire common or preferred shares in a failing firm, take a security interest in the assets of a failing firm, and sell assets that the FDIC has acquired from a failing firm. This authority, as it relates to an individual firm, would be temporary and would last until the firm was placed in receivership and liquidated. The dissolution process would not affect financial institution liquidation processes already in place, such as federal deposit insurance, Securities Investor Protection Corporation (SIPC) protection, and state insurance insolvency regimes.

The FDIC would also have the authority to liquidate the company's assets and organize a bridge financial company, or merge the financial institution with another company, or transfer its assets and any liabilities. A maximum of $200 billion would be available to the FDIC to dissolve failing firms; $150 billion would come from a Systemic Dissolution Fund that would be pre-funded by assessments on financial companies with more than $50 billion in assets and by hedge funds with more than $10 billion in assets. Assessments would be risk-based, so that more complex institutions engaged in riskier activities would pay more. The remaining $50 billion could come from the Treasury's general fund, as borrowing that would be paid back through industry assessments, and would be available only upon approval from Congress.

The FDIC's resolution authority could only be employed to ensure broader financial stability and not solely to preserve a particular failing institution. Shareholders in a failing institution would not recoup any losses from the fund. The FDIC would also be required to remove management responsible for the company's failure. Companies placed into receivership by the FDIC would be subject to the executive compensation limits included in EESA (Pub. L. 110–343).

Under the House bill, the FDIC's appointment as receiver of a financial institution would terminate at the end of one year, with the ability to extend the appointment for two one-year periods. The FDIC's general receivership authority would sunset on December 31, 2013, unless Congress approved a joint resolution extending the authority.

In addition, the bill would also create a Consumer Financial Protection Agency to oversee institutions providing financial services and products to consumers, provide the Securities and Exchange Commission (SEC) with expanded powers including the ability to regulate the over-the-counter derivatives market, require hedge funds and other private pools of capital to register with the SEC, and introduce new regulations for credit rating agencies.

Republicans in the House unanimously opposed H.R. 4173. In the area of resolution authority, some Republican members criticized the systemic risk-related supervisory powers that the bill granted to the Board of Governors of the Federal Reserve, a criticism that was shared by some House Democrats. The Federal Reserve's recent regulatory record and failure to anticipate the bursting of the housing bubble give critics little faith that the Federal Reserve will be an effective agent for identifying and regulating systemic risk.[705] The Federal Reserve's mission, in their view, should be modified to focus solely on monetary policy. In addition, some Republicans argue, although the bill is allegedly designed to end the too big to fail phenomenon, it in fact gives the federal government unlimited authority to prop up ailing financial institutions through the new powers granted to the FDIC and the Council. And although the identity of those firms deemed to pose a systemic risk is supposed to remain confidential, SEC disclosures and changes in the identified firms' behaviors or strategies could make it relatively easy for market watchers to discern which firms are listed, according to the bill's critics. Such a designation would foster favoritism and reduce competition in the marketplace, providing an advantage to the firms with the special designation. Finally, critics assert that by funding the Systemic Dissolution Fund through assessments on all financial companies with over $10 billion in assets, the bill would penalize stable, profitable firms by making them pay for the resolution of failed firms.[706]

The favored alternative of House Republicans is H.R. 3310, a bill sponsored by the ranking member of the House Financial Services

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[705] House Republican Conference, *Democrat Systemic Risk Legislation—Permanent Bailout Mania for the Politically Significant* (Nov. 16, 2009) (online at www.gop.gov/policy-news/09/11/16/democrat-systemic-risk-legislation) (hereinafter "House Republican Conference on Systemic Risk").

[706] The Republican Cloakroom, Republican Leader John Boehner, *Statement of Republican Policy, H.R. 4173, Wall Street Reform and Consumer Protection Act* (Dec. 9, 2009) (online at http://repcloakroom.house.gov/news/DocumentSingle.aspx?DocumentID=159983).

Committee, Representative Spencer Bachus. The Republican-sponsored *Consumer Protection and Financial Regulatory Enhancement Act* would create a Market Stability and Capital Adequacy Board, chaired by the Secretary of the Treasury, to examine interactions of various areas of the financial system, and to issue recommendations to policymakers and regulators to stem potential systemic risk. This bill would also provide the FDIC with enhanced resolution authority for large banks and create a new chapter of the Bankruptcy Code for failing non-financial institutions.[707] This new chapter would facilitate coordination between regulators and the courts to ensure technical and specialized expertise is applied when dealing with complex institutions. Bankruptcy judges under this proposal would also have the power to stay claims by creditors and counterparties to prevent runs on troubled institutions.

c. Senate Bill

On November 10, 2009, Senate Banking Committee Chairman Christopher Dodd (D–CT) unveiled a discussion draft for comprehensive financial regulatory reform.[708] Unlike the House Financial Services Committee, which passed the components of the regulatory reform bill in piecemeal fashion, Senator Dodd intends to report one bill out of committee. Senator Dodd's discussion draft proposes even more sweeping changes to the current financial regulatory framework than the bill that passed the House. For example, it would consolidate all federal banking regulation in one agency, the newly created Financial Institutions Regulatory Administration (FIRA).

In order to address systemic risk, the discussion draft would enact regulatory measures similar to those in the House bill, but it would employ a much different institutional structure. Rather than an inter-agency council of regulators, Senator Dodd's proposal would create an independent Agency for Financial Stability (AFS) responsible for identifying, monitoring, and addressing systemic risks posed by large, complex companies as well as products and activities that can spread risk throughout the financial system. The agency would be governed by a board of nine members and led by an independent chairman, appointed by the President and confirmed by the Senate.[709] The agency would collect and analyze data on emerging risks to the financial system and would be empowered to set strict prudential standards for firms identified as systemically important. Enhanced resolution authority would be vested in the FDIC for companies that continued to pose a systemic risk.

Under Senator Dodd's proposal, the Agency for Financial Stability would be empowered to regulate certain financial companies, upon a determination by the Agency that the material financial distress or failure of such a firm would pose a threat to financial stability and economic growth. The agency would establish prudential standards and reporting and disclosure requirements on a

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[707] *Protection and Regulatory Enhancement Act,* H.R. 3310, 111th Cong., 1st session (2009).
[708] Discussion Draft (online at banking.senate.gov/public/__files/AYO09D44__xml.pdf).
[709] The board would include the secretary of the Treasury; chair of the Federal Reserve; the chair of the Financial Institutions Regulatory Administration; head of the Consumer Financial Protection Agency; chair of the Securities and Exchange Commission; chair of the Federal Deposit Insurance Corporation; chair of the Commodity Futures Trading Commission; and independent members, including the chair, appointed by the President and confirmed by the Senate.

graduated scale based on the size and complexity of each firm. The prudential standards would include risk-based capital requirements, leverage limits, liquidity requirements, concentration limits, and prompt corrective action requirements. In addition, the companies would be required to establish a Board-level risk committee responsible for the oversight of the enterprise-wide risk management practices of the company. The companies would also be required to issue a minimum amount of contingent capital, long-term hybrid debt convertible to equity if a company fails to meet prudential standards or its conversion is deemed necessary by the AFS to preserve financial stability.

Each specified financial company would be required to develop a plan for the rapid and orderly dissolution of the company in the event of material financial distress or failure. The company would report periodically to the AFS, FIRA, and FDIC on the resolution plan, as well as the nature and extent of the company's credit exposure and indebtedness to other financial companies. Upon review of the resolution plan and credit exposure reports, FIRA and FDIC could jointly determine that a resolution plan is not credible and require the company to resubmit a revised plan. If the company failed to provide a satisfactory plan within a specified timeframe, FIRA and FDIC could impose more stringent prudential requirements and restrict certain growth, activities, and operations. In consultation with AFS, the company could also be required to sell certain assets and business operations.

Bank holding companies with total assets of over $10 billion would automatically be subject to heightened prudential standards and reporting and disclosure requirements without the need for an AFS evaluation of their systemic significance. The stringency of the heightened standards, which would include risk-based capital, leverage, and liquidity requirements, would increase on a graduated scale based on the size of the company. The bank holding companies would be required to establish a risk committee to oversee all risk-management practices.

The Dodd proposal gives FIRA, with FDIC serving as receiver, the authority to break up firms posing a systemic risk on a case-by-case basis. Following consultation with AFS and FIRA, FDIC would have a range of options at its disposal for resolving the institution, including making loans, purchasing debt obligations, purchasing or guaranteeing assets, purchasing an equity stake, taking a lien on any or all assets, or liquidating the company by selling or transferring all of its assets, liabilities, obligations, equity interests, or securities.

Senator Dodd's proposal stipulates that any exercise of the enhanced resolution authority must be for the purpose of financial stability and not for the purpose of rescuing or preserving a particular company. Shareholders in the company would not be eligible to recoup their investment until all other claims are fully paid. The FDIC would be required to ensure that the management responsible for the failed condition of the company be removed. If proceeds from the sale of the company or its assets were insufficient to cover the costs of the resolution, the difference would be recouped from assessments on financial companies with assets of over $10 billion.

Shortly after Senator Dodd released his discussion draft, Senator Richard Shelby, the ranking member of the Senate Banking Committee, announced his opposition to the bill and his intention to draft his own alternative bill, in particular because of his opposition to the creation of a Consumer Financial Protection Agency and his view that the legislation would institutionalize permanent bailout authority for the government.[710] Senator Dodd has agreed to work with Senator Shelby and other Republicans on the Banking Committee in order to arrive at a bipartisan bill. The two sides are currently negotiating.

H. Conclusions and Recommendations

Treasury holds, on behalf of the American taxpayer, a diverse collection of assets that it must dispose of with all deliberate speed, transparency, and good stewardship. In general Treasury has made progress toward meeting these requirements, but it could improve certain aspects of its performance.

Strengthen Transparency and Accountability

In its past oversight reports, the Panel has repeatedly urged Treasury to disclose greater detail about the goals, metrics, and future plans for the programs that it has launched and operated under the TARP. This same exceptional degree of transparency will remain critical as Treasury exits the TARP.

In particular, Treasury should disclose to the public more information about its plan for disposing of its assets. There are some details that Treasury either cannot disclose (because of the need to comply with securities laws, for example, or the need to work with banking regulators using confidential information) or should not disclose (because of the need to time the market for asset sales). Treasury should, however, be transparent with respect to the constraints under which it operates (for example, any limits to Treasury's authority on how and when to sell assets) and how it will balance its sometimes conflicting obligations to maintain systemic stability, preserve the stability of individual institutions, and maximize taxpayers' return on investment. Treasury should also disclose the metrics that it is using to determine timing and manner of sales, and Treasury should publicly explain its objectives so the American people can measure its success.[711] Though it is the banking regulators' responsibility to disclose their criteria for allowing repayments, Treasury also should be able to articulate this policy in view of the broader economic issues it raises. This lack of clarity breeds uncertainty and instability in the financial markets and provides a disservice to taxpayers as well as investors.

Treasury should be particularly transparent with respect to any plans to acquire additional assets or obligations under the TARP, whether as a result of the TARP programs under which money remains to be expended, or as a result of arrangements with other

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[710] Senate Committee on Banking, Housing, and Urban Affairs, Opening Statement of Senator Richard Shelby, *Mark Up: Restoring American Financial Security Act,* 111th Cong. (Nov. 19, 2009) (online at shelby.senate.gov/public/index.cfm?FuseAction=PressRoom.Speeches&ContentRecord__id=0da23880-802a-23ad-45c9-2c06baab4f5f&Region__id=&Issue__id=&County__id=).

[711] *See also* COP September Oversight Report, *supra* note 108, at 112.

governmental entities. If, for example, Treasury were to acquire any of the assets that the Federal Reserve has acquired as a result of its market interventions, those arrangements, and Treasury's plans for disposition of those assets, should be subject to the same transparency considerations discussed above.

Reprising a theme of the Panel's September report, Treasury should also be more transparent with respect to corporate governance issues, including management succession issues, and provide greater detail about the circumstances in which Treasury will be involved in business decisions with respect to its investee companies.[712] Greater clarity will help to reassure both taxpayers and market participants about the scope of Treasury's role as a major investor in the private sector.

Because of the unprecedented nature of the TARP and the many challenges involved in executing the sale of such an enormous pool of assets, transparency is crucial to Treasury's credibility and to the functioning of the markets in which Treasury is now a key participant.

Demand Greater Transparency from TARP Participants

The need for greater transparency in TARP programs is not limited to Treasury. Many TARP-recipient financial institutions have provided very limited disclosures about their use of TARP funds, denying taxpayers the opportunity to account precisely for their tax dollars.

Any future recipient of TARP funds, including banks participating in the small business initiative, must be obligated to give a complete accounting of what they did with the money and how those actions served the objectives of the TARP.

Improve Operations to Protect Taxpayers

Exiting the TARP will be a lengthy and demanding process, and a successful exit will require that Treasury have expertise in complex markets and instruments. Treasury should take steps to ensure that it will continue to be staffed, through final exit from the TARP, with qualified and expert personnel. Treasury should also give due consideration to each stage of its exit strategy, including how it will handle the period in the future when only a few recipients are left in the system.

Treasury should also be frank in addressing the potential for conflicts of interest in light of the government's dual role as investor and overseer of the financial industry. To limit any conflicts of interest and facilitate an effective exit strategy, Treasury should continue to consider holding its TARP assets in a trust that would be insulated from political pressure and government interference, especially as circumstances change. Any such trust, however, should address the concerns discussed above, which have been raised by Professor Verret and others, so that the trust assets are managed in the best interests of taxpayers.

Treasury should provide quarterly TARP financial statements, and consider improving the readability of its Management's Discussion and Analysis.

[712] *See* COP September Oversight Report, *supra* note 108, at 102.

Take Steps to Resolve Implicit Guarantees

Perhaps the largest problem that Treasury faces is one that Treasury cannot solve alone: the continued existence of a broad implicit guarantee that hangs over the markets. There are multiple options available and there is broad agreement that a new approach to systemic risk regulation is necessary so that businesses are not insulated from the effects of their own bad decisions.

In the aftermath of the government's extraordinary economic stabilization efforts, markets may believe that too big to fail financial institutions operate under an implicit guarantee: that the American taxpayer would bear any price, and absorb any loss, to avert a financial meltdown. To the degree that lenders and borrowers believe that such an implicit guarantee remains in effect, moral hazard will continue to distort the market in the future, even after TARP programs wind down. As Treasury contemplates an exit strategy for the TARP and similar financial stability efforts, addressing the implicit guarantee of government support is critical.

SECTION TWO: ADDITIONAL VIEWS

A. Damon Silvers

The Panel's January Report is an extraordinarily detailed survey of many issues associated with the windup of the programs created under the Emergency Economic Stabilization Act of 2008. Because of the breadth of the Report, I think it is important to express in one place clearly what I see as the problem with the direction the TARP has taken in recent weeks.

In the course of several weeks in December 2009, the Board of Governors of the Federal Reserve announced it was allowing three of the nation's largest banks to return their TARP monies—allowing Bank of America and Wells Fargo to escape TARP's limitations on executive pay, and allowing Citigroup to escape the extraordinary limits on executive pay associated with institutions receiving extraordinary aid, even though Citigroup continued to be the beneficiary of tens of billions of TARP funds in the form of common stock. Citigroup is now the only company in which the TARP holds common stock that is not subject to the rulings of the Special Master on Executive Pay.

But despite the intense interest that the executives of Citigroup, Bank of America and Wells Fargo appeared to have in the executive pay issue, that issue is a secondary one in relation to the repayment decision. The real issues are about systemic stability and moral hazard.

In relation to systemic stability the question is—are these banks really sound after repayment? Given their enormous size, if they are not sound after repayment allowing them to repay would be a profoundly irresponsible act, making another systemic financial crisis far more likely. Then there is the question of these large banks' ability to withstand future economic and financial turmoil. It would not be good for the country if it turned out that these repayment transactions were high stakes bets on continued economic and financial stability.

It is very important that the public and Congress understand that the Congressional Oversight Panel has no ability to answer this critical question because (1) we have never received, despite repeated requests, the algorithms at the heart of the stress tests (see our earlier hearings and our correspondence with Secretary Geithner); (2) we were unable to determine the extent of or the value of the toxic assets that continue to be held by the major banks (see our August 2009 report) and (3) because the bank regulators have never disclosed the criteria for allowing repayment.

Following the stress tests, each of these three banks began to press to be allowed to repay their TARP funds. Because we do not know what the criteria were for being allowed to repay, it is impossible to know when they met them. But it is puzzling to note that in the case of Wells Fargo and Bank of America, the result of bank regulators allowing repayment transactions not entirely funded by new equity was to reduce those banks' Pro forma Tier 1 capital ratios, a basic measure of bank capital strength, to below the level that it had been at these banks at the end of the second quarter of 2009, when the Treasury steadfastly refused to permit them to repay TARP funds. One explanation for the regulator opposing

transactions that weakened Tier I capital is that the regulators were exclusively focused on measures of common equity capital strength. But an approach focused on common stock is odd in the context of the fact that all of TARP's efforts to strengthen bank capital have involved preferred stock infusions.

Then there is Citigroup. While our conversations with Treasury and others on this matter are ongoing, we have yet to receive a satisfactory explanation for how it is possible that Citigroup, which had a Tier 1 capital ratio of 11.92 percent at the end of 2008, and was generally understood to be the walking dead, is now healthy enough to be let out of TARP with a Pro forma Tier 1 capital ratio post-repayment of 11.0 percent. Citigroup gets more puzzling in light of several other facts: Citigroup posted net losses available to common shareholders in the first and third quarters of 2009, and most analysts believe it will lose money in the fourth quarter; its equity offering ran into trouble; its stock price post-repayment is just over $3 per share; and its total preferred and common equity market capitalization is the same as it was at the beginning of 2009. Of course, by converting the majority of its TARP preferred to common, then selling common to replace preferred at the close to option value price of $3.25, Citigroup has been able to raise its common equity ratios significantly. But does trading government preferred stock for government common stock transform a sick bank into a healthy bank?

As to moral hazard, repayment converts what had been a time-buying strategy into a fait accompli. We now know for certain that, barring another systemic crisis requiring revisiting these issues, the public has definitely rescued the shareholders, bondholders and executives of these large banks from the consequences of their actions. What is far less clear is whether as a result we have strong, stable banks able to play their proper role as provider of credit to the real economy.

Note on Recusal

In July, 2009, I recused myself from participation in any Panel discussions about and votes on matters pertaining to General Motors, Chrysler or their financial affiliates, including but not limited to GMAC. I did not vote on or participate in discussions related to the Panel's September Report, *The Use of TARP Funds in Support and Reorganization of the Domestic Automotive Industry*. My vote in favor of this Report and the Panel's December Report, entitled *Taking Stock: What Has the Troubled Asset Relief Program Achieved?* should not be taken as an expression of opinion on sections of the report dealing with General Motors, Chrysler, or their financial affiliates. Lastly, my votes in favor of this report and the December Report were addressed only to those portions of the reports that did not relate to General Motors, Chrysler, or their financial affiliates.

B. J. Mark McWatters and Paul S. Atkins

We concur with the issuance of the January report and offer additional observations below. We thank the Panel for incorporating suggestions offered during the drafting process.

1. Executive Summary

We offer the following summary of our analysis:

- Treasury should request that each TARP recipient submit a formal exit strategy and update such strategy each calendar quarter. Treasury should also provide the Panel with its written assessment of the exit strategies and updates submitted by the TARP recipients.
- In order to expedite the swift metamorphosis of many TARP recipients from insolvent to investment grade, the institutions were arguably subsidized through government-sponsored purchases of mortgage-backed securities and by the all but unlimited investment of (and commitment to invest) public funds in Fannie Mae, Freddie Mac and AIG. One may argue that the government has created without meaningful public debate or analysis a series of "bad banks" within the Federal Reserve, Treasury, Fannie Mae, Freddie Mac, and AIG to accomplish what TARP alone failed to achieve. These "bad banks" or, perhaps, "debt consolidation entities" operate by *actually* and *virtually* removing toxic assets from the books of TARP recipients and other holders and issuers. The Federal Reserve and Treasury have *actually* removed up to $1 trillion of troubled assets from the books of TARP recipients and other holders and issuers through outright purchases. The Federal Reserve and Treasury have also *virtually* removed additional troubled assets from the books of TARP recipients and other holders and issuers by propping up the market values of such assets and maintaining historically low mortgage rates.
- A question arises as to whether the termination of the AIG credit default swaps (CDSs) at par—that is, without any discount or haircut—constituted an inappropriate subsidy of the AIG counterparties—which included TARP recipients Goldman Sachs, Merrill Lynch and Bank of America—and necessitated the investment of additional TARP funds in AIG. Although then-FRBNY President Geithner denies that the payments by the Federal Reserve Bank of New York (FRBNY) constituted a "backdoor bailout" of the AIG counterparties, without any other explanation it is difficult to conclude that the FRBNY insisted that AIG terminate the CDSs other than as a mechanism to provide a direct—yet not particularly transparent—government-sponsored subsidy to the AIG counterparties. Without a better explanation of a straightforward business purpose for these transactions, the taxpayers may be best served by having Treasury seek recission from the AIG counterparties, reversing cancellation of the CDS contracts and requiring the counterparties to purchase the underlying collateralized debt obligations (CDOs) at their $62.1 billion par value.

• Since Treasury is charged with protecting the interests of the taxpayers who funded the Home Affordable Modification Program (HAMP) and the other TARP programs, we recommend that Treasury's foreclosure mitigation efforts be structured so as to incorporate an effective exit strategy by allowing Treasury to participate in any subsequent appreciation in the home equity of any mortgagor whose loan is modified under HAMP or any other taxpayer subsidized program.

2. Required Submission of Proposed Exit Strategies by TARP Recipients

One job of effective oversight is to assess the exit strategies proposed by TARP recipients and Treasury. In discharging this responsibility the Panel undertook in the January report to analyze (i) how each major TARP recipient plans to repay its TARP funds, (ii) how Treasury expects to recoup the TARP funds advanced to each major TARP recipient, and (iii) each of these strategies for transparency, effectiveness and taxpayer protection. The January report serves as an intermediate step in an ongoing process, the ultimate effectiveness of which will depend upon the transparency and accountability of the disclosure provided by the TARP recipients and Treasury. The Panel cannot claim unique expertise regarding the wide array of financial institutions and non-financial institutions, such as Chrysler and General Motors, which have accepted TARP funds and, as such, must rely to a significant extent upon good faith submissions by TARP recipients and Treasury.

In our view, Treasury should request that each TARP recipient submit a formal exit strategy and update such strategy each calendar quarter. Treasury should also provide the Panel with its written assessment of the exit strategies and updates submitted by the TARP recipients. Because Treasury has stated that it has a "reluctant shareholder" investment strategy, the Panel and its staff, together with outside experts and advisors, should commit periodically to offer updated assessments of the proposed exit strategies for major TARP recipients as an addendum to the Panel's monthly reports. In our view, Treasury should exit each TARP investment as soon as possible,[713] and apply all proceeds received with respect to each TARP investment permanently to repay the national debt.[714]

3. The Repayment of TARP Funds

It is encouraging that several of the most significant recipients of TARP funds have been permitted by their regulators[715] to repay

[713] It does not appear, however, that Treasury in fact is operating as a reluctant shareholder in all instances. The investment of yet another $3.8 billion in GMAC—an apparently non-systemically significant financial institution—indicates a contrary strategy. Treasury's exit strategy with respect to GMAC remains a mystery. In addition, although the Panel in reports predating our membership on the Panel, has encouraged Treasury to hold its TARP investments in a series of trusts, as the January report acknowledges, such a structure is problematic and we cannot recommend it.

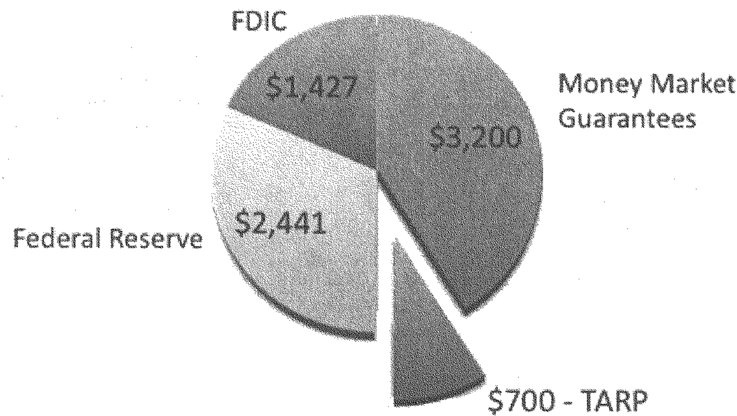
[714] Treasury has interpreted TARP as a "revolving facility" pursuant to which payments received under the program may be recycled and remitted to other TARP recipients. We disagree with this analysis and contend that all such payments should be applied *permanently* to repay the national debt.

[715] We assume the applicable regulators have analyzed the many challenges facing financial institutions, including, without limitation, (i) rising credit card, consumer and home equity loan defaults, (ii) rising commercial real estate and private equity/leveraged buyout loan defaults, (iii)

their TARP advances.[716] It is more satisfying that many of these recipients have funded their redemptions by successfully accessing the private capital markets. We remain optimistic that many—if not most—of these former TARP recipients will not return to business-as-usual, but will endeavor to operate with best practices in corporate governance and risk management guidelines and policies.

As the December Report discussed, TARP is only a small part of the total activity of the federal government to intervene in the financial markets in 2008, including larger government programs instituted by the Federal Reserve and the FDIC. TARP amounted to approximately 10 percent of the total exposure of the taxpayer.

U.S. Financial Stabilization Exposures – May 2009
(*$billions*)



Source: COP Report: *Stress Testing and Shoring Up Bank Capital*, 9 June 2009

Thus, we are troubled that some may view TARP as monochromatic whereby any institution that receives regulatory approval to redeem its TARP advances must necessarily be financially stable. This may not be the case. It is possible that but for the other programs and intervening events, many TARP recipients would not have been financially strong enough to receive regulatory clearance to exit TARP.

Financial institutions (and the automobile companies) have received many direct and indirect financial and regulatory subsidies, including:

- The support of TARP recipients by the Federal Reserve and Treasury with non-TARP sourced funds; and

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the loss of traditional profits centers due to recent regulatory changes, and (iv) the fall in loan demand from borrowers. *See Loan-Rate Differences are Challenges for Banks,* Wall Street Journal (Jan. 4, 2010) (online at online.wsj.com/article/SB10001424052748704162104574630570328742070.html).

[716] Recipients of TARP funds appear eager to exit the program most likely because of the executive compensation restrictions as well as the general stigma associated with participation in the program and the risk that Congress and Treasury will mandate the application of additional adverse laws and regulations to such recipients.

- The settlement of AIG credit default swap obligations with certain TARP recipients at par value (i.e., without any discount).

It is possible that these subsidies contributed to the alleged transformation of a group of essentially insolvent banks in 2008 into non-TARP dependent financial institutions by the end of 2009. These subsidies were delivered at significant cost, and the taxpayers—not the TARP recipients—will most likely ultimately bear those costs.[717]

We have heard much lately about the success of TARP and how the Capital Purchase Program—the original bailout program for approximately 700 financial institutions—may actually yield an overall net profit. This assessment appears premature and inappropriate. The final operating results of TARP should not be tallied without including the costs of the other subsidies afforded TARP recipients by the Federal Reserve, Treasury, Fannie Mae, Freddie Mac, and AIG (channeling Federal Reserve money).

a. Support by the Federal Reserve and Treasury of TARP Recipients

Fannie Mae and Freddie Mac together own or guarantee approximately $5.5 trillion of the $11.8 trillion in U.S. residential mortgage debt and financed as much as 75 percent of new U.S. mortgages during 2009.[718] On December 24, 2009, Treasury announced that it would provide an *unlimited* amount of additional assistance to the two government-sponsored enterprises (GSEs) as required over the next three years.[719] Treasury apparently took this action out of concern that the $400 billion of support that it previously committed to the GSEs could prove insufficient. Additional assistance by Treasury will also allow the GSEs to honor their mortgaged-backed securities (MBS) guarantee obligations and to absorb further losses from the modification or write down of distressed mortgage loans.[720] Treasury also revised upwards to $900 billion the cap[721] on the retained mortgage portfolio of each of the GSEs which means the GSEs will not be forced to sell MBS into a distressed market just as the Federal Reserve is preparing to end its program to purchase up to $1.25 trillion of MBS.[722] The increased

[717] It is also likely that a series of unintended consequences—such as the establishment of the United States government as the implicit/explicit guarantor of certain "too big to fail" institutions—will gain sounder footing from these investments. We do not support the recently announced proposal to levy a special tax, fee or assessment against financial institutions. Such a levy could impede lending in an already tight credit market.

[718] Dawn Kopecki, *Mortgage Anxieties Mean Limbo for Fannie and Freddie* (Update 2), Bloomberg (Dec. 28, 2009) (online at www.bloomberg.com/apps/news?pid=newsarchive&sid=aLEn75100iNg#).

[719] U.S. Department of the Treasury, *Treasury Issues Update on Status of Support for Housing Programs* (Dec. 24, 2009) (online at www.treasury.gov/press/releases/2009122415345924543.htm).

[720] Nick Timiraos, *Questions Surround Fannie, Freddie,* Wall Street Journal (Dec. 30, 2009) (online at online.wsj.com/article/SB20001424052748704234304574626630520798314.html#mod=todays__us__money__and__investing).

[721] The revised number should not be viewed as a "cap" since Treasury may again elect to increase the amount of retained MBS.

[722] Nick Timiraos, *Questions Surround Fannie, Freddie,* Wall Street Journal (Dec. 30, 2009) (online at online.wsj.com/article/ SB20001424052748 704234304574626630520798314.html#mod=todays__us__money__and__investing).

"The relaxed portfolio limits calmed investor worries that Fannie and Freddie would be forced to sell some of their mortgage holdings just as the Federal Reserve was preparing to wind down its purchases of mortgage-backed securities next spring. The Federal Reserve's commitment to

commitment and revised cap enhance the likelihood that the GSEs will undertake to make "large-scale" purchases of distressed MBS for which they provided a guarantee.[723] Presumably, the GSEs may make such purchases from TARP recipients and other holders and issuers, and it will be interesting to note how the GSEs elect to employ the proceeds of this unlimited facility.

As reflected on its November 25, 2009 balance sheet, the Federal Reserve System holds $155 billion face-value federal agency debt securities representing the direct obligations of Fannie Mae, Freddie Mac and the Federal Home Loan Banks, and $852 billion of face-value MBS representing securities guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae. Since November 26, 2008, the Federal Reserve has increased its holdings of federal agency debt securities by $143 billion, and the $852 billion of MBS is entirely new since that date.[724] In addition, Treasury anticipates that as of December 31, 2009, it will have purchased $220 billion of GSE-guaranteed MBS under the Housing and Economic Recovery Act of 2008 (HERA).[725]

It does not seem unreasonable to conclude that the actions of Treasury and the Federal Reserve in support of the MBS market and the GSEs also offered material assistance to many TARP recipients and expedited the exit of some recipients from the TARP.[726] By directly and indirectly (through the GSEs) funding the acquisition of MBS[727] from TARP recipients and other holders

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buy up to $1.25 trillion has helped to keep mortgage rates near record lows; without that support some economists have said that could rise to 6% by the end of 2010.

Others said the new flexibility means that Fannie and Freddie could replace the Federal Reserve as a big buyer of mortgage-backed securities, especially if weak demand for mortgage-backed securities from private investors drives rates higher."

[723] Jody Chenn, *Fannie Changes Clear Way for 'Large-Scale' Buyouts (Update 1),* Bloomberg (Dec. 28, 2009) (online at www.bloomberg.com/apps/news?pid=newsarchive&sid=aA7QrMCZHhRs#).

[724] Board of Governors of the Federal Reserve System, *Federal Reserve System Monthly Report on Credit and Liquidity Programs and Balance Sheet* (Dec. 2009) (online at federalreserve.gov/monetarypolicy/files/monthlyclbsreport200912.pdf).

[725] U.S. Department of the Treasury, *Treasury Issues Update on Status of Support for Housing Programs* (Dec. 24, 2009) (online at www.treasury.gov/press/releases/2009122415345924543.htm).

[726] This is not to say that the overarching purposes and mechanics of the Treasury and Federal Reserve programs are necessarily transparent. A number of questions—without limitation—are presented.

- What is the authority for Treasury's unlimited assistance to the GSEs?
- Will the GSEs continue to use funds contributed by Treasury to guarantee the MBS purchased by the Federal Reserve?
- If so, are the taxpayers—through Treasury's recently announced unlimited capital commitment to the GSEs—in effect bailing out the Federal Reserve for its efforts to create a liquid one-buyer market for MBS?
- Is one of the principal purposes of these circular purchases, capital infusions and guarantee payments simply to remove MBS from the books of TARP recipients (the original purpose of TARP) and other holders and issuers at favorable prices to the sellers?
- Is the Federal Reserve in effect bailing out TARP recipients and other holders and issuers of MBS?
- If so, will this action also placate foreign sovereigns and other holders and issuers that acquired GSE guaranteed MBS with the understanding that it was full faith and credit paper of the United States government?
- Have the purchases of MBS by the Federal Reserve coupled with the unlimited assistance from Treasury converted the implicit guarantee into an explicit guarantee of the GSEs by the United States government?
- If so, under what authority was such action taken?
- Has the Federal Reserve or Treasury purchased any MBS from any TARP recipient or other holder or issuer for consideration in excess of the then existing market value?
- If so, under what authority was such action taken?

[727] To the extent Treasury or the Federal Reserve purchased MBS from TARP recipients for consideration in excess of market value, it is possible that some or all of the spread should be

Continued

and issuers, Treasury and the Federal Reserve added liquidity to an all but frozen MBS market and no doubt enhanced the trading value of such securities. It is difficult to imagine that the Federal Reserve's public commitment to purchase up to $1.25 trillion of MBS did not materially move the market and permit holders of MBS—including TARP recipients—to liquidate their investments at more favorable pricing. Even if the Federal Reserve ends its program to purchase MBS within the next few months[728] the GSEs could potentially pick up the slack by funding the acquisition of MBS through Treasury's recently announced expansion of its commitment to the GSEs. Further, by funding Fannie Mae's and Freddie Mac's performance of their MBS guarantee obligations, Treasury has directly supported the MBS market and, as such, quite likely improved the net worth of many TARP recipients. Similarly, by purchasing MBS and GSE-issued mortgage bonds, the Federal Reserve has kept mortgage rates near historic lows,[729] thereby facilitating mortgage loan originations and refinancings and lessening the default rate on existing adjustable rate mortgage loans—all of which have benefited many TARP recipients.

In order to expedite the swift metamorphosis of many TARP recipients from insolvent to investment grade, the institutions were arguably subsidized through government-sponsored purchases of MBS and by the all but unlimited investment of (and commitment

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classified as a subsidy—without an offsetting additional reimbursement obligation—for the benefit of the selling TARP recipients. We question whether many TARP recipients would have sold a material portion of their MBS portfolios for less than the original purchase price paid for the securities due to the adverse effect the recognition of any resulting losses would have had on their required capital ratios. In addition, these transactions would have provided lower "marks" for valuation purposes, which could have had significant adverse balance sheet and income statement effects under FAS 157. Thus, the revision of the mark-to-market accounting rules noted below in the text may have also encouraged TARP holders to defer any sales of MBS for consideration less than their original purchase price. In addition to the cash infusion generated from the sale of illiquid MBS at favorable prices, the selling TARP recipients may have been able to book trading profits from the MBS dispositions and it is possible that some TARP recipients generated material trading gains by purchasing distressed MBS at well below par and selling the securities to Treasury or the Federal Reserve at or near par. These transactions would have bolstered the recipient's capital and expedited its exit from TARP.

The quantification of any such subsidy is not free from doubt since each MBS purchased by Treasury or the Federal Reserve apparently carried a GSE guarantee and presumably would have been paid pursuant to the terms of the guarantee contract assuming the guarantor remained solvent. Nevertheless, GSE guaranteed MBS presumably may trade below par if the guarantee obligation has not been triggered (or has only been partially triggered) and the disposition of any such MBS by a TARP recipient for consideration in excess of its prevailing market price may in certain instances be viewed as a subsidy to the selling recipient. The recognition of significant subsidies would have improved the financial position and operating results of TARP recipients and assisted their exit from the program. The cost of providing such subsidies to the TARP recipients will be borne by the taxpayers and not the recipients.

[728] *Fed may re-enter MBS market later in 2010—Market News,* Reuters (Jan. 5, 2010) (online at www.reuters.com/article/idUSN0530695520100105?type=marketsNews):

"The Federal Reserve is discussing re-entering the mortgage-backed securities market later this year if its buying power is needed to hold down interest rates, Market News said on Tuesday in a story citing Fed officials.

The $5 trillion agency mortgage-backed securities market may weaken when last year's biggest buyer, the Federal Reserve, ends its $1.25 trillion agency MBS purchasing program at the end of the first quarter of 2010."

See also, Fed Minutes Show Division on Emergency Steps, New York Times (Jan. 6, 2010) (online at www.nytimes.com/2010/01/07/business/07fed.html?hp); *see also, Fed Plan to Stop Buying Mortgages Feeds Recovery Worries,* Wall Street Journal (Jan. 8, 2010) (online at online.wsj.com/article/SB126291088200220743.html).

[729] Although the purchases have reduced the cost of capital of the GSEs and lowered mortgage rates, some analysts fear that the withdrawal of Federal Reserve support for the GSEs will lead to an "asset collapse" while others note that such concerns are "overblown." *See Mortgage Anxieties Mean Limbo for Fannie and Freddie (Update 2),* Bloomberg (Dec. 28, 2009) (online at www.bloomberg.com/apps/news?pid=newsarchive&sid=aLEn75100iNg#); *see also, Mortgage Bond Rally May End, Rates Rise as Fed Stops Purchases,* Bloomberg (Dec. 31, 2009) (online at www.bloomberg.com/apps/news?pid=20601087&sid=aukqYVzx6x3w&pos=4).

to invest) public funds in Fannie Mae, Freddie Mac and AIG. One may argue that the government has created without meaningful public debate or analysis a series of "bad banks" within the Federal Reserve, Treasury, Fannie Mae, Freddie Mac and AIG[730] to accomplish what TARP alone failed to achieve. These "bad banks" or, perhaps, "debt consolidation entities" operate by *actually* and *virtually* removing toxic assets from the books of TARP recipients and other holders and issuers. The Federal Reserve and Treasury have *actually* removed up to $1 trillion of troubled assets from the books of TARP recipients and other holders and issuers through outright purchases.[731] The Federal Reserve and Treasury have also *virtually* removed additional troubled assets from the books of TARP recipients and other holders and issuers by propping up the market values of such assets and maintaining historically low mortgage rates.

Although Treasury and the Federal Reserve have arguably bolstered the net worth of many TARP recipients by purchasing MBS and investing in the two GSEs, much of the risk associated with Treasury's and the Federal Reserve's investments will fall to the taxpayers even though substantial benefits may inure to many TARP recipients. Such actions by Treasury and the Federal Reserve have all but enshrined the "implicit guarantee" of the United States government with respect to institutions that are deemed "too big or too interconnected to fail" and may have intentionally or inadvertently subsidized the early exit from TARP of many recipients at an increasing cost of the taxpayers.

b. AIG and Credit Default Swap Payments

On November 17, 2009, the Special Inspector General for TARP (SIGTARP) issued a report addressing the termination of certain AIG CDSs at par (SIGTARP Report).[732] In order to close out the AIG CDSs the FRBNY remitted $27.1 billion to the AIG counterparties (CPs) in return for $62.1 billion of face value CDOs held by the CPs.[733] The CPs were also permitted to retain $35 billion of cash collateral previously pledged by AIG pursuant to the CDSs. The CPs—which included TARP recipients Goldman Sachs, Merrill Lynch and Bank of America—were paid the full face value of their

[730] It is our understanding that many of the distressed assets of AIG are housed in a group of special purpose vehicles with the common name "Maiden Lane LLC."

[731] Treasury anticipates that it will have purchased approximately $220 billion face value of mortgage-backed securities guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae by December 31, 2009, and the Federal Reserve's November 25, 2009 balance sheet discloses the purchase of $852 billion face value of mortgage-backed securities guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae. See U.S. Department of the Treasury, *Treasury Issues Update on Status of Support for Housing Programs* (Dec. 24, 2009) (online at www.treasury.gov/press/releases/20091224153459245 43.htm; *see also,* Board of Governors of the Federal Reserve System, *Federal Reserve System Monthly Report on Credit and Liquidity Programs and Balance Sheet* (Dec. 2009) (online at www.federalreserve.gov/monetarypolicy/files/monthlyclbsreport200912.pdf).

[732] Office of the Special Inspector General for the Troubled Asset Relief Program, *Factors Affecting Efforts To Limit Payments to AIG Counterparties* (Nov. 17, 2009) (online at www.sigtarp.gov/reports/audit/2009/Factors_Affecting_Efforts_to_Limit_Payments_to_AIG_Counterparties.pdf).

[733] Each AIG CDS was structured with the applicable CP based upon a unique set of facts. The noted description is, by necessity, simplified.

respective CDOs and the FRBNY failed in its efforts to receive a discount in payment from any CP.[734]

A question arises as to whether the termination of the CDSs at par—that is, without any discount or haircut—constituted an inappropriate subsidy of the CPs and necessitated the investment of additional TARP funds in AIG. According to the SIGTARP Report, the CPs refused to accept a discounted payment and terminate the CDSs for less than par because (i) the collateral previously posted under the CDS contracts ($35 billion) plus the then fair market value of the CDOs ($27.1 billion) equaled the full face value of the CDOs ($62.1 billion), (ii) the United States government had clearly signaled that it would not permit AIG to fail and, therefore, the CDSs would be honored in full, (iii) certain CPs had hedged against a default by AIG under the CDSs, and (iv) the CPs were entitled to par value payments pursuant to the CDS contracts.[735] Although the FRBNY apparently asked the CPs to accept a discounted payment for the settlement of the CDSs, their efforts ultimately proved unsuccessful.

These justifications proffered by the CPs, and accepted by the FRBNY, are not compelling. If the CPs believed that the United States government would not permit AIG to fail, then why did the FRBNY insist on terminating the CDSs? If the CPs were confident that AIG—or the FRBNY in its absence—would continue to post collateral if the fair market value of the CDOs declined or that the CDOs could be sold for their then market value if AIG collapsed, then why not let the CPs assume that risk? If the CPs believed that their third-party hedges against an AIG default would be honored in full, then (again) why not let the CPs assume that risk? Although the SIGTARP Report notes that then-FRBNY President Geithner denies that the payments by the FRBNY constituted a "backdoor bailout" of the CPs,[736] without any other explanation, it is difficult to conclude that the FRBNY insisted that AIG terminate the CDSs other than as a mechanism to provide a direct—yet not particularly transparent—government-sponsored subsidy to the CPs.[737]

Even if the FRBNY did not intend for the termination of the CDSs to serve as a government-sponsored subsidy of the CPs, why did the FRBNY fail to negotiate material discounts with each CP? Although the CPs may have believed that (i) the United States government would not let AIG fail, (ii) AIG—or the FRBNY—would continue to post collateral under the CDS contracts or that the CDOs could be sold for their then market value if AIG collapsed,

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[734] The aggregate face amount of the underlying CDOs equaled $62.1 billion and the CPs received $27.1 billion from the FRBNY and were permitted to retain $35 billion of cash collateral previously pledged under the CDS contracts. *Id.*

[735] Office of the Special Inspector General for the Troubled Asset Relief Program, *Factors Affecting Efforts to Limit Payments to AIG Counterparties,* at 15 (Nov. 17, 2009) (online at www.sigtarp.gov/reports/audit/2009/Factors__Affecting__Efforts__to__Limit__Payments__to__AIG__Counterparties.pdf).

[736] Office of the Special Inspector General for the Troubled Asset Relief Program, *Factors Affecting Efforts to Limit Payments to AIG Counterparties,* at 30 (Nov. 17, 2009) (online at www.sigtarp.gov/reports/audit/2009/Factors__Affecting__Efforts__to__Limit__Payments__to__AIG__Counterparties.pdf).

[737] Is it likely that the market value of the referenced CDOs would have dropped from $27.1 billion to zero and necessitated that AIG post additional collateral of $27.1 billion? By terminating the CDS contracts at par, the FRBNY effectively assumed that the market value of the CDOs would drop to zero within the very near term.

and (iii) their third-party hedges would be honored in full, such assumptions were by no means free from doubt. All doubt was resolved, however, in favor of the CPs upon their receipt of cash payments from the FRBNY for the full par value of the CDOs. It seems that the negation of these risks should have merited the termination of the CDS contracts at a material discount to par value.

In addition, other justifications exist for discounting the payments remitted by the FRBNY to the CPs. Prior to the termination of the CDSs, the CPs held cash collateral of $35 billion. Yet, after the termination of the CDSs, the CPs held actual cash in the same amount. The transformation of cash collateral into actual cash must have been of some benefit to the CPs.[738] Further, prior to the termination of the CDSs, the CPs held CDOs with a (falling) market value of $27.1 billion, but after the termination of the CDSs, the CPs held actual cash in the same amount.[739] In effect, the FRBNY permitted—if not directly encouraged—the CPs to convert illiquid cash collateral and illiquid CDOs into $62.1 billion of actual cash. Trading cash collateral and CDOs with a problematic market value for cash during a worldwide liquidity crunch must have been of substantial benefit to the CPs. Why was the FRBNY unable to terminate the CDSs at a material discount to par value? Why did the FRBNY not insist on these discounts? Again, the inescapable conclusion, without other facts, seems to be that this was a direct government-sponsored subsidy to the CPs.

It is unlikely that the FRBNY (or the United States government) has a basis to seek to unwind the termination of the CDSs or compel the CPs to promptly remit a suitable discount to the FRBNY. It appears that the CPs—including several TARP recipients—received another taxpayer subsidy for which they hold no reimbursement obligation. Without this substantial subsidy, it is possible that at least some of the CPs would not have been permitted by their regulators to exit the TARP program on an expedited basis. We recommend that the Panel investigate this matter in its upcoming report on AIG. Without a better explanation of a straightforward business purpose for these transactions, the taxpayers nevertheless may be best served by having Treasury seek recission from the CPs, reversing cancellation of the CDS contracts and requiring the CPs to purchase the underlying CDOs at their $62.1 billion par value.

4. Exit Strategy from HAMP and Other Foreclosure Mitigation Programs

The TARP-funded HAMP program carries a 100 percent subsidy rate according to the General Accounting Office.[740] This means that the United States government will recover *none* of the $50 billion of taxpayer sourced TARP funds invested in the HAMP fore-

[738] This assumes that posted collateral under these transactions was encumbered by contractual and legal restrictions.

[739] At the time the FRBNY financed the termination of the AIG CDSs, the CDO market was illiquid—if not frozen—and it is doubtful that lenders would have accepted CDOs as collateral without the imposition of substantial discounts to their then significantly depressed market values.

[740] Government Accountability Office, *Financial Audit: Office of Financial Stability (Troubled Asset Relief Program) Fiscal Year 2009 Financial Statements* (Dec. 2009) (online at www.gao.gov/new.items/d10301.pdf).

closure mitigation program.[741] The projected shortfall will become more burdensome to the taxpayers as Treasury contemplates expanding HAMP or introducing additional programs targeted at modifying or refinancing distressed home mortgage loans. Since Treasury is charged with protecting the interests of the taxpayers who funded HAMP and the other TARP programs, we recommend that Treasury's foreclosure mitigation efforts be structured so as to incorporate an effective exit strategy by allowing Treasury to participate in any subsequent appreciation in the home equity of any mortgagor whose loan is modified under HAMP or any other taxpayer subsidized program.[742] In order to encourage the participation of mortgage lenders in Treasury's foreclosure mitigation efforts, such lenders should also be granted the right—subordinate to the right granted Treasury—to participate in any subsequent equity appreciation. The incorporation of an equity participation right may be achieved by the filing of a one-page document in the local real estate property records when the applicable home mortgage loan is modified. The mechanics of such a feature may be illustrated by the following example of a typical home mortgage loan modification.

> Assume a homeowner borrows $200,000 and purchases a residence in the same amount.[743] The home subsequently declines in value to $175,000 and the homeowner and the mortgage lender agree to restructure the loan under a TARP-sponsored foreclosure mitigation program pursuant to which the outstanding principal balance of the loan is reduced to $175,000 and Treasury advances $10,000 in support of the restructure. Immediately after the modification the mortgage lender has suffered a $25,000[744] economic loss and Treasury has advanced $10,000 of TARP funds. If the homeowner subsequently sells the residence for $225,000, the $50,000 of realized equity proceeds[745] will be allocated in accordance with the following waterfall—the first $10,000[746] is remitted to reimburse Treasury for the TARP funds advanced under the foreclosure

[741] 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).

[742] Congressional Oversight Panel, *Taking Stock: What Has the Troubled Asset Relief Program Achieved?,* Additional views of former panelist Congressman Jeb Hensarling (Dec. 9, 2009) (online at cop.senate.gov/documents/cop-120909-report-hensarling.pdf).

[743] These facts illustrate the zero ($0.00) down-payment financings that were more common a few years ago.

[744] The $25,000 loss equals the $200,000 principal balance of the original loan, less the $175,000 principal balance of the modified loan. The example does not consider the consequences of modifying the interest rate on the loan.

[745] The $50,000 of realized equity proceeds equals the $225,000 sales price of the residence, less the $175,000 outstanding balance of the modified loan. The example makes certain simplifying assumptions such as the absence of transaction and closing fees and expenses.

[746] In order to more appropriately protect the taxpayers, the $10,000 advanced under the TARP sponsored foreclosure mitigation program should accrue interest at an objective and transparent rate of interest. For example, if the 30-year fixed rate of interest on mortgage loans equals five-percent when the mortgage loan is modified, the $10,000 advance should accrue interest at such a rate and Treasury should be reimbursed the aggregate accrued amount upon realization of the equity proceeds. If at such time $2,500 of interest has accrued, Treasury should be reimbursed $12,500 ($10,000 originally advanced, plus $2,500 of accrued interest) instead of only the $10,000 of TARP proceeds originally advanced.

mitigation program; the next $25,000[747] is remitted to the mortgage lender to cover its $25,000 economic loss; and the balance of $15,000 is paid to the homeowner.

Prior to the repayment of all funds advanced by Treasury and the economic loss suffered by the mortgage lender the homeowner should not be permitted to borrow against any appreciation in the net equity value of the mortgaged property unless the proceeds are applied in accordance with the waterfall noted above. That is, instead of selling the residence for $225,000 as assumed in the foregoing example, the homeowner should be permitted to borrow against any net equity in the residence, provided $10,000 is remitted to Treasury and $25,000 is paid to the mortgage holder prior to the homeowner retaining any such proceeds.[748] Such flexibility allows the homeowner to cash out the interests of Treasury and the mortgage lender without selling the residence securing the mortgage loan. The modified loan documents should also permit the homeowner to repay Treasury and the mortgage lender from other sources such as personal savings or the disposition of other assets.[749]

We also recommend that to the extent permitted by applicable law, Treasury should structure all mortgage loan modifications and refinancings under HAMP and any other foreclosure mitigation programs as recourse obligations to the homeowners. If the loans are structured as non-recourse obligations, under state law or otherwise, the homeowners may have a diminished incentive to repay Treasury the funds advanced under TARP.[750]

In our view, the incorporation of these specifically targeted modifications into each TARP funded foreclosure mitigation program will enhance the possibility that Treasury will exit the programs at a reduced cost to the taxpayers.

5. Implicit Guarantees

The January report analyzes the difficulties that may arise when the United States government directly or indirectly undertakes to prevent certain systemically significant institutions from failing. Although the government does not generally guarantee the assets and obligations of private entities, its actions and policies may nevertheless send a clear message to the market that some institutions are simply too big, or too interconnected, to fail. Once the government adopts such a policy it is difficult to know how and where to draw the line. With little public debate, automobile manufacturers were recently transformed into financial institutions so they could be bailed out with TARP funds and an array of arguably non-sys-

[747] The mortgage lender may also argue that its $25,000 loss should accrue interest in the same manner as provided Treasury. In such event, the mortgage lender would be entitled to recover $25,000, plus accrued interest upon the realization of sufficient equity proceeds.

[748] Prudent underwriting standards should apply to all such home equity loans.

[749] Treasury may wish to structure its foreclosure mitigation efforts so as to encourage the early repayment of TARP funds by homeowners. Treasury, for example, could agree to a ten-percent discount or waive the accrual of interest on the TARP funds advanced if a homeowner repays such funds in full within three years following the restructuring. Any such incentives should appear reasonable to the taxpayers and should not negate the intent of the equity participation right. Mortgage lenders may also agree to similar incentives.

[750] Roger Lowenstein, *Walk Away From Your Home,* New York Times (Jan. 7, 2009) (online at www.nytimes.com/2010/01/10/magazine/10FOB-wwln-t.html?hp). The article implies that a recourse structure is of little benefit if the homeowner is otherwise judgment proof.

temically significant institutions—such as GMAC[751]—received many billions of dollars of taxpayer funded subsidies. In its haste to restructure favored institutions, the government may assume the role of king maker—as was surely the case in the Chrysler and GM bankruptcies—and dictate a reorganization structure that arguably contravenes years of well-established commercial and corporate law precedent. The unintended consequences of these actions linger in the financial markets and legal community long after the offending transactions have closed and adversely—yet subtly—affect subsequent transactions that carry any inherent risk of future governmental intervention. The uninitiated may question why two seemingly identical business transactions merit disparate risk-adjusted rates of return or why some transactions appear over-collateralized or inexplicably complicated. The costs of mitigating political risk in private sector business transactions are seldom quantified or even discussed outside the cadre of businesspersons and their advisors who structure, negotiate and close such transactions, yet such costs certainly exist and must be satisfied.

The resolution of the fundamental public policy issues arising from implicit guarantee and political risk should remain with Congress.

[751] Although Treasury indicates that GMAC was (again) saved so as to support its auto financing business, it also appears that substantial GMAC losses stem from speculation in the MBS market. It is unclear why GMAC—a putative auto finance company—chose to speculate in the MBS market. We recommend that the Panel investigate GMAC and the inherent ongoing subsidies that its taxpayer-supported operations afford to Chrysler and GM in contrast to their competitors.

SECTION THREE: CORRESPONDENCE WITH TREASURY UPDATE

Secretary of the Treasury, Timothy Geithner, sent a letter to Chair Elizabeth Warren on December 10, 2009[752] in response to a series of questions presented by the Panel regarding the Supervisory Capital Assessment Program (the "stress tests").

On behalf of the Panel, Chair Elizabeth Warren sent a letter on December 24, 2009[753] to Secretary of the Treasury, Timothy Geithner, requesting information with respect to the Emergency Economic Stabilization Act of 2008 provisions governing executive compensation at TARP-recipient financial institutions and regarding the authority of the Special Master for TARP Executive Compensation. The Panel requested a written response from Treasury by January 13, 2010. The Panel has not yet received a response from Secretary Geithner.

On behalf of the Panel, Chair Elizabeth Warren sent a letter on January 11, 2010[754] to Secretary of the Treasury Timothy Geithner, to follow-up on a letter sent on November 25, 2009,[755] requesting information with respect to Treasury's assistance to CIT Group, Inc. As of the publication of this report, the Panel has not received a response from Secretary Geithner.

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[752] See Appendix I of this report, *infra.*

[753] See Appendix II of this report, *infra.*

[754] See Appendix III of this report, *infra.*

[755] See Appendix IV of the Panel's December oversight report. Congressional Oversight Panel, *December Oversight Report: Taking Stock: What Has the Troubled Asset Relief Program Achieved?* (Dec. 9, 2009) (online at cop.senate.gov/documents/cop-120909-report.pdf).

SECTION FOUR: TARP UPDATES SINCE LAST REPORT

A. Restructuring of Treasury's Investment in GMAC

Treasury injected an additional $3.8 billion of capital into GMAC on December 30, 2009. The $3.8 billion is divided into a $2.54 billion purchase of Trust Preferred Securities (TruPs), $127 million in warrants to purchase TruPs exercised on December 30, a $1.25 billion purchase of Mandatory Convertible Preferred Stock (MCP), and $63 million in warrants to purchase MCP exercised on December 30.

In addition, Treasury converted $3 billion of the $7.5 billion in MCP it purchased in May 2009 into common equity; Treasury now owns 56 percent of GMAC's common stock, up from 35 percent prior to this transaction. As a result, Treasury will appoint four members of GMAC's board of directors, up from two before the restructuring. The restructuring also converted Treasury's preferred stock and warrants, from a $5 billion purchase in December 2008, into MCP. Treasury exercised warrants it held following both transactions prior to the conversions, totaling $375 million and $250 million, respectively.

Treasury made the additional purchases and restructured the investment in order to help GMAC satisfy its additional capital requirements under the Supervisory Capital Assistance Program (SCAP) following the May 2009 stress tests. Treasury's additional commitment came in under the $5.6 billion Treasury previously estimated GMAC would require under SCAP.

For a more complete discussion of the restructuring of Treasury's GMAC investment, please see Section D.8 of this report.

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 December 14, 2009, includes data through the end of October 2009. Treasury reported that the overall outstanding loan balance at the top CPP recipients declined by one percent between the end of September 2009 and the end of October 2009.

C. TARP Repayments

Since the Panel's most recent oversight report, additional banks have repaid their TARP investments under CPP. A total of 58 banks have repaid their preferred stock TARP investments provided under the CPP to date. Treasury has also liquidated the warrants it holds in 40 of these 58 banks.

Most notably, Bank of America and Wells Fargo & Company both repaid their full $25 billion CPP investments. In addition, both Bank of America and Citigroup repaid all $20 billion Treasury invested in both institutions through the TIP. Finally, General Motors repaid the first $1 billion of a $6.7-billion debt obligation to Treasury remaining after GM's bankruptcy proceedings. Similar quarterly payments will continue until the debt is repaid.

During November 2009, Treasury received $1.87 billion in dividends and $13.5 million in interest from its investments.

D. Asset Guarantee Program Termination

On December 23, 2009, Treasury, the Federal Reserve, the Federal Deposit Insurance Corporation, and Citigroup terminated a loss-sharing agreement on $301 billion of ring-fenced Citigroup assets reached under Treasury's Asset Guarantee Program (AGP) in January 2009 and expected to run for 10 years. As a result of the early termination, Treasury cancelled $1.8 billion in Trust Preferred Securities, leaving Treasury with a little over $2.2 billion in Trust Preferred Securities and a warrant for 66 million shares of Citigroup common stock in exchange for the guarantee. This transaction was the only one ever consummated under the AGP, and Treasury is terminating the program.

E. Public-Private Investment Program

On December 18, 2009, the last of the nine pre-qualified PPIP fund managers, Oaktree Capital Management, L.P., closed a PPIF transaction. As a result, Treasury has made available to fund managers its full complement of $30 billion financing, representing $10 billion in equity capital and $20 billion in secured debt financing.

As of December 22, 2009, Treasury reported that PPIP transactions totaling $24 billion in purchasing power had closed, representing $6 billion in private equity capital, $6 billion in Treasury equity capital, and $12 billion in secured debt financing.

On January 4, 2010, Treasury entered into a wind-up and liquidation agreement with TCW Asset Management, one of the nine pre-qualified PPIP fund managers. The agreement will unwind a Treasury investment of $356.3 million, with a portion of the losses backstopped by TCW.

F. Term Asset-Backed Securities Loan Facility (TALF)

At the December 14, 2009 facility, investors requested $1.3 billion in loans for legacy CMBS. Investors did not request any loans for new CMBS. By way of comparison, investors requested $1.4 billion in loans for legacy CMBS at the November facility and $2.1 billion at the October facility. Investors requested $72.2 million in loans for new CMBS at the November facility, the only loans requested for new CMBS during TALF's operation.

At the January 7, 2010 facility, investors requested $1.1 billion in loans to support issuance of ABS collateralized by loans in the credit card, floorplan, and small business sectors. No loans were requested in the auto, equipment, premium financing, servicing advances, and student loan sectors. By way of comparison, at the December 3, 2009 facility, investors requested $3 billion in loans collateralized by the issuance of ABS in the credit card, equipment, floorplan, small business, servicing advances, and student loan sectors; investors did not request any loans in the auto or premium financing sectors.

G. Warrant Auctions

Treasury previously announced that it would sell its warrant positions in JPMorgan Chase & Co. and TCF Financial Corporation through a modified Dutch auction process. The auction of

JPMorgan Chase warrants closed on December 10, 2009, with proceeds to Treasury of $950.3 million. The auction of TCF Financial warrants closed on December 15, 2009, with proceeds to Treasury of $9.6 million.

H. Metrics

Each month, the Panel's report highlights a number of metrics that the Panel and others, including Treasury, the Government Accountability Office (GAO), Special Inspector General for the Troubled Asset Relief Program (SIGTARP), and the Financial Stability Oversight Board, consider useful in assessing the effectiveness of the Administration's efforts to restore financial stability and accomplish the goals of EESA. This section discusses changes that have occurred in several indicators since the release of the Panel's December report.

- Interest Rate Spreads. Interest rate spreads have continued to tighten since the Panel's December report, showing further signs of financial stability. Interest rates on overnight commercial paper have returned to near pre-crisis levels. The interest rate spread for AA asset-backed commercial paper, which is considered mid-investment grade, has decreased by nearly 8 percent since the Panel's December report and is at its lowest level since July 2007. Interest rate spreads on overnight A2/P2 commercial paper, considered to be lower quality, have decreased over 95 percent since the enactment of EESA.

FIGURE 14: INTEREST RATE SPREADS

Indicator	Current Spread (as of 12/31/09)	Percent Change Since Last Report (as of 11/30/09)
3 month LIBOR-OIS spread[756]	0.09	−33
1 month LIBOR-OIS spread[757]	0.10	−16
TED spread[758] (in basis points)	19	−5
Conventional mortgage rate spread[759]	1.29	−12.8
Corporate AAA bond spread[760]	1.56	−11.9
Corporate BAA bond spread[761]	2.66	−9.5
Overnight AA asset-backed commercial paper interest rate spread[762]	0.17	−7.6
Overnight A2/P2 nonfinancial commercial paper interest rate spread[763]	0.13	52.3

[756] *3 Mo LIBOR-OIS Spread,* Bloomberg (online at www.bloomberg.com/apps/quote?ticker=.LOIS3:IND) (accessed Jan. 4, 2010) (hereinafter "3 Mo LIBOR-OIS Spread").

[757] *1 Mo LIBOR-OIS Spread,* Bloomberg (online at www.bloomberg.com/apps/quote?ticker=.LOIS1:IND) (accessed Jan. 4, 2010).

[758] *TED Spread,* SNL Financial.

[759] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release H.15: Selected Interest Rates: Historical Data* (Instrument: Conventional Mortgages, Frequency: Weekly) (online at www.federalreserve.gov/releases/h15/data/Weekly__Thursday__/H15__MORTG__NA.txt) (accessed Jan. 4, 2010); Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release H.15: Selected Interest Rates: Historical Data* (Instrument: U.S. Government Securities/Treasury Constant Maturities/Nominal 10-Year, Frequency: Weekly) (online at www.federalreserve.gov/releases/h15/data/Weekly__Friday__H15__TCMNOM__Y10.txt) (hereinafter "Federal Reserve Statistical Release H.15") (accessed Jan. 4, 2010).

[760] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release H.15: Selected Interest Rates: Historical Data* (Instrument: Corporate Bonds/Moody's Seasoned AAA, Frequency: Weekly) (online at www.federalreserve.gov/releases/h15/data/Weekly__Friday__H15__AAA__NA.txt) (accessed Jan. 4, 2010); Federal Reserve Statistical Release H.15, *supra* note 759 (accessed Jan. 4, 2010).

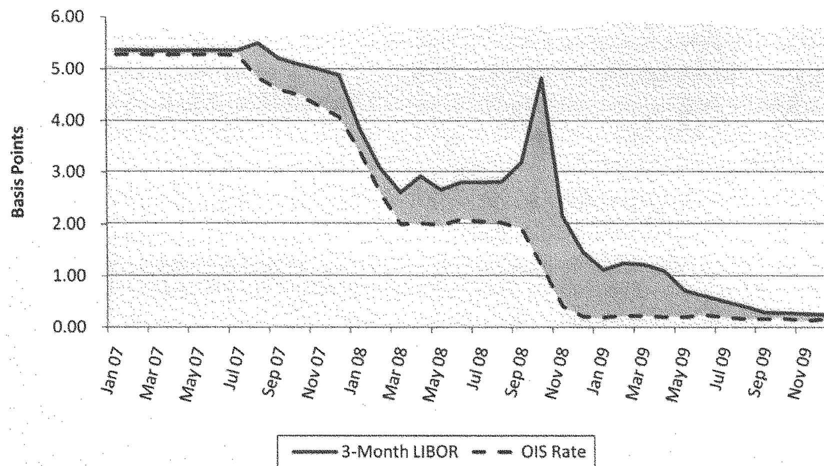
[761] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release H.15: Selected Interest Rates: Historical Data* (Instrument: Corporate Bonds/Moody's Seasoned BAA, Frequency: Weekly) (online at www.federalreserve.gov/releases/h15/data/Weekly__Friday__/H15__BAA__NA.txt) (accessed Jan. 4, 2010); Federal Reserve Statistical Release H.15, *supra* note 759 (accessed Jan. 4, 2010).

[762] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release: Commercial Paper Rates and Outstandings: Data Download Program* (Instrument: AA Asset-Backed Discount Rate, Frequency: Daily) (online at www.federalreserve.gov/DataDownload/Choose.aspx?rel=CP) (hereinafter "Federal Reserve Statistical Release on Commercial Paper") (accessed Jan. 4, 2010); Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release: Commercial Paper Rates and Outstandings: Data Download Program* (Instrument: AA Nonfinancial Discount Rate, Frequency: Daily) (online at www.federalreserve.gov/DataDownload/Choose.aspx?rel=CP) (accessed Jan. 4, 2010). In order to provide a more complete comparison, this metric utilizes a five-day average of the interest rate spread for the last five days of the month.

[763] Federal Reserve Statistical Release on Commercial Paper, *supra* note 762. In order to provide a more complete comparison, this metric utilizes a five-day average of the interest rate spread for the last five days of the month.

• LIBOR-OIS Spread. The LIBOR-OIS spread provides another example of how credit conditions have improved. This spread measures the difference between 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. 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.[764]

FIGURE 15: 3 MONTH LIBOR-OIS SPREAD (AS OF DECEMBER 2009)[765]



• TED Spread. The TED spread, which is the difference between LIBOR and short-term Treasury bill interest rates, is another indicator of perceived credit risk. After peaking in late 2008, the TED spread has fallen to pre-crisis levels, as Figure 16 illustrates. The TED spread has continued to tighten since the Panel's December report, declining 5 percent since November 30, 2009.[766]

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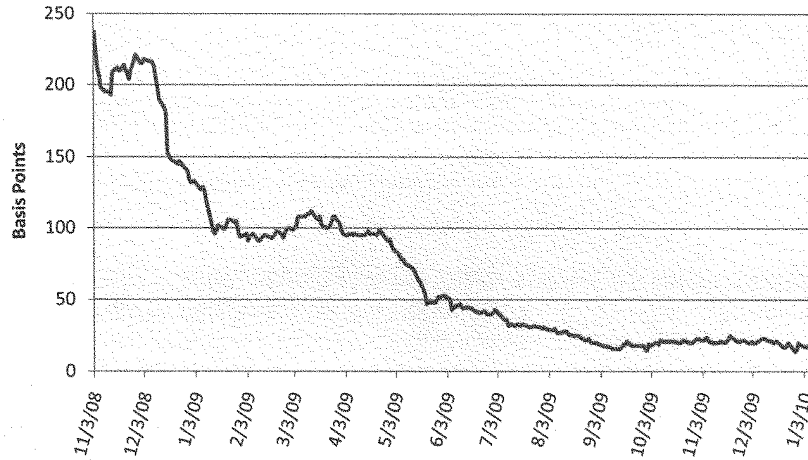
[764] Federal Reserve Bank of St. Louis, *What the Libor-OIS Spread Says* (May 11, 2009) (online at research.stlouisfed.org/publications/es/09/ES0924.pdf).

[765] *See* 3 Mo LIBOR-OIS Spread, *supra* note 756.

[766] SNL Financial, *Historical Dividend Yield Values, 3 Month Libor* (online at www1.snl.com/InteractiveX/history.aspx? RateList=1&Tabular=True&GraphType=2&Frequency=0&TimePeriod2=11&BeginDate=12%2F29%2F06&EndDate=11%2F4%2F2009&SelectedYield2=YID%3A63&ctl00%24ctl09%24IndexPreference=default&ComparisonIndex2=0&ComparisonYield2=1&CustomIndex=0&ComparisonTicker2=&Action=Apply) (accessed Nov. 5, 2009) (hereinafter "Historical Dividend Yield Values, 3 Month Libor"); SNL Financial, *Historical Dividend Yield Values, 3 Month Treasury Bill* (online at www1.snl.com/InteractiveX/history.aspx?RateList=1&Tabular=True&GraphType=2&Frequency=0&TimePeriod2=11&BeginDate=12%2F29%2F06&EndDate=11%2F4%2F2009&Selected Yield2=YID%3A63&ctl00%24ctl09%24IndexPreference=default&ComparisonIndex2=0&ComparisonYield2=1&CustomIndex=0&ComparisonTicker2=&Action=Apply) (accessed Nov. 5, 2009).

FIGURE 16: TED SPREAD SINCE OCTOBER 3, 2008[767]



• Commercial Paper Outstanding. Commercial paper outstanding, a rough measure of short-term business debt, is an indicator of the availability of credit for enterprises. The amount of commercial paper outstanding has decreased across the three categories the Panel measures since the December 2009 report. Financial commercial paper outstanding has decreased by over 9 percent since the Panel's last report while nonfinancial commercial paper outstanding fell by over 13.5 percent.[768] Commercial paper outstanding has continued to decrease since the enactment of EESA. Asset-backed commercial paper outstanding has declined nearly 32 percent and nonfinancial commercial paper outstanding has decreased by over 49 percent since October 2008.[769]

FIGURE 17: COMMERCIAL PAPER OUTSTANDING

Indicator	Current Level (as of 12/31/09) *(billions of dollars)*	Percent Change Since Last Report (11/25/09)
Asset-backed commercial paper outstanding (seasonally adjusted)[770]	$485.8	−2.35
Financial commercial paper outstanding (seasonally adjusted)[771]	578	−9.13
Nonfinancial commercial paper outstanding (seasonally adjusted)[772]	103.1	−13.57

[770] Federal Reserve Statistical Release on Commercial Paper, *supra* note 762.
[771] Federal Reserve Statistical Release on Commercial Paper, *supra* note 762.
[772] Federal Reserve Statistical Release on Commercial Paper, *supra* note 762.

[767] Historical Dividend Yield Values, 3 Month Libor, *supra* note 766; Historical Dividend Yield Values, 3 Month Libor, *supra* note 766.
[768] Federal Reserve Statistical Release on Commercial Paper, *supra* note 762.
[769] Federal Reserve Statistical Release on Commercial Paper, *supra* note 762.

• Lending by the Largest TARP-recipient Banks. Treasury's Monthly Lending and Intermediation Snapshot tracks loan originations and average loan balances for the 22 largest recipients of CPP funds across a variety of categories, ranging from mortgage loans to commercial real estate to credit card lines. The data below exclude lending by two large CPP-recipient banks, PNC Bank and Wells Fargo, because significant acquisitions by those banks since October 2008 make comparisons difficult.[773]

[773] 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.

In October, these 20 institutions originated over $187 billion in loans, a decrease of nearly one percent compared to September 2009.[774]

FIGURE 18: LENDING BY THE LARGEST TARP-RECIPIENT BANKS (WITHOUT PNC AND WELLS FARGO) [775]

Indicator	Most Recent Data (October 2009) *(millions of dollars)*	Percent Change Since September 2009	Percent Change Since October 2008
Total loan originations	$187,033	−0.67	−14.3
Total mortgage originations	54,645	0.84	23.4
Small business originations	5,394	8	[776] 5.6
Mortgage refinancing	30,427	−0.15	62.1
HELOC originations (new lines & line increases)	2,226	−1.98	−53.2
C&I renewal of existing accounts	47,677	−12.6	−17
C&I new commitments	41,824	19.7	−29.1
Total average loan balances	$3,398,679	−0.89	−0.7

[775] Treasury Snapshot for October, *supra* note 774.
[776] Treasury only began reporting data regarding small business originations in its April Lending Survey. U.S. Department of the Treasury, *Treasury Department Monthly Lending and Intermediation Snapshot* (hereinafter "Treasury Snapshot for April").

• Housing Indicators. Foreclosure filings decreased by over seven percent from October to November, and are nearly 10 percent above the level of October 2008. Housing prices, as illustrated by both the S&P/Case-Shiller Composite 20 Index and the FHFA House Price Index, increased slightly in October.

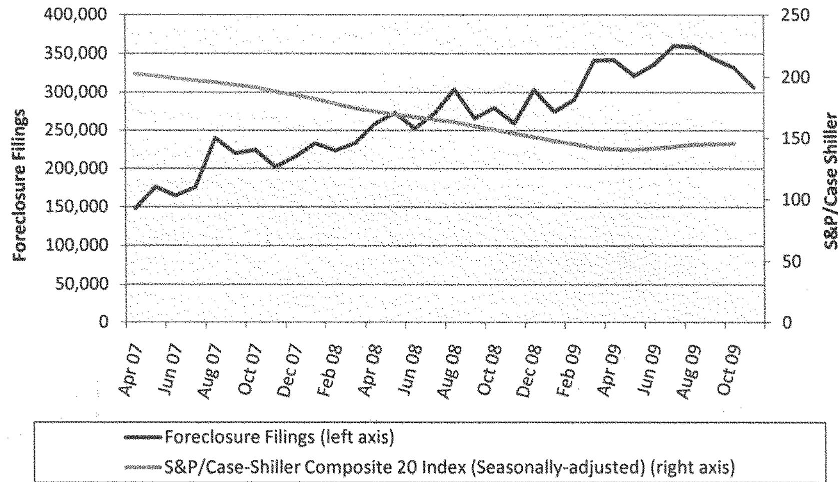
FIGURE 19: HOUSING INDICATORS

Indicator	Most Recent Monthly Data	Percent Change From Data Available at Time of Last Report	Percent Change Since October 2008
Monthly foreclosure filings [777]	306,627	−7.7	9.7
Housing prices—S&P/Case-Shiller Composite 20 Index [778]	145.4	0.37	−7.3
FHFA Housing Price Index [779]	199.41	0.64	−1.91

[777] RealtyTrac, *Foreclosure Activity Press Releases* (online at www.realtytrac.com//ContentManagement/PressRelease.aspx) (accessed Jan. 4, 2010) (hereinafter "RealtyTrac Foreclosure Activity Data"). The most recent data available is for October 2009.
[778] Standard & Poor's, *S&P/Case-Shiller Home Price Indices* (Instrument: Seasonally Adjusted Composite 20 Index) (online at www.standardandpoors.com/prot/servlet/BlobServer?blobheadername3=MDT-Type&blobcol=urldata&blobtable=MungoBlobs&blobheadervalue2=inline%3B+filename%3DSA__CSHomePrice__History__122925.xls&blobheadername2=Content-Disposition&blobheadervalue1=application%2Fexcel&blobkey=id&blobheadername1=content-type&blobwhere=1243629218624&blobheadervalue3=UTF–8) (hereinafter "S&P/Case-Shiller Home Price Indices") (accessed Jan. 4, 2010). The most recent data available is for October 2009.
[779] Federal Housing Finance Agency, *U.S. and Census Division Monthly Purchase Only Index* (Instrument: USA, Seasonally Adjusted) (online at www.fhfa.gov/webfiles/15321/MonthlyIndex__Jan1991__to__Latest.xls) (accessed Jan. 4, 2010). The most recent data available is for October 2009.

[774] U.S. Department of the Treasury, *Treasury Department Monthly Lending and Intermediation Snapshot: Summary Analysis for October 2009* (Jan. 4, 2010) (online at www.financialstability.gov/docs/surveys/Snapshot__Data__October__2009.xls) (hereinafter "Treasury Snapshot for October").

FIGURE 20: FORECLOSURE FILINGS AS COMPARED TO THE CASE-SHILLER 20 CITY HOME PRICE INDEX (AS OF OCTOBER 2009) [780]



• Commercial Real Estate. The commercial real estate market has continued to deteriorate since the Panel's last report. New CRE lending by the top 22 CPP recipients has decreased by over 71 percent since the enactment of EESA. Respondents to Treasury's survey of the top 22 CPP participants reported that demand for C&I and CRE loans was still below normal levels due to the lack of new construction.[781] A recent Goldman Sachs report notes that rent growth in this market declined at an annualized rate of 8.7 percent in the second quarter and estimates that there will be a total of $287 billion in aggregated losses.

FIGURE 21: COMMERCIAL REAL ESTATE LENDING BY TOP 22 CPP RECIPIENTS (WITHOUT PNC AND WELLS FARGO) [782]

Indicator	Current Level as of 12/31/09) *(millions of dollars)*	Percent Change Since September 2009	Percent Change Since EESA Signed into Law (10/3/08)
CRE New Commitments	$2,977	−4.07	−71.7
CRE Renewal of Existing Accounts	9,194	−11.9	2.2
CRE Average Total Loan Balance	370,569	−1.16	−1.14

[782] Treasury Snapshot for October, *supra* note 735.

[780] RealtyTrac Foreclosure Activity Data, *supra* note 777; S&P/Case-Shiller Home Price Indices, *supra* note 778. The most recent data available is for October 2009.

[781] Treasury Snapshot for April, *supra* note 776. The Goldman Sachs Group, Inc., *US Commercial Real Estate Take III: Reconstructing Estimates for Losses, Timing* (Sept. 29, 2009).

I. Financial Update

Each month, the Panel summarizes the resources that the federal government has committed to economic stabilization. The following financial update provides: (1) An updated accounting of the TARP, including a tally of dividend income, repayments and warrant dispositions that the program has received as of November 30, 2009; and (2) an updated accounting of the full federal resource commitment as of December 30, 2009.

1. TARP

a. Costs: Expenditures and Commitments

Treasury has committed or is currently committed to spend $532.6 billion of TARP funds through an array of programs used to purchase preferred shares in financial institutions, offer loans to small businesses and automotive companies, and leverage Federal Reserve loans for facilities designed to restart secondary securitization markets.[783] Of this total, $297 billion is currently outstanding under the $698.7 billion limit for TARP expenditures set by EESA, leaving $403.3 billion available for fulfillment of anticipated funding levels of existing programs and for funding new programs and initiatives. The $297 billion includes purchases of preferred and common shares, warrants and/or debt obligations under the CPP, AIGIP/SSFI Program, PPIP, and AIFP; and a $20 billion loan to TALF LLC, the special purpose vehicle (SPV) used to guarantee Federal Reserve TALF loans.[784] Additionally, Treasury has allocated $35.5 billion to the Home Affordable Modification Program, out of a projected total program level of $50 billion.

b. Income: Dividends, Interest Payments, and CPP Repayments

As of December 30, 2009, a total of 58 institutions have completely repurchased their CPP preferred shares. Of these institutions, 37 have repurchased their warrants for common shares that Treasury received in conjunction with its preferred stock investments; Treasury sold the warrants for common shares for three other institutions at auction.[785] Treasury received $50.9 million in repayments from 13 CPP participants during December.[786] The vast majority of this total was repaid by two institutions—Bank of America and Wells Fargo—that each repaid $25 billion received as part of the CPP.[787] Furthermore, Treasury closed its Targeted Investment Program (TIP) after Citigroup and Bank of America's program repayments of $20 billion each ended any of TIP's outstanding obligations. In addition, Treasury receives dividend payments on the preferred shares that it holds, usually five percent

[783] EESA, as amended by the Helping Families Save Their Homes Act of 2009, limits Treasury to $698.7 billion in purchasing authority outstanding at any one time as calculated by the sum of the purchase prices of all troubled assets held by Treasury. Pub. L. No. 110–343, 115(a)–(b); Helping Families Save Their Homes Act of 2009, Pub. L. No. 111–22, 402(f) (reducing by $1.26 billion the authority for the TARP originally set under EESA at $700 billion). For further discussion of pending legislation that may affect the total amount of TARP funds available, see Section F, *infra*.

[784] TARP Transactions Report for Period Ending December 30, 2009, *supra* note 166.

[785] TARP Transactions Report for Period Ending December 30, 2009, *supra* note 166.

[786] TARP Transactions Report for Period Ending December 30, 2009, *supra* note 166.

[787] TARP Transactions Report for Period Ending December 30, 2009, *supra* note 166.

per annum for the first five years and nine percent per annum thereafter.[788] In total, Treasury has received approximately $186.5 billion in income from repayments, warrant repurchases, dividends, and interest payments deriving from TARP investments,[789] and another $1.2 billion in participation fees from its Guarantee Program for Money Market Funds.[790]

[788] *See, e.g.*, U.S. Department of the Treasury, *Securities Purchase Agreement: Standard Terms* (online at www.financialstability.gov/docs/CPP/spa.pdf) (accessed Jan. 4, 2010).

[789] *See* Cumulative Dividends Report as of November 30, 2009, *supra* note 241; TARP Transactions Report for Period Ending December 30, 2009, *supra* note 166.

[790] U.S. Department of the Treasury, *Treasury Announces Expiration of Guarantee Program for Money Market Funds* (Sept. 18, 2009) (online at www.treasury.gov/press/releases/tg293.htm).

c. TARP Accounting

FIGURE 22: TARP ACCOUNTING (AS OF DECEMBER 30, 2009) [791]

[Dollars in billions]

TARP Initiative	Anticipated Funding	Actual Funding	Total Repayments	Funding Outstanding	Funding Available
Capital Purchase Program (CPP) [792]	$218.0	$204.9	$121.9	$83	$13.1
Targeted Investment Program (TIP) [793]	40.0	40.0	40	0	0
AIG Investment Program (AIGIP)/Systemically Significant Failing Institutions Program (SSFI)	69.8	[794] 46.9	0	46.9	22.9
Automobile Industry Financing Program (AIFP) [795]	81.3	81.3	3.2	78.1	0
Asset Guarantee Program (AGP) [796]	5.0	5.0	[797] 5.0	0	0
Capital Assistance Program (CAP) [798]	....	....	....	....	....
Term Asset-Backed Securities Lending Facility (TALF)	20.0	20.0	0	20.0	0
Public-Private Investment Partnership (PPIP)	30.0	30.0	0	30.0	0
Supplier Support Program (SSP)	[799] 3.5	3.5	0	3.5	0
Unlocking SBA Lending	15.0	0	N/A	0	15.0
Home Affordable Modification Program (HAMP)	50.0	[800] 35.5	0	35.5	14.5
Total Committed	532.6	467.1	--	297	65.5
Total Uncommitted	166.1	N/A	170.1	N/A	[801] 336.2
Total	**$698.7**	**$467.1**	**$170.1**	**$297**	[802] **$401.7**

[791] TARP Transactions Report for Period Ending December 30, 2009, *supra* note 166.

[792] As of December 30, 2009, the CPP was closed. This figure reflects funds that were committed but unused. This information was provided by Treasury in response to Panel inquiry.

[793] Both Bank of America and Citigroup repaid the $20 billion in assistance each institution received under the TIP on December 9 and December 23, 2009, respectively. Therefore the Panel accounts for these funds as repaid and as uncommitted. U.S. Department of the Treasury, *Treasury Receives $45 Billion in Repayments from Wells Fargo and Citigroup* (Dec. 22, 2009) (online at www.treas.gov/press/releases/20091229716198713.htm) (hereinafter ''Treasury Receives $45 Billion from Wells Fargo and Citigroup'').

[794] In information provided by Treasury in response to a Panel request, AIG has completely utilized the $40 billion made available on November 25, 2008 and drawn-down $5.3 billion of the $29.8 billion made available on April 17, 2009. This figure also reflects $1.6 billion in compounding of accumulated but unpaid dividends owed by AIG to Treasury due to the restructuring of Treasury's investment from cumulative preferred shares to non-cumulative shares. TARP Transactions Report for Period Ending December 30, 2009, *supra* note 166.

[795] Treasury indicated that it would most likely not provide additional assistance to companies through the AIFP. Government Accountability Office, *Auto Industry: Continued Stewardship Needed as Treasury Develops Strategies for Monitoring and Divesting Financial Interests in Chrysler and GM,* at 28 (Nov. 2009) (GAO–10–151) (online at www.gao.gov/new.items/d10151.pdf) (''Although the immediate crisis of helping Chrysler and GM maintain solvency has passed for now and Treasury has no plans for further financial assistance to the companies, the significant sums of taxpayer dollars that are invested in these companies warrant continued oversight''). However, on January 5, 2010, Treasury announced a restructuring of its investment in GMAC, which resulted in $3.8 billion in additional funds being provided to the company through the AIFP.

[796] Treasury, the Federal Reserve, and the Federal Deposit Insurance Company terminated the asset guarantee with Citigroup on December 23, 2009. The agreement was terminated with no losses to Treasury's $5 billion second-loss portion of the guarantee. Citigroup did not repay any funds directly, but instead terminated Treasury's outstanding exposure on its $5 billion second-loss position. As a result, the $5 billion is now accounted for as available. Treasury Receives $45 Billion from Wells Fargo and Citigroup, *supra* note 793.

[797] Although this $5 billion is no longer exposed as part of the AGP and is accounted for as available, Treasury did not receive a repayment in the same sense as with other investments. *See infra* notes 806–807. Treasury did receive other income as consideration for the guarantee, which is not a repayment and is accounted for in Figure 25. *See id.*

[798] On November 9, 2009, Treasury announced the closing of this program and that only one institution, GMAC, was in need of further capital from Treasury. Treasury Announcement Regarding the CAP, *supra* note 486.

[799] On July 8, 2009, Treasury lowered the total commitment amount for the program from $5 billion to $3.5 billion. This action reduced GM's portion from $3.5 billion to $2.5 billion and Chrysler's portion from $1.5 billion to $1 billion. TARP Transactions Report for Period Ending December 30, 2009, *supra* note 166.

[800] This figure reflects the total of all the caps set on payments to each mortgage servicer and not the disbursed amount of funds for successful modifications. TARP Transactions Report for Period Ending December 30, 2009, *supra* note 166.

[801] This figure is the sum of the uncommitted funds remaining under the $698.7 billion cap ($166.1 billion) and the repayments ($170.1 billion).

[802] This figure is the sum of the uncommitted funds remaining under the $698.7 billion cap ($166.1 billion) and the difference between the total anticipated funding and the net current investment ($297 billion).

FIGURE 23: TARP REPAYMENTS AND INCOME

[Dollars in billions]

TARP Initiative	Repayments (as of 12/30/09)	Dividends [803] (as of 11/30/09)	Interest [804] (as of 11/30/09)	Warrant Repurchases (as of 12/30/09)	Other Proceeds (as of 12/30/09)	Total
Total	$165.1	$11.7	$0.36	$4.03	–	$183.7
CPP	121.9	8	0.02	4.03	–	134
TIP	40	2.7	N/A	0	–	42.7
AIFP	3.2	0.75	0.33	N/A	–	4.3
ASSP	N/A	N/A	0.01	N/A	–	0.01
AGP	[805] 0	0.26	N/A	0	[806] $2.23	2.5
Bank of America Guarantee	–	–	–	–	[807] 0.28	.28

[803] *See* Cumulative Dividends Report as of November 30, 2009, *supra* note 241.

[804] *See* Cumulative Dividends Report as of November 30, 2009, *supra* note 241.

[805] Although Treasury, the Federal Reserve, the FDIC, and Citigroup have terminated the AGP, and although Treasury's $5 billion second-loss position no longer counts against the $698.7 TARP ceiling, Treasury did not receive any repayment income. See *infra* notes 806–807. Treasury did receive other income as consideration for the guarantee, which is not a repayment and is accounted for in Figure 25. *See id.*

[806] As a fee for taking a second-loss position up to $5 billion on a $301 billion pool of ring-fenced Citigroup assets as part of the AGP, Treasury received $4.03 billion in Citigroup preferred stock and warrants; Treasury exchanged these preferred stocks and warrants for trust preferred securities in June 2009. Following the early termination of the guarantee, Treasury cancelled $1.8 billion of the trust preferred securities, leaving Treasury with a $2.23 billion investment in Citigroup trust preferred securities in exchange for the guarantee. U.S. Department of the Treasury, *Troubled Asset Relief Program Transactions Report for Period Ending December 30, 2009* (Jan. 4, 2010) (online at www.financialstability.gov/docs/transaction-reports/1-4-10%20Transactions%20Report%20as%20of%2012-30-09.pdf).

[807] Although Treasury, the Federal Reserve, and the FDIC negotiated with Bank of America regarding a similar guarantee, the parties never reached an agreement. In September 2009, Bank of America agreed to pay each of the prospective guarantors a fee as though the guarantee had been in place during the negotiations. This agreement resulted in payments of $276 million to Treasury, $57 million to the Federal Reserve, and $92 million to the FDIC. U.S. Department of the Treasury, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Bank of America Corporation, *Termination Agreement,* at 1–2 (Sept. 21, 2009) (online at www.financialstability.gov/docs/AGP/BofA%20-%20Termination%20Agreement%20-%20executed.pdf).

Rate of Return

As of December 30, 2009, the average internal rate of return for all financial institutions that participated in the CPP and fully repaid the U.S. government (including preferred shares, dividends, and warrants) is 14.4 percent.[808] The internal rate of return is the annualized effective compounded return rate that can be earned on invested capital.

[808] Participating privately-held qualified financial institutions provided Treasury with warrants to purchase additional preferred stock, which Treasury exercised immediately. TARP Transactions Report for Period Ending December 30, 2009, *supra* note 166. The corresponding figure does not reflect the repayment of private institutions' preferred stock. The internal rate of return for repayments by these institutions is 16.7 percent.

Institution	Investment Date	QEO	Warrant Repurchase Date	Warrant Repurchase Amount	Panel Valuation (Best Est.)	Price/ Estimate	IRR
Old National Bancorp	12/12/2008	No	5/8/2009	1,200,000	2,150,000	0.5581	9.30%
Iberiabank Corporation	12/5/2008	Yes	5/20/2009	1,200,000	2,010,000	0.5970	9.40%
Firstmerit Corporation	1/9/2009	No	5/27/2009	5,025,000	4,260,000	1.1796	20.30%
Sun Bancorp, Inc	1/9/2009	No	5/27/2009	2,100,000	5,580,000	0.3763	15.30%
Independent Bank Corp.	1/9/2009	No	5/27/2009	2,200,000	3,870,000	0.5685	15.60%
Alliance Financial Corporation	12/19/2008	No	6/17/2009	900,000	1,580,000	0.5696	13.80%
First Niagara Financial Group	11/21/2008	Yes	6/24/2009	2,700,000	3,050,000	0.8852	8.00%
Berkshire Hills Bancorp, Inc.	12/19/2008	No	6/24/2009	1,040,000	1,620,000	0.6420	11.30%
Somerset Hills Bancorp	1/16/2009	No	6/24/2009	275,000	580,000	0.4741	16.60%
SCBT Financial Corporation	1/16/2009	No	6/24/2009	1,400,000	2,290,000	0.6114	11.70%
HF Financial Corp	11/21/2008	No	6/30/2009	650,000	1,240,000	0.5242	10.10%
State Street	10/28/2008	Yes	7/8/2009	60,000,000	54,200,000	1.1070	9.90%
U.S. Bancorp	11/14/2008	No	7/15/2009	139,000,000	135,100,000	1.0289	8.70%
The Goldman Sachs Group, Inc.	10/28/2008	No	7/22/2009	1,100,000,000	1,128,400,000	0.9748	22.80%
BB&T Corp.	11/14/2008	No	7/22/2009	67,000,000	68,200,000	0.9824	8.70%
American Express Company	1/9/2009	No	7/29/2009	340,000,000	391,200,000	0.8691	29.50%
Bank of New York Mellon Corp	10/28/2008	No	8/5/2009	136,000,000	155,700,000	0.8735	12.30%
Morgan Stanley	10/28/2008	No	8/12/2009	950,000,000	1,039,800,000	0.9136	20.20%
Northern Trust Corporation	11/14/2008	No	8/26/2009	87,000,000	89,800,000	0.9688	14.50%
Old Line Bancshares Inc.	12/5/2008	No	9/2/2009	225,000	500,000	0.4500	10.40%
Bancorp Rhode Island, Inc.	12/19/2008	No	9/30/2009	1,400,000	1,400,000	1.0000	12.60%
Centerstate Banks of Florida Inc.	11/21/2008	No	10/28/2009	212,000	440,000	0.4818	5.90%
Manhattan Bancorp	12/5/2008	No	10/14/2009	63,364	140,000	0.4526	9.80%
Bank of Ozarks	12/12/2008	No	11/24/2009	2,650,000	3,500,000	0.7571	9.00%
Capital One Financial	11/14/2008	No	12/3/2009	148,731,030	232,000,000	0.6411	12.00%
JP Morgan Chase & Co.	10/28/2008	No	12/10/2009	950,318,243	1,006,587,697	0.9441	10.90%

TCF Financial Corp	1/16/2009	No	12/16/2009	9,599,964	11,825,830	0.8118	11.00%
LSB Corporation	12/12/2008	No	12/16/2009	560,000	535,202	1.0463	9.00%
Wainwright Bank & Trust Company	12/19/2008	No	12/16/2009	568,700	1,071,494	0.5308	7.80%
Wesbanco Bank, Inc.	12/5/2008	No	12/23/2009	950,000	2,387,617	0.3979	6.70%
Union Bankshares Corporation	12/19/2008	Yes	12/23/2009	450,000	1,130,418	0.3981	5.80%
Trustmark Corporation	11/21/2008	No	12/30/2009	10,000,000	11,573,699	0.8640	9.40%
Flushing Financial Corporation	12/19/2008	No	12/30/2009	900,000	2,861,919	0.3145	6.50%
Total				**$4,023,718,318**	**$4,365,453,457**	**0.9217**	**14.40%**

2. Other Financial Stability Efforts

Federal Reserve, FDIC, and Other Programs

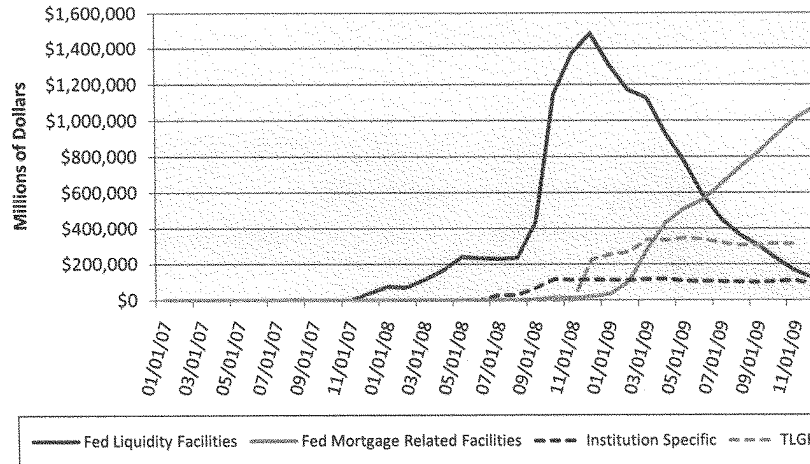
In addition to the direct expenditures Treasury has undertaken through TARP, the federal government has engaged in a much broader program directed at stabilizing the U.S. financial system. Many of these initiatives explicitly augment funds allocated by Treasury under specific TARP initiatives, such as FDIC and Federal Reserve asset guarantees for Citigroup, or operate in tandem with Treasury programs, such as the interaction between PPIP and TALF. Other programs, like the Federal Reserve's extension of credit through its section 13(3) facilities and SPVs and the FDIC's Temporary Liquidity Guarantee Program, operate independently of TARP.

Figure 25 below reflects the changing mix of Federal Reserve investments. As the liquidity facilities established to face the crisis have been wound down, the Federal Reserve has expanded its facilities for purchasing mortgage related securities. The Federal Reserve has announced that it intends to purchase $175 billion of federal agency debt securities and $1.25 trillion of agency mortgage-backed-securities.[809] As of January 7, 2010, $160 billion of federal agency (government-sponsored enterprise) debt securities and $909 billion of agency mortgage-backed-securities have been purchased. The Federal Reserve has announced that these purchases will be completed by April 2010.[810]

[809] Board of Governors of the Federal Reserve System, *Minutes of the Federal Open Market Committee,* at 10 (Dec. 15–16, 2009) (online at www.federalreserve.gov/newsevents/press/monetary/fomcminutes20091216.pdf) (hereinafter "Minutes of the Federal Open Market Committee").

[810] RealtyTrac Foreclosure Activity Data *supra* note 809, at 10 ("In order to promote a smooth transition in markets, the Committee is gradually slowing the pace of these purchases, and it anticipates that these transactions will be executed by the end of the first quarter of 2010"); Board of Governors of the Federal Reserve System, *Factors Affecting Reserve Balances* (Jan. 7, 2010) (online at www.federalreserve.gov/Releases/H41/Current/).

FIGURE 25: FEDERAL RESERVE AND FDIC FINANCIAL STABILITY EFFORTS[811]



3. Total Financial Stability Resources (as of November 30, 2009)

Beginning in its April report, the Panel broadly classified the resources that the federal government has devoted to stabilizing the economy through myriad 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.

[811] 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 Jan. 4, 2010). 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–Nov. 2009) (online at www.fdic.gov/regulations/resources/TLGP/reports.html).

With respect to the FDIC and Federal Reserve programs, the risk of loss varies significantly across the programs considered here, as do the mechanisms providing protection for the taxpayer against such risk. As discussed in the Panel's November report, the FDIC assesses a premium of up to 100 basis points on TLGP debt guarantees.[812] In contrast, the Federal Reserve's liquidity programs are generally available only to borrowers with good credit, and the 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," 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. In this way, the risk to the taxpayer on recourse loans only materializes if the borrower enters bankruptcy. The only loans currently "underwater"—where the outstanding principal amount exceeds the current market value of the collateral—are two of the three non-recourse loans to the Maiden Lane SPVs (used to purchase Bear Stearns and AIG assets).

FIGURE 26: FEDERAL GOVERNMENT FINANCIAL STABILITY EFFORT (AS OF NOVEMBER 30, 2009)

[Dollars in billions]

Program	Treasury (TARP)	Federal Reserve	FDIC	Total
Total	**$698.7**	**$1,509.9**	**$678.4**	**$2,887**
Outlays[i]	299.8	1,069.5	69.4	1,438.7
Loans	42.7	440.4	0	483.1
Guarantees[ii]	20	0	609	629
Uncommitted TARP Funds	336.2	0	0	336.2
AIG	**69.8**	**68.7**	**0**	**138.5**
Outlays	[iii]6938	0	0	69.8
Loans	0	[iv]68.7	0	68.7
Guarantees	0	0	0	0
Bank of America	**0**	**0**	**0**	**0**
Outlays	[v]0	0	0	0
Loans	0	0	0	0
Guarantees	0	0	0	0
Citigroup	**25**	**0**	**0**	**25**
Outlays	[vi]25	0	0	25
Loans	0	0	0	0
Guarantees	0	0	0	0
Capital Purchase Program (Other)	**71.1**	**0**	**0**	**71.1**
Outlays	[vii]71.1	0	0	71.1
Loans	0	0	0	0
Guarantees	0	0	0	0
Capital Assistance Program	**N/A**	**0**	**0**	[viii]**N/A**
TALF	**20**	**180**	**0**	**200**
Outlays	0	0	0	0
Loans	0	[x]180	0	180
Guarantees	[ix]20	0	0	20
PPIP (Loans)[xi]	**0**	**0**	**0**	**0**
Outlays	0	0	0	0
Loans	0	0	0	0
Guarantees	0	0	0	0
PPIP (Securities)	[xii]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**	[xiv]**50**

[812] COP November Oversight Report, *supra* note 2, at 36.

FIGURE 26: FEDERAL GOVERNMENT FINANCIAL STABILITY EFFORT (AS OF NOVEMBER 30, 2009)—Continued

[Dollars in billions]

Program	Treasury (TARP)	Federal Reserve	FDIC	Total
Outlays	[xiii]50	0	0	50
Loans	0	0	0	0
Guarantees	0	0	0	0
Automotive Industry Financing Program	[xv]**78.2**	**0**	**0**	**75.4**
Outlays	59	0	0	75.4
Loans	19.2	0	0	19.2
Guarantees	0	0	0	0
Auto Supplier Support Program	**3.5**	**0**	**0**	**3.5**
Outlays	0	0	0	0
Loans	[xvi]3.5	0	0	3.5
Guarantees	0	0	0	0
Unlocking SBA Lending	[xvii]**15**	**0**	**0**	**15**
Outlays	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	[xviii]609	609
Deposit Insurance Fund	**0**	**0**	**69.4**	**69.4**
Outlays	0	0	[xix]69.4	69.4
Loans	0	0	0	0
Guarantees	0	0	0	0
Other Federal Reserve Credit Expansion	**0**	**1,261.2**	**0**	**1,261.2**
Outlays	0	[xx]1,069.5	0	1,069.5
Loans	0	[xxi]191.7	0	191.7
Guarantees	0	0	0	0
Uncommitted TARP Funds	**336.2**	**0**	**0**	**336.2**

[i]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 used here represent investment and asset 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.

[ii]Although 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.

[iii]This number includes investments under the AIGIP/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). As of January 5, 2010, AIG had utilized $45.3 billion of the available $69.8 billion under the AIGIP/SSFI. This information was provided by Treasury in response to a Panel inquiry.

[iv]This number represents the full $35 billion that is available to AIG through its revolving credit facility with the Federal Reserve ($22.2 billion had been drawn down as of December 31, 2009) and the outstanding principal of the loans extended to the Maiden Lane II and III SPVs to buy AIG assets (as of December 31, 2009, $15.7 billion and $18 billion, respectively). 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*, at 17 (Oct. 2009) (online at www.federalreserve.gov/monetarypolicy/files/monthlyclbsreport200910.pdf). 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. 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=UGFyZW50SUQ9MjE40D18Q2hpbGRJRD0tMXxUeXB1PTM=&t=1).

[v]Bank of America repaid the $45 billion in assistance it had received through TARP programs on December 9, 2009. U.S. Department of the Treasury, *Troubled Asset Relief Program Transactions Report for Period Ending December 30, 2009* (Jan. 4, 2010) (online at www.financialstability.gov/docs/transaction-reports/1-4-10%20Transactions%20Report%20as%20of%2012-30-09.pdf) (hereinafter ''TARP Transactions Report'').

[vi]As of December 30, 2009, the U.S. Treasury held $25 billion of Citigroup common stock. *See* TARP Transactions Report, *supra* note v.

[vii]This figure represents the $218 billion Treasury has anticipated spending under the CPP, minus the $25 billion investment in Citigroup ($25 billion) identified above, and the $121.9 billion in repayments that are reflected as available TARP funds. This figure does not account for future repayments of CPP investments, nor does it account for dividend payments from CPP investments.

[viii]On November 9, 2009, Treasury announced the closing of the CAP and that only one institution, GMAC, was in need of further capital from Treasury. GMAC, however received further funding through the AIFP, therefore the Panel considers CAP unused and closed. 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).

[ix]This figure represents a $20 billion allocation to the TALF SPV on March 3, 2009. *See* TARP Transactions Report, *supra* note vi. As of January 7, 2010, investors had requested a total of $64.3 billion in TALF loans ($9.2 billion in *CMBS* and $55 billion in non-CMBS). Federal Reserve Bank of New York, *Term Asset-Backed Securities Loan Facility: CMBS* (accessed Jan. 7, 2009) (online at www.newyorkfed.org/markets/CMBS__recent__operations.html); Federal Reserve Bank of New York, *Term Asset-Backed Securities Loan Facility: non-CMBS* (accessed Jan. 7, 2009) (online at www.newyorkfed.org/markets/talf__operations.html).

[x]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.

[xi]It is 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) and Federal Deposit Insurance Corporation, *Legacy Loans Program—Test of Funding Mechanism* (July 31, 2009) (online at www.fidc.gov/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.

[xii]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 December 30, 2009, Treasury reported $19.9 billion in outstanding loans and $9.9 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. TARP Transactions Report, *supra* note v.

[xiii]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, $35.5 billion has been allocated as of December 30, 2009. *See* TARP Transactions Report, *supra* note v.

[xiv]Fannie Mae and Freddie Mac, government-sponsored entities (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).

[xv]*See* TARP Transactions Report, supra note v. A substantial portion of the total $81 billion in loans extended under the AIFP have since been converted to common equity and preferred shares in restructured companies. $19.2 billion has been retained as first lien debt (with $6.7 billion committed to GM, $12.5 billion to Chrysler). This figure ($78.2 billion) represents Treasury's current obligation under the AIFP after repayments.

[xvi]*See* TARP Transactions Report, *supra* note v.

[xvii]U.S. Department of Treasury, *Fact Sheet: Unlocking Credit for Small Businesses* (Oct. 19, 2009) (online at www.financialstability.gov/roadtostability/unlockingCreditforSmallBusinesses.html) (''*Jumpstart Credit Markets For Small Businesses By Purchasing Up to $15 Billion in Securities*'').

[xviii]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 institutes participating. $313 billion of debt subject to the guarantee has been issued to date, which represents about 51 percent of the current cap, Federal Deposit Insurance Corporation, *Monthly Reports on Debt Issuance Under the Temporary Liquidity Guarantee Program: Debt Issuance Under Guarantee Program* (Nov. 30, 2009) (online at www.fdic.gov/regulations/resources/TLGP/total_issuance11-09.html) (updated Jan. 4, 2010). The FDIC has collected $10.3 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* (Nov. 30, 2009) (online at www.fdic.gov/regulations/resources/TLGP/fees.html) (updated Jan. 4, 2010).

[xix]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, second and third 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); Federal Deposit Insurance Corporation, *Chief Financial Officer's (CFO) Report to the Board: DIF Income Statement (Third Quarter 2009)* (online at www.fdic.gov/about/strategic/corporate/cfo_report_3rdqtr_09/income.html). This figure includes the FDIC's estimates of its future losses under loss-sharing 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. See, for example Federal Deposit Insurance Corporation, *Purchase and 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). In information provided to Panel staff, the FDIC disclosed that there were approximately $132 billion in assets covered under loss-sharing agreements as of December 18, 2009. Furthermore, the FDIC estimates the total cost of a payout under these agreements to be $59.3 billion. Since there is a published loss estimate for these agreements, the Panel continues to reflect them as outlays rather than as guarantees.

[xx]Outlays are comprised of the Federal Reserve Mortgage Related Facilities. The Federal Reserve balance sheet accounts for these facilities under Federal agency debt securities and mortgage-backed securities held by the Federal Reserve. 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 Jan. 4, 2010). Although 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).

[xxi]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). 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 Jan. 4, 2010); *see id.*

SECTION FIVE: OVERSIGHT ACTIVITIES

The Congressional Oversight Panel was established as part of the Emergency Economic Stabilization Act (EESA) and formed on November 26, 2008. Since then, the Panel has produced thirteen 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 December oversight report, which assessed the performance of the Troubled Asset Relief Program (TARP) since its inception, the following developments pertaining to the Panel's oversight of the TARP took place:

- The Panel held a hearing in Washington, DC with Secretary of the Treasury Timothy Geithner on December 10, his third appearance before the Panel. Secretary Geithner answered questions relating to the Panel's December oversight report, discussed the TARP exit strategy, and provided an overview of how the TARP would be used as it is extended into 2010. Secretary Geithner has agreed to testify before the Panel once per quarter.

Upcoming Reports and Hearings

The Panel will release its next oversight report in February. The report will address the TARP's role in mitigating continued concerns about the commercial real estate market.

The Panel is planning a field hearing in Atlanta on January 27, 2010. The hearing will discuss the implications of the troubled commercial real estate market on sustained financial stability.

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 the 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. Effective December 9, 2009, Congressman Jeb Hensarling resigned from the Panel and House Minority Leader John Boehner announced the appointment of J. Mark McWatters to fill the vacant seat.

APPENDIX I: LETTER FROM SECRETARY TIMOTHY GEITHNER TO CHAIR ELIZABETH WARREN, RE: STRESS TESTS, DATED DECEMBER 10, 2009

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

December 10, 2009

Elizabeth Warren
Chair
Congressional Oversight Panel
732 North Capitol Street, NW
Rooms C-320 and C-617
Mailstop: COP
Washington, DC 20401

Dear Chair Warren:

Thank you for your letter of September 15, 2009, regarding the Supervisory Capital Assessment Program (SCAP or "stress tests").

The design and detailed implementation of the stress tests were the responsibility of the banking supervisory agencies. Consequently, questions regarding the detailed execution and implementation of the stress tests are better addressed to the banking supervisory agencies. Nevertheless, I appreciate the opportunity to provide additional insight on your important questions in the enclosed document.

Thank you again for your letter.

Sincerely,

Timothy F. Geithner

Enclosure

(1) What inputs and formulae were used in the stress tests?

As described above, questions about the precise nature of the inputs and formulae used in the stress tests are best addressed to the various banking supervisors who have access to this information. The Federal Reserve's Design and Implementation white paper describes inputs that were used in the stress tests, including the following:

- For first and second lien mortgages, the participating BHCs provided detailed and uniform descriptions of their residential mortgage portfolio risk characteristics. In particular, firms provided information on type of product, loan-to-value (LTV) ratio, FICO score, geography, level of documentation, year of origination, and other features.
- For credit cards, data included FICO scores, payment rates, utilization rates, and geographic concentrations.
- For other types of consumer loans, such as auto loans, stress test participants provided information on FICO scores, LTV, term, vehicle age, and geographic concentration.
- For C&I loans, analysis was based on the distribution of exposures by industry, internal and third-party credit ratings, and default probabilities.
- For commercial real estate (CRE) loans, firms were asked to submit detailed portfolio information on property type, loan to value (LTV) ratios, debt service coverage ratios (DSCR), geography, and loan maturities.
- For securities in available-for-sale and hold-to-maturity portfolios, banks provided information relating to each security, such as collateral type, vintage, metropolitan area, and property type, as well as elements of each security's structure, such as credit ratings, current credit support, and carrying and market values.
- The supervisors used information on trading book positions from the firms' internal risk-management reports to project loss amount under a market stress scenario. In evaluating counterparty credit risk, the supervisors reviewed the firms' loss estimates for mark-to-market losses stemming from credit valuation adjustments consistent with the trading shock scenario.
- The firms provided the underlying assumptions for their pre-provision net revenue estimates (PPNR), including internal management and financial reports, and the supervisors examined historical trends in the main components of PPNR. Supervisors also examined the historical relationship between PPNR and its main components to measures of macroeconomic activity. Allowance for loan losses for newly extended credits were based on loss rates by loan category from 2007.

The foregoing inputs were used to estimate losses, revenues, and reserve needs for BHCs in 2009 and 2010 under the "baseline" and "more adverse" scenarios.

(2) The loss rates relied upon in the stress tests were set higher than those experienced by the U.S. during the Great Depression. What factors led you to believe that it was necessary to use such a conservative estimate?

As I mentioned in my testimony, the primary goal of the supervisory assessment was to ensure that the equity capital held by the 19 bank holding companies was sufficient--in both quantity and quality--to allow those institutions to withstand a worse-than-expected macroeconomic environment over the subsequent two years and still remain healthy and able to lend, enabling

Americans to access the credit that is necessary to start a business, buy a home or send a child to college.

In order to make this assessment, the federal bank regulatory agencies developed an adverse economic scenario that was based on historical analysis and assumptions for unemployment and house-prices that were more unfavorable than those implied by the consensus of private-sector forecasters. This scenario was viewed as having a low percent probability of actually materializing. Given that the recent financial crisis has been, in many regards, the worst since the Great Depression, using metrics and loss rates that are similar or worse than those experienced at that time was deemed prudent. Indeed, the conservative nature of the assumptions was critical to the credibility of the stress test. It is largely a result of these conservative assumptions that the stress test results instilled confidence that our nation's largest financial institutions would be able to withstand a severe economic deterioration.

(3) Now that results from the first two quarters of 2009 are available, how do the actual first and second quarter results compare to the estimated loss rates and the indicative rates? Are you able to provide us actual loss rates in each of the twelve categories for both quarters? To the extent that the actual results differ from the indicative rates, what factors contributed to the divergence?

The stress test provided an estimate of total losses over a two year period (not quarterly loss rates). As a result, it is not possible to make a direct comparison between the losses that were estimated by the stress test and those published by these financial institutions over the past two quarters. Furthermore, an accurate comparison of actual and estimated losses is not possible due to the fact that SCAP loss estimates were made under a forecast scenario that is materially different from what has been realized. With these caveats being noted, however, actual loss rates from the first two quarters of 2009 appear to indicate lower losses than would be implied by a pro-rata percentage (25%) of the estimated two-year loss rates under the SCAP adverse scenario.

(4) You testified that the fact that unemployment figures are higher than were estimated in the more adverse scenario is immaterial to the value of the stress test results. Because the unemployment metrics were those advanced by Treasury, can you explain why this is true?

First, it is important to put the unemployment assumptions in perspective. At the time the stress tests were conducted, the Blue Chip Forecast for the annual average unemployment rate was 8.3 percent for 2009 and 8.7 percent for 2010. The stress tests used much more conservative assumptions of 8.9 percent for 2009 and 10.3 percent for 2010. The average unemployment rate for 2009 has now reached 8.9 percent year to date and the Blue Chip Forecast for the average unemployment rate 2010 is currently 9.8 percent. While the 2009 assumption may end up being too low, the 2010 assumption still appears to be significantly higher than the Blue Chip Forecast and it remains a conservative estimate of the adverse scenario.

At the same time, the housing market appears to be performing better than the assumptions used in the stress test. The adverse scenario used in the stress test assumed that house prices would fall by 22 percent in 2009 and by an additional 7 percent in 2010. However, in recent months house prices appear to have been bottoming out as house price indexes have registered two straight months of increases. If housing prices remain constant for the rest of the year, then the

2009 decline in housing prices would be approximately 5 percent, which is well below the assumption used in the stress tests. Furthermore, the Case-Shiller futures market predicts that house prices will actually rise by 1 percent in 2010, again making the assumptions used in the stress test appear conservative.

Real GDP growth was the third macroeconomic variable used in the stress test, and as with the assumptions about housing prices, the assumptions that were made about real GDP growth have proved to be conservative. At the time the stress tests were conducted, the Blue Chip Forecast was that real GDP growth would be -2.1 percent for 2009 and 2.0 percent for 2010. The adverse scenario in the stress tests used more conservative assumptions of -3.3 percent for 2009 and 0.5 percent for 2010. Today the Blue Chip Forecast for GDP growth in 2009 is -2.6 percent and the forecast for 2010 is 2.4 percent. Today the adverse scenario used in the stress test is more conservative than even the average of the bottom 10 forecasts in the Blue Chip Forecast.

(5) What factors were considered in reaching the metrics that underlay the indicative loss rates and how was each factor weighed? Why were these factors selected and how was it determined how they should be weighed?

Treasury was not involved in the actual administration of the assessments, the granular details of the loss rates applied, or the weighting of each individual factor or metric. As mentioned in the SCAP Overview of Results, the indicative loss rate ranges were derived using a variety of methods for predicting loan losses, including analysis of historical loss experience at large BHCs and quantitative models relating the performance of loans or groups of loans to macroeconomic variables. The specific factors selected in these models are the variables that historically have been shown to be the primary drivers of credit losses for the various categories of loans being analyzed. While supervisors viewed these indicative ranges as useful indicators of industry loss rates and in that way they can serve as a general guide, they also recognized that they might not adequately capture differences across individual firms that could affect the performance and losses in significant ways. Thus, supervisors asked firms to provide granular data about the particular characteristics of their portfolios in order to make more tailored quantitative assessments of loss. Loss estimates for the SCAP thus relied ultimately on firm-specific information about factors such as past performance, origination year, borrower characteristics, and geographic distribution.

APPENDIX II: LETTER FROM CHAIR ELIZABETH WARREN TO SECRETARY TIMOTHY GEITHNER, RE: EXECUTIVE COMPENSATION, DATED DECEMBER 24, 2009

ELIZABETH WARREN, CHAIR
SEN. JOHN E. SUNUNU
REP. JEB HENSARLING
RICHARD H. NEIMAN
DAMON SILVERS

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

Congress of the United States

CONGRESSIONAL OVERSIGHT PANEL

December 24, 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:

I am writing to you, on behalf of the Congressional Oversight Panel, to obtain details about important aspects of Treasury's approach to the Emergency Economic Stabilization Act of 2008 (EESA) provisions governing executive compensation at financial institutions that have received assistance under the Troubled Asset Relief Program (TARP). Appropriate and effective controls are necessary to ensure that the executive compensation arrangements at these institutions do not create incentives for the unnecessary risk of taxpayer-supplied funds.

Section 111 of EESA sets, or authorizes Treasury to set, executive compensation and corporate governance standards for TARP recipients.[1] For institutions that have received at least $500 million in assistance, some standards apply to at least the senior executive officers[2] (SEOs) of those institutions. Other standards – including restrictions on bonus, retention, and incentive compensation – apply to both those officers and at least the institutions' 20 "next most highly-compensated employees" (together, "covered individuals"). These standards apply so long as assistance to their respective financial institutions remains outstanding (the "coverage period").

The executive compensation provisions give important, and unique, responsibilities to the Treasury. The Department has undertaken these duties by issuing an extensive interim final rule (the "Interim Rule") and appointing a Special Master for TARP Executive Compensation (the "Special Master") in the Interim Rule. The Special Master has in turn applied the Interim Rule to seven financial institutions that are designated as having received "exceptional financial assistance" under the TARP. (The "seven institutions" are American International Group, Bank of America, Chrysler Financial, Chrysler Group, Citigroup, General Motors, and General Motors Acceptance Corporation.)

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[1] Section 7001 of the American Recovery and Reinvestment Act of 2009, Pub. L. 111-5 (2009), amended the original provisions of section 111 of EESA that dealt with executive compensation and governance. In this letter, citations are to section 111 as amended, as are references to the "statute."

[2] Under section 111, the senior executive officers of an institution are that institution's five most highly paid executives of a company according to disclosure rules of the United States Securities and Exchange Commission (SEC).

Staff of the Congressional Oversight Panel met with Treasury staff on November 10, 2009, to discuss the work of the Special Master as well as aspects of the Interim Rule generally. The meeting was informative and helpful, but a number of questions remain:

1. The compensation rules bar payment of any bonus, retention award, or incentive compensation other than through long-term restricted stock that cannot constitute more than one-third of the employee's total compensation and whose full vesting cannot occur while TARP assistance is outstanding (the "bonus restrictions").

a. Some commentators have expressed concern that a substantial portion of the increase in value of the restricted stock issued under the bonus restrictions could result in a windfall to covered individuals, because the stock has been granted at historic lows in each institution's stock price and any rise in that price will derive in part from public investment and the implicit cushion created by a perceived "too-big-to-fail" guarantee by federal authorities.

For example, the closing price of a share of common stock of Bank of America on February 12, 2009, when the Interim Rule went into effect, was $5.84, and the price on December 1, 2009, was $15.89, an increase of 172 percent; for Wells Fargo the respective numbers are $16.70 on February 12, 2009, and $27.99 on December 1, 2009, an increase of 67.6 percent.

Please explain the extent to which Treasury considered this issue in drafting the Interim Rule. If this issue was considered, please explain why Treasury rejected the imposition of some cap on the gain covered individuals could receive from their restricted stock.

b. Please explain the protections the Interim Rule provides against employment contract "make-up" provisions designed to avoid the effect of the bonus restrictions. During the November 10 meeting, Treasury staff explained that the Interim Rule effectively prohibits such provisions by preventing accrual of benefits to be paid after a TARP recipient exits the TARP. However, under the Financial Accounting Standards Board No. 5 (FASB 5), *Accounting for Contingencies*, in order for a liability to be accrued the amount must be both probable and estimable. Please explain how the provisions of the Interim Rule would apply under FASB 5.

c. Please explain why an economic payment equivalent to that foregone by the bonus restrictions cannot be built into a "golden parachute" payment, by formula or amount, for the period for which the bonus restrictions operate, even if the parachute payments may not be made until the end of the coverage period (or, in the case of any employee other than an SEO and the next five most highly-compensated employees, during the coverage period).

d. For financial institutions that have received at least $25 million in TARP assistance, the number of employees subject to the bonus restrictions is set in the

statute, but the statute gives Treasury the general discretion to expand that number in the public interest.

Please explain why Treasury has not made use of that authority (other than to authorize review of the "structure of the compensation" of the next 75 most highly-compensated of the seven institutions), and the standards it has employed in deciding not to do so, in light of the fact that the Interim Rule's definition of "highly-compensated employee" includes individuals, such as traders, who are not executive officers. Has Treasury considered extending compensation restrictions to these very senior executives, notwithstanding the fact that they are not among the very most highly compensated employees in their institutions?

e. Treasury officials explained during the November 10 meeting that the bonus restrictions are not applied to executives hired in 2009 to direct the recovery of the relevant institutions. Please explain the standards Treasury has used in applying this exception, as well as the levels of compensation that executives covered by the exception are allowed to receive. Please include in that explanation details reflecting actual compensation paid to a selected group of such employees who have become one of the five SEOs of an institution to which this exception has been applied.

f. Under the statute, restricted stock, granted under the bonus restrictions, may not fully vest during the coverage period. The Interim Rule interprets this language to permit partial vesting as TARP assistance is repaid and final vesting when TARP assistance is fully repaid. Why was repayment of TARP assistance the only relevant standard used in the Interim Rule, in light of the number of key statutory purposes – for example, increasing lending levels and strengthening banks' capital position – for the TARP?

g. The nation's largest financial institutions have received hundreds of billions of dollars in taxpayer assistance. The statute requires Treasury to review "bonuses, retention, awards, and other compensation" paid on or before February 11, 2009 (the date of the statute's enactment) by any institution that has received TARP assistance to determine "whether any such payments *were inconsistent with the purposes of the statute or the TARP or were otherwise inconsistent with the public interest*." (Emphasis supplied.)

> i. Has Treasury conducted such a "look-back" review? Has it conducted such a review for any institution other than one of the seven institutions? In either case, what standards has it used, or will it use, in such a review, that are more specific than the general discretionary standards outlined in the Interim Rule?
>
> ii. The possibility of compensation restrictions was apparent, based on the original language of section 111 of EESA, before enactment of the statute, and it is likely that protective provisions were placed into employment

contracts as a result. If Treasury has not conducted a review of such provisions for any group of relevant institutions, why has it not done so?

iii. If Treasury makes a determination described immediately above for a particular TARP recipient, it must "seek to negotiate with the TARP recipient and the subject employee for appropriate reimbursements to the Federal Government." Has Treasury done so? Has it done so for any institution other than the seven institutions? If Treasury has not done so, please explain why not. Does Treasury have any plans do to so? If so, when?

iv. The Interim Rule gives authority to the Special Master to conduct all of the look-back reviews, not just those for the seven institutions. Please explain this expansion of the Special Master's authority beyond the seven institutions.

2. The statute requires that the rules promulgated by Treasury bar incentives for SEOs to take "unnecessary and excessive risks that threaten the value of the [financial institution]."

a. The Interim Rule does not explain the meaning of this requirement generally. Instead it merely restates the language of the statute. Please explain why this is so.

b. The Interim Rule, however, contains an extensive explanation of the meaning and application of prohibition against "unnecessary and excessive risks" for the seven institutions (or for any other institution that seeks an advisory opinion from the Special Master). Please explain this difference in treatment, given that many recipients other than the seven institutions continue to hold large amounts of TARP assistance.

3. The statute requires a "claw-back" of bonus, retention award, or incentive compensation to a covered individual based on financial information or "other criteria" that are "found to be materially misleading."

a. Under the Interim Rule, the claw-back provision applies in two situations:

The first is [the relevant] "employee . . . *knowingly engag[ing]* in providing inaccurate information (including knowingly failing to timely correct inaccurate information) relating to . . . [the institution's] financial statements or performance metrics [on which the employee's bonus compensation is based]." (Emphasis supplied.)

The second is any case in which "a financial statement or performance metric criteria is materially inaccurate [under] *all the facts and circumstances*." (Emphasis supplied.)

b. What are the ramifications under the federal securities laws of a senior employee's provision of materially inaccurate information for the financial statement of a public company? Why is it appropriate to provide a definition for operation of the claw-back rule that requires a serious violation of the securities laws before the former rule comes into operation? The Interim Rule makes use of provisions of the regulations issued under the securities laws in a number of critical places. The Panel requests Treasury's view on this matter.

c. Except for the situation described immediately above, the Interim Rule states that whether information is materially misleading "depends on all the facts and circumstances." SEC Staff Accounting Bulletin 99 provides extensive definitions of materiality applicable to the financial disclosure of public companies. Why did Treasury not adopt this guidance as the basis for operation of the claw-back provision, especially in light of the fact that the claw-back rule and Accounting Bulletin 99 apply to the same set of financial disclosures?

4. The Interim Rule mainly relies on certifications of the compensation committee of the institutions' board of directors and of the principal executive and financial officers of the institution to assure that the terms of the Interim Rule have been observed.

a. Please explain this approach, in light of the fact that many of the compensation arrangements before the financial crisis were themselves approved by such compensation committees, senior executives, or both?

b. In the case of the compensation committee, the committee must include the certification in their required annual financial disclosures. In Treasury's view, what would be the consequences of a materially inaccurate certification under the federal securities laws?

c. What are the consequences under the federal securities laws if the certification required of an institution's CEO and CFO is materially inaccurate?

d. Would any of the certifications required by the Interim Rule be subject to audit by a public company's independent public accountants? Would they be subject to the internal control provisions of the Sarbanes-Oxley Act of 2002?

5. How will Treasury enforce the terms of the statute and the Interim Rule? What are the consequences for any institution that fails to observe those terms?

6. The Interim Rule creates the Office of the Special Master for TARP Executive Compensation.

a. Are the Special Master's decisions subject to review by the Assistant Secretary of the Treasury for Financial Stability, or by any other senior official of the Department?

b. If not, has authority similar to that given the Special Master (*i.e.*, authority to act without review) been delegated to any other employee of the Treasury?

c. What unique authorities has Treasury assigned to the Special Master? To the extent that the Special Master's authorities are unique, what authority does either section 111 or any other provision of EESA provide for this arrangement?

d. Officials at the November 10 meeting confirmed that the Special Master is an uncompensated special government employee, as defined in 18 U.S.C. § 202. Who determined that such a status was appropriate for the Special Master, and what factors were considered in making that determination? What statutory and regulatory ethical provisions and restrictions, that apply to regular Treasury employees – and what additional standards – apply to the Special Master and other special government employees whom he has chosen to assist him? What restrictions will apply to the Special Master and such other employees, and any firm with which they are or become affiliated, after they leave the Treasury's employ? Has the Special Master's list of clients in his private law and consulting practice, and those of related persons subject to the ethical provisions that apply to the Special Master, been reviewed by appropriate Treasury officials to determine the absence of any conflicts of interest? If so, what has been the result of that review?

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.

The Panel seeks written responses to these questions by January 13, 2010. I would be happy to answer any questions about this letter that you may have. If you would prefer, a member of your staff may contact the Panel's Executive Director, Naomi Baum, at [redacted] [redacted].

Sincerely,

Elizabeth Warren
Chair
Congressional Oversight Panel

Cc: Mr. Paul Atkins
Mr. Mark McWatters
Mr. Richard H. Neiman
Mr. Damon A. Silvers

APPENDIX III: LETTER FROM CHAIR ELIZABETH WARREN TO SECRETARY TIMOTHY GEITHNER, RE: CIT GROUP ASSISTANCE, DATED JANUARY 11, 2010

ELIZABETH WARREN, CHAIR
PAUL S. ATKINS
RICHARD H. NEIMAN
DAMON SILVERS
J. MARK McWATTERS

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

Congress of the United States

CONGRESSIONAL OVERSIGHT PANEL

January 11, 2010

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 November 25, 2009, I wrote to you to request information on Treasury's assistance to CIT Group, Inc., in conjunction with the Congressional Oversight Panel's oversight of the Capital Purchase Program. As of the date of this letter, the Panel has yet to receive your response. We ask that you provide your reply as soon as possible, and no later than January 26, to allow us to incorporate your response in our forthcoming oversight work.

I would be happy to answer any questions about this matter that you may have. If you would prefer, a member of your staff can contact the Panel's Executive Director, Naomi Baum, to discuss such questions. Ms. Baum's telephone number is [redacted].

Sincerely,

Elizabeth Warren
Chair
Congressional Oversight Panel

Cc: Mr. Paul Atkins
Mr. Mark McWatters
Mr. Richard H. Neiman
Mr. Damon A. Silvers