

# FINANCIAL STABILITY OVERSIGHT BOARD

## QUARTERLY REPORT TO CONGRESS

**For the quarter ending  
September 30, 2009**

**Submitted pursuant to section 104(g) of the  
Emergency Economic Stabilization Act of 2008**

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Mary L. Schapiro  
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Securities and Exchange Commission

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Acting Director  
Federal Housing Finance Agency

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## I. INTRODUCTION

This report constitutes the fourth quarterly report of the Financial Stability Oversight Board (“Oversight Board”) pursuant to section 104(g) of the Emergency Economic Stabilization Act of 2008 (“EESA”). This report covers the period from July 1, 2009, through September 30, 2009 (the “quarterly period”).

The Oversight Board was established by section 104 of the EESA to help oversee the Troubled Asset Relief Program (“TARP”) and other emergency authorities and facilities granted to the Secretary of the Treasury (“Secretary”) under the EESA. The Oversight Board is composed of the Secretary, the Chairman of the Board of Governors of the Federal Reserve System (“Federal Reserve Board”), the Director of the Federal Housing Finance Agency (“FHFA”), the Chairman of the Securities and Exchange Commission (“SEC”), and the Secretary of the Department of Housing and Urban Development (“HUD”). During the quarterly period, Mr. Edward J. DeMarco became Acting Director of FHFA and a Member of the Oversight Board upon the resignation of James Lockhart as Director of that agency.

Through Oversight Board meetings and consultations between the staffs of the agencies represented by each Member of the Oversight Board, the Oversight Board has continued to review and monitor the development and ongoing implementation of the policies and programs under TARP to restore liquidity and stability to the U.S. financial system.

Based on its assessment to date, the Oversight Board believes that the accumulated effects of Treasury’s actions under TARP contributed significantly to improved conditions in many financial markets during the quarterly period. By providing capital investments in numerous financial institutions and establishing programs to restore the flow of credit, TARP has been a key stabilizing factor for the financial system. While lending activity has been less than robust, the actions of Treasury under TARP have likely prevented a greater deterioration in the availability of credit to households and businesses. Further, during the quarterly period measurable interim results began to emerge from the Home Affordable Modification Program (“HAMP”). As of quarter-end, roughly 760,000 offers had been extended, trial modifications periods had begun for about 490,000 of these, and some permanent modifications had been put in place. Under the program terms, these modifications are expected to materially reduce borrowers’ mortgage debt service obligations and thereby can reduce the risk of foreclosure. Indications of greater stability in home prices also emerged in the quarterly period, building on the positive influences of other TARP programs and other initiatives by Treasury, the Federal Reserve, HUD, and FHFA. The Oversight Board welcomes these positive developments, recognizing that more progress is needed and that many of the favorable indications remain linked to the presence of TARP and other government initiatives.

This report is divided into four parts. Following this Introduction (Part I), Part II (Oversight Activities of the Financial Stability Oversight Board) highlights the key

oversight activities and administrative actions taken by the Oversight Board during the quarterly period. Part III (Evaluating the Effects of EESA Programs) presents the Oversight Board's evaluation of the effects thus far of the policies and programs implemented by Treasury under TARP. Finally, Part IV (Discussion of the Actions Taken by Treasury under the EESA during the Quarterly Period) provides a more detailed description of the programs, policies, and administrative actions taken, and financial commitments entered into, by Treasury under TARP during the quarterly period.

## **II. OVERSIGHT ACTIVITIES OF THE FINANCIAL STABILITY OVERSIGHT BOARD**

The Oversight Board met three times during the quarterly period, specifically on July 29, August 31, and September 28, 2009. During these meetings, Members focused attention on Treasury's continued efforts to establish, expand, or enhance programs under TARP and the Financial Stability Plan ("FSP") announced by the Obama Administration in February 2009. As reflected in the minutes of the Oversight Board's meetings,<sup>1</sup> the Oversight Board received presentations and briefings from Treasury officials and, where appropriate, other government officials, including officials from the other agencies represented on the Oversight Board, concerning the implementation and the effects of the programs established under TARP. For example, at the Oversight Board meetings held on July 29, August 31, and September 28, 2009, Seth Wheeler, Senior Advisor to the Secretary, in conjunction with officials from HUD and FHFA, provided the Members with an update on the Home Affordable Modification Program ("HAMP"), including updates concerning the pace at which participation in HAMP was expanding and its possible effects on housing markets. Members also received briefings concerning TARP programs for which investments had already been made, to allow for monitoring of these programs. For example, at the Oversight Board meeting held on July 29, 2009, Ron Bloom, Lead Advisor to the Secretary of the Treasury and Member of the Presidential Task Force on the Automotive Industry, reviewed and discussed the Automotive Industry Financing Program ("AIFP") and the recent actions taken by Treasury under the program to assist the domestic automotive industry in becoming financially viable.

### **a. Key Initiatives and Developments**

The following highlights some of the key initiatives and actions taken under TARP and the FSP during the quarterly period, which were reviewed and discussed by the Oversight Board.

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<sup>1</sup> Approved minutes of the Oversight Board's meetings are made available on the internet at: <http://www.financialstability.gov/about/oversight.html>.

*Preventing Avoidable Foreclosures*

- Home Affordable Modification Program.
  - Treasury continued to build its network of servicers participating in the Making Home Affordable (“MHA”) program. As of September 30, 2009, 63 servicers had signed participation agreements to modify loans in accordance with MHA guidelines. Between loans managed by these servicers and loans owned or guaranteed by the government-sponsored enterprises (“GSEs”), approximately 85 percent of first-lien residential mortgage loans in the U.S. are now covered by the program;
  - Treasury released the first of a series of Servicer Performance Reports, on August 4, 2009, which details, by servicer, the number of trial modifications extended to eligible borrowers under HAMP, the number of trial modifications underway and the performance of these home mortgage modifications. As of September 30, 2009, some 757,955 trial modification offers had been extended and 487,081 trial modifications were currently underway;
  - Treasury directed Freddie Mac to audit a sample of rejected MHA modification applications to determine whether there were inadvertent denials of borrower applications and assist servicers in further improving program operations;
  - Treasury issued a Supplemental Directive for the Home Price Decline Protection Program (“HPDP”), a program that will make up to \$10 billion in payments available to provide additional incentives to lenders for modifications where home price declines have been the most severe. The Supplemental Directive addresses investor eligibility in the program, the calculation of HPDP incentive payments, the accrual of incentive compensation, and compliance issues; and
  - Treasury and other agencies met with all participating servicers, developed standard performance metrics, and took other steps to improve the overall effectiveness and efficiency of HAMP.

*Stabilizing Financial Markets and Financial Institutions and Maintaining Confidence in the U.S. Financial System*

- Public-Private Investment Program (“PPIP”). The PPIP, which Treasury announced in March 2009, is designed to help promote liquidity in the market for assets and securities originated prior to the onset of severe financial stress (“legacy assets”), promote transparency in the pricing of such assets, and promote new lending by financial institutions by facilitating the cleansing of legacy assets from their balance sheets. The Legacy Securities component of the program (“S-PPIP”) is intended to provide seed capital for asset managers to acquire and hold legacy real estate-related assets and thereby to support market functioning and facilitate price discovery in the market for mortgage-backed securities (“MBS”). During the quarterly period, Treasury—
  - Announced that nine fund managers had, after a thorough review, prequalified to participate in the S-PPIP and had begun to raise capital from private sources. These pre-qualified fund managers also have established meaningful partnerships with small-, minority-, and women-owned businesses; and
  - Completed initial closings with two Public-Private Investment Funds (“PPIFs”), each of which had raised at least \$500 million of committed equity capital from private investors. Treasury expects the remaining initial closings to occur throughout October 2009.
- Capital Purchase Program (“CPP”). Treasury continued to provide new capital to small banks under the CPP to stimulate a recovery in lending.
  - As of the close of the quarterly period, Treasury had disbursed \$204.62 billion in capital to 685 institutions in 48 states under the CPP. Treasury has provided more than \$58 million to small and community banks as a result of the re-opening and expansion of the CPP, which Treasury had announced during the preceding quarterly period; and
  - As of the close of the quarterly period, Treasury had received \$6.8 billion in dividends, interest and fees from CPP investments; \$70.72 billion in repayments; and \$2.9 billion in warrant proceeds, including proceeds from the repurchase of shares received through the exercise of warrants, since the inception of the program.

***Restoring the Flow of Credit to Consumers and Businesses***

- Term Asset-Backed Securities Loan Facility (“TALF”). To promote the flow of credit to businesses and households and to facilitate the financing of commercial properties, the Federal Reserve and Treasury extended the deadline to participate in TALF to March 31, 2010, for newly-issued asset-backed securities (“ABS”) and legacy commercial mortgage-backed securities (“CMBS”), and to June 30, 2010, for newly issued CMBS. After analyzing a number of potential candidates for additional types of collateral, the Federal Reserve and Treasury announced that they are holding in abeyance any further expansion in the types of collateral eligible for TALF. In July, the first subscription for legacy CMBS resulted in \$669 million in requested TALF loans. In the aggregate, more than \$50.8 billion in ABS loans have been extended under TALF, as of September 30, 2009, and a total of approximately \$79.6 billion of TALF-eligible ABS has been issued.

***Supporting the Orderly Restructuring of the Domestic Auto Companies***

- Automotive Industry Financing Program (“AIFP”). During the quarterly period, Treasury announced several important developments under the AIFP. Most notably, Treasury announced that it had transitioned from day-to-day restructuring of the companies participating in the program to monitoring the government’s investment in them. As of the close of the quarterly period, Treasury held an ownership interest in the newly formed Chrysler Group LLC (“New Chrysler”) (9.9 percent equity interest); the newly formed General Motors Company (“New GM”) (60.8 percent equity interest); and GMAC LLC (“GMAC”) (35 percent equity interest and \$13.1 billion in preferred shares). In addition to these developments—
  - On emergence from their respective bankruptcies, Chrysler and GM paid back in full \$280 million and \$361 million, respectively, of warranty loans outstanding under the Warranty Commitment Program, thereby terminating that program;
  - Chrysler and GM reduced their potential borrowing under the Auto Supplier Support Program by a total of \$1.5 billion; and
  - On July 14, 2009, Chrysler Financial fully repaid the \$1.5 billion loan, which Treasury had made in January 2009 to help the company finance the purchase of Chrysler vehicles by consumers.

***Transparency and Reporting***

- During the quarterly period, Treasury published three Monthly Bank Lending and Intermediation Snapshots, three CPP Monthly Lending Reports, three Monthly Dividend and Interest Reports, three section 105(a) reports, and multiple Transaction Reports. Treasury also revised the format of the section 105(a) reports to improve transparency and public understanding of the progress of TARP programs.
- On July 17, 2009, Treasury also released its first Dividends and Interest Report through May 2009 detailing for each institution dividends and interest received in that reporting month as well as the life-to-date dividend and interest received information. During the quarterly period, Treasury published Dividends and Interest Reports for the months of June, July, and August.

Additional details concerning each of these programs and investments are included in Part IV below.

**b. Coordination with Other Oversight Bodies**

During the quarterly period, the Oversight Board also monitored Treasury's responses to the recommendations made by the Office of the Special Inspector General for the TARP ("SIGTARP") and the Government Accountability Office ("GAO"). Throughout the quarterly period, the Oversight Board received updates on Treasury's progress in addressing the issues raised by these oversight bodies with respect to transparency, the establishment of internal controls, compliance and risk monitoring, staffing and Treasury's communication strategy. For example, at the Oversight Board meeting held on September 28, 2009, the Members discussed the improvements made by Treasury to HAMP, which included, among other things, Treasury's efforts to finalize a comprehensive system of internal controls for the program. In addition, staff of the Oversight Board and of the agencies represented by each Member of the Oversight Board continued to have regular discussions with representatives from the SIGTARP and GAO to discuss recent and upcoming activities of the oversight bodies. These efforts continued to help facilitate coordinated oversight and minimize the potential for duplication.

**c. Aggregate Level of Commitments, Disbursements and Repayments**

As part of its oversight activities, the Oversight Board also reviewed and discussed the aggregate level and distribution of commitments and disbursements under TARP, repayments of TARP funds, and the level of resources that remain available under TARP. EESA authorized \$700 billion for TARP. As of September 30, 2009, Treasury had announced plans to invest \$636.85 billion for specific TARP programs. Of that amount, Treasury had entered into commitments to invest \$455.5 billion and had disbursed \$365.09 billion, some of which was repaid earlier in the year. A large part of

the total investments to date occurred last fall under the CPP following the enactment of EESA in October 2008. The more recent commitments include amounts extended under the FSP. The chart in Figure 1 summarizes TARP commitments, disbursements and repayments as of September 30, 2009.

Figure 1

<b>TARP/Financial Stability Plan Budget Table</b> (Status as of 10/01/09)			
<small>*All dollars in billions* All figures are as of COB the prior business day and are subject to adjustment(s) after final reconciliation.</small>	<u>Planned</u> <u>Allocation</u>	<u>Face Value</u> <u>Obligations</u>	<u>Face Value</u> <u>Disbursed/ Outlays</u> <sup>1</sup>
Capital Purchase Program (CPP)	218.00	204.62	204.62
Targeted Investment Program (TIP)	40.00	40.00	40.00
Asset Guarantee Program (Citigroup loss share agmt. w/ USG)	5.00	5.00	0.00
Capital Assistance Program (CAP)	TBD	TBD	TBD
Consumer & Business Lending Initiative (CBLI)			
1) TALF 1.0	20.00	20.00	0.10
2) SBA Securities Purchase	15.00	0.00	0.00
3) TALF Asset Expansion (New Issuance)	35.00	0.00	0.00
<i>Subtotal - - Consumer Business Lending Initiative</i>	<u>70.00</u>	<u>20.00</u>	<u>0.10</u>
Legacy Securities Public-Private Investment Program (S-PPIP)	100.00	6.67	0.00
Systemically Significant Failing Institutions Program (SSFI)	70.00	69.84	43.21
Automotive Industry Financing Program (AIFP)	82.59	81.05	75.90
Home Affordable Modification Program (HAMP)	50.00	27.07	0.00
Helping Families Save Their Homes Act <sup>3</sup>	1.26	1.26	1.26
<b>PROGRAM TOTALS:</b>	<u>636.85</u>	<u>455.50</u>	<u>365.09</u>
<i>Remaining Available Funds:</i>	63.15	244.50	334.91
<i>Actual Redemptions / Repayments :</i>	70.72	70.72	70.72
<i>Loan Principal Repaid:</i>	2.14	2.14	2.14
<i>Remainder of \$700 billion (total accessible):</i>	<u>136.01</u>	<u>317.36</u>	<u>407.77</u>
<i>Percentage of \$700 billion (total accessible):</i>	<u>19%</u>	<u>45%</u>	<u>58%</u>
<i>Dividends Received To Date:</i>	9.29		
<i>Interest Received To Date:</i>	0.21		
<i>Proceeds from the sale of Warrants and Preferred Stock: (received as a result of Exercised Warrants)</i>	2.90		
<i>Proceeds from Additional Notes:</i>	0.02		

<sup>1</sup> Represents TARP cash that has left the Treasury.

<sup>2</sup> Up to \$20B may be disbursed as credit protection for the \$200B Federal Reserve Loan Facility. Treasury will only provide funding to cover assets put to the TALF SPV and will receive 90% of funds accumulated in the SPV (from Interest spreads on the \$200B Federal Reserve Loan Facility) over a 3-5 year period. Expected receipts exceed the expected disbursements, resulting in a significant negative subsidy rate. Initial funding of \$100M on 3/25/09.

<sup>3</sup> Reduction of \$1.244B in TARP funds to offset costs of program changes for the "Helping Families Save Their Homes Act of 2009", Public Law No: 111-22, Section 202 (b). An additional \$15M is allocated for administrative expenditures relating to the Special Inspector General for the Troubled Asset Relief Program (SIGTARP). Funds are not yet apportioned.

**Note:** Redemptions are made under the provisions of the Emergency Economic Stabilization Act of 2008 (EESA) and repayments under the provisions of the American Recovery and Reinvestment Act (ARRA).

### III. EVALUATING THE EFFECTS OF EESA PROGRAMS

In light of severe stresses in the U.S. and global financial markets, Congress passed the EESA 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.”<sup>2</sup> Utilizing this authority, Treasury has implemented or announced a range of extensive programs to stabilize the financial markets and financial institutions, restore the flow of credit to consumers and businesses, and help at-risk homeowners remain in their homes and avoid foreclosure. These programs are described in more detail in Part IV of this report. This section provides the Oversight Board’s evaluation to date of the effects of Treasury’s efforts under EESA, building on the assessments made in the three previous quarterly reports.

Based on its assessment to date, the Oversight Board believes that the accumulated effects of Treasury’s actions under TARP contributed significantly to improved conditions in many financial markets during the quarterly period. By providing capital investments in numerous financial institutions and establishing programs to restore the flow of credit, TARP has been a key stabilizing factor for the financial system. While lending activity has been less than robust, the actions of Treasury under TARP have likely prevented a greater deterioration in the availability of credit to households, businesses, and communities. For example, TARP capital investments in banking organizations, in conjunction with TALF and other government programs, have contributed to the easing of liquidity pressures and increased market confidence in banking organizations since late 2008.

Further, during the quarterly period, measurable interim results began to emerge from HAMP. As of September 30, 2009, roughly 760,000 offers had been extended, trial modifications periods had begun for about 490,000 of these, and some permanent modifications had been put in place. Under the program terms, these modifications are expected to materially reduce borrowers’ mortgage debt service obligations and thereby can reduce the risk of foreclosure. Indications of greater stability in home prices also emerged in the quarterly period, building on the positive influences of other TARP programs and other initiatives by Treasury, the Federal Reserve, HUD, and FHFA. The Oversight Board welcomes these positive developments, recognizing that more progress is needed and that many of the favorable indications remain linked to the presence of TARP and other government initiatives.

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<sup>2</sup> 12 U.S.C. § 5201(1). For an overview of the conditions in the financial markets prior to passage of the EESA, see Part V.a of the Oversight Board’s First Quarterly Report to Congress for the quarter ending December 31, 2008 (“First Quarterly Report”).

**a. Assessment of the effect of the actions taken by Treasury in stabilizing financial markets**

The Oversight Board believes that Treasury's actions under the EESA continued to reduce uncertainty among financial market participants and to provide meaningful support to core financial markets during the third quarter of 2009. The steps taken by Treasury to bolster financial stability under TARP and FSP continued to be reinforced by other actions taken by the United States and foreign governments to assist financial markets. Taken together, the cumulative effects of these actions have improved capital positions at larger bank holding companies and conditions in short-term funding markets, and likely had positive effects on bank and nonbank lending activity. However, the magnitude of the beneficial effects of Treasury actions is difficult to separate from the effects of other government programs, the broader influences of U.S. and global economic activity, and the normal adverse effects of economic cycles on lending markets. Even a year after the financial crisis came to a head, there remain significant conceptual and practical challenges to identifying the effect of Treasury actions on financial markets.

Conditions and sentiment in financial markets continued to improve during the third quarter of 2009, as economic data pointed to a pickup in activity and programs funded by TARP reduced uncertainty. Improvements were apparent across many markets: pressures in short-term funding markets eased considerably, broad stock price indexes increased, on net, and risk spreads on corporate bonds narrowed. However, the improvement in market conditions was tempered by concerns about the timing and the pace of the nascent economic recovery as well as continued uncertainty surrounding the outlook for commercial and residential real estate valuations. Amid this uncertain backdrop, lending by banks also remained weak in the third quarter.

Figure 2

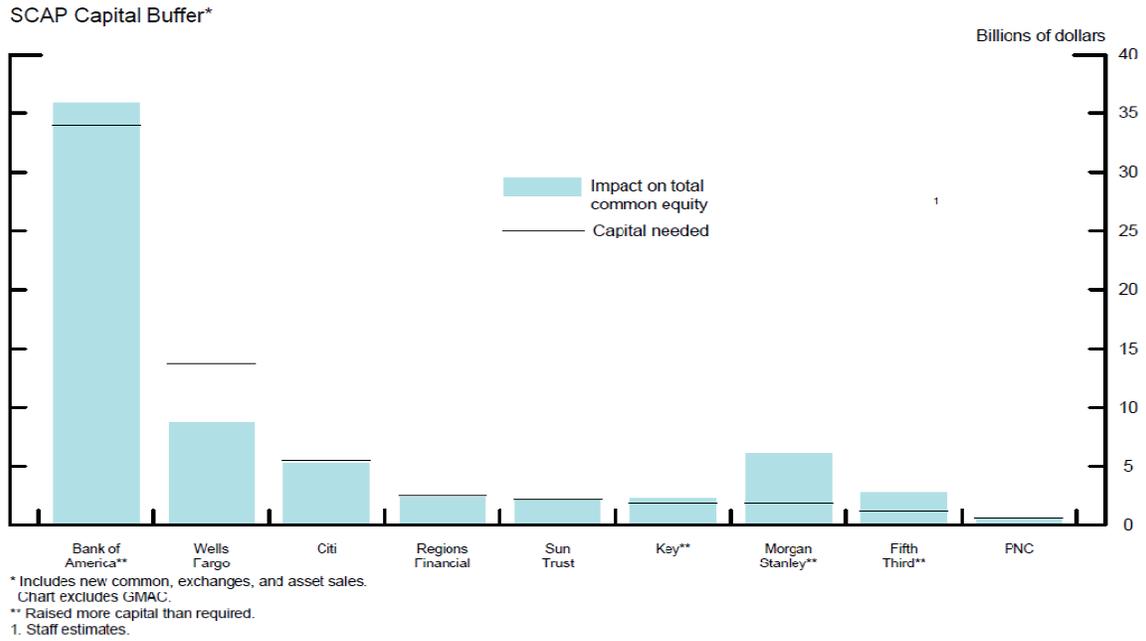
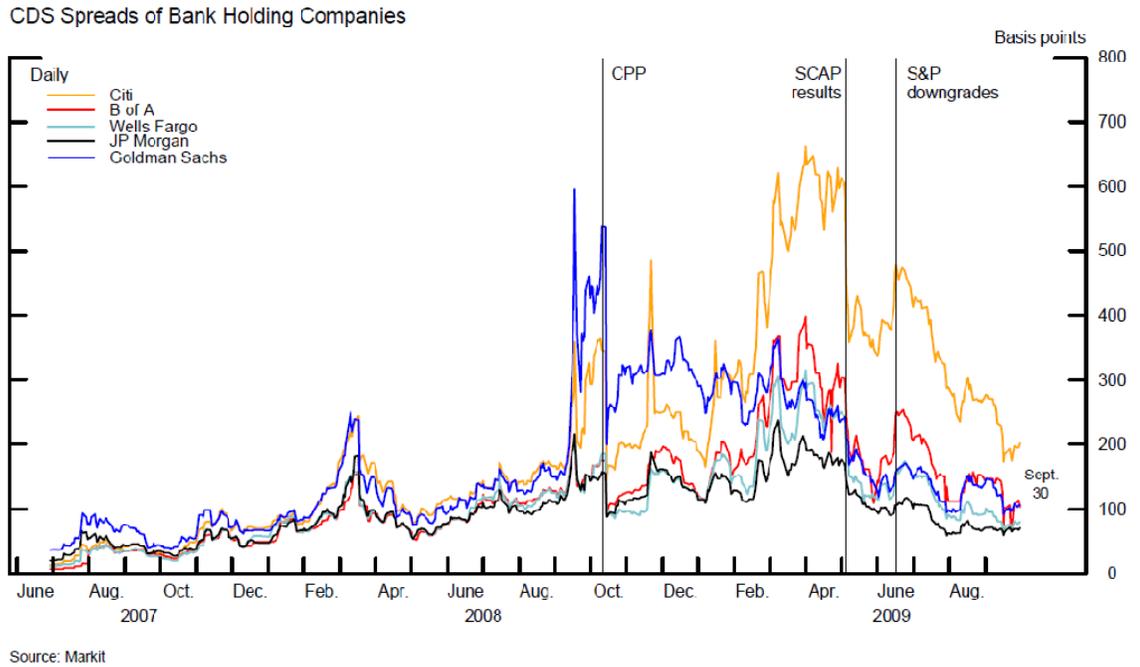


Figure 3



The Supervisory Capital Assessment Program (“SCAP”), which was completed in May 2009, generally reassured investors regarding the financial condition of major banking organizations. As discussed in the Oversight Board’s previous report, the SCAP exercise identified ten bank holding companies that needed to raise capital to meet the SCAP capital buffer requirements. These institutions were given until November 9, 2009, to raise the required capital amount, including through Treasury’s Capital Assistance Program (“CAP”). The evaluated BHCs raised a significant amount of capital from new common equity since May. By the end of the third quarter, most appeared to have met or exceeded the required capital, pending supervisory review (figure 2).

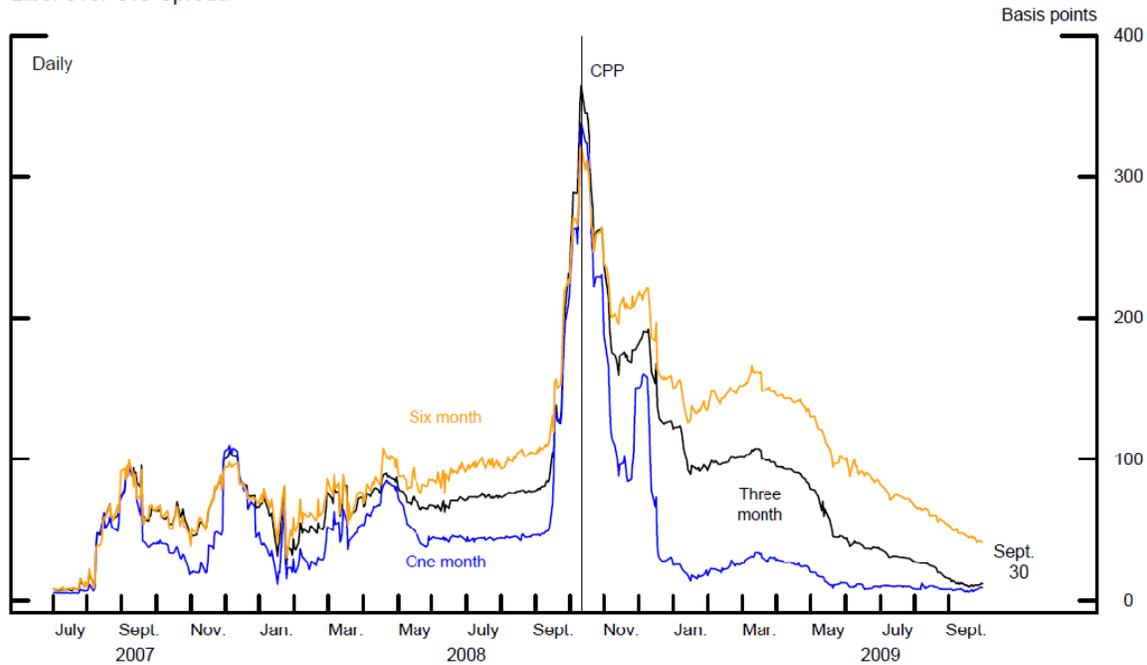
Consistent with the improved sentiment among market participants, credit default swap (“CDS”) spreads for major banking organizations, a key measure of investors’ concerns about the health of these institutions, posted significant declines during the third quarter (figure 3). Bank stock prices also moved up considerably over the course of the third quarter (figure 4).

Figure 4



Figure 5

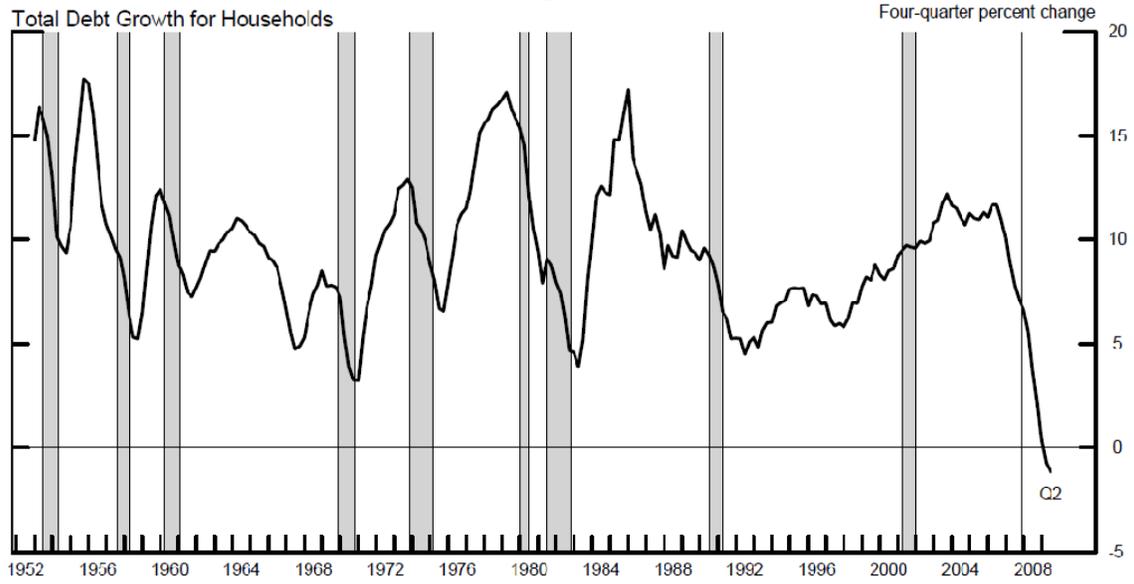
Libor over OIS Spread



Source: Bloomberg.

As a further indication of diminished concerns about the health of large banking organizations, conditions in interbank markets have continued to improve. The spreads of LIBOR rates to overnight index swap (“OIS”) rates, a useful measure of banks’ short-term borrowing costs, continued to decline in the third quarter (figure 5). The spreads of the one-month and three-month LIBOR over OIS have narrowed to levels about equal to those prevailing before the financial crisis. Although the spread of the six-month LIBOR over OIS also declined in the third quarter, it has not returned to pre-crisis levels, suggesting that some strains persist. In line with these improvements in bank funding markets, the use of the Federal Reserve liquidity facilities directed at depository institutions has declined.

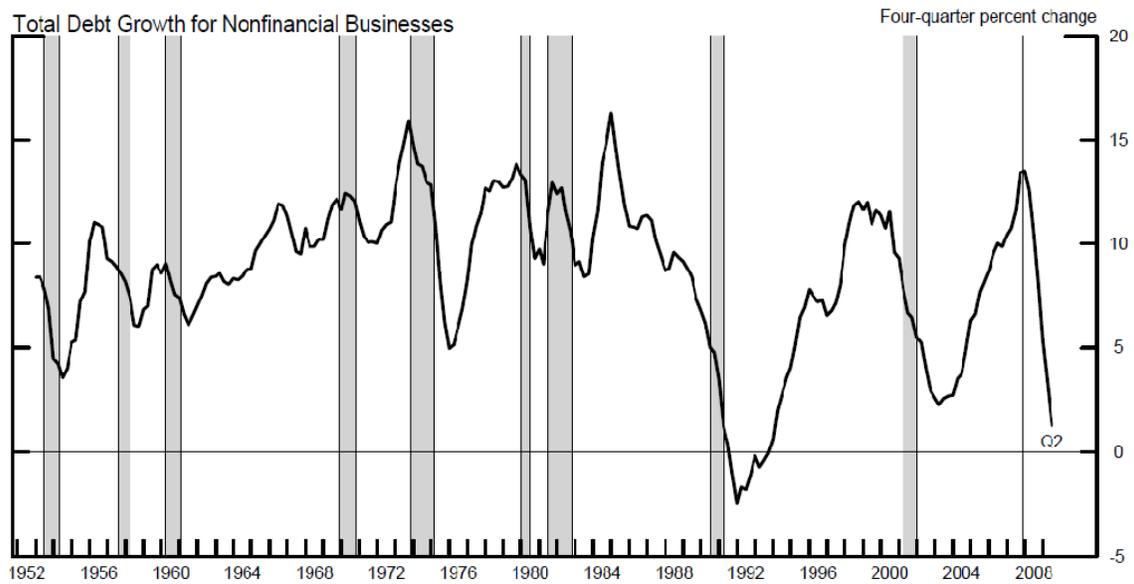
Figure 6



Source: Federal Reserve Board, Flow of Funds Accounts.

Note: Shaded areas denote NBER recession periods. The solid line is the December 2007 business cycle peak identified by the NBER.

Figure 7



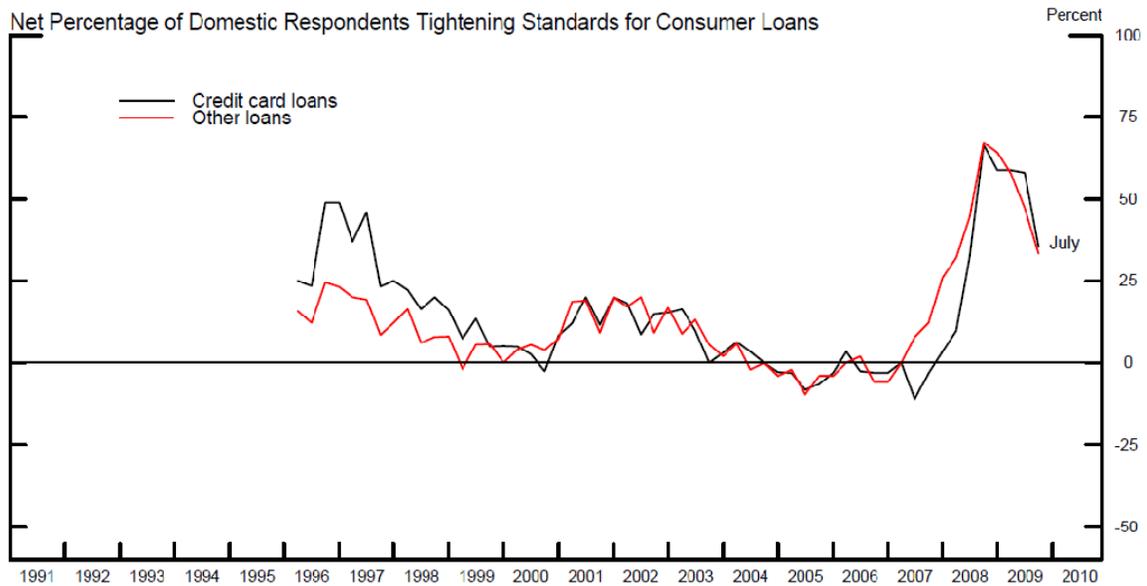
Source: Federal Reserve Board, Flow of Funds Accounts.

Note: Shaded areas denote NBER recession periods. The solid line is the December 2007 business cycle peak identified by the NBER.

Debt growth for nonfinancial businesses and households, however, has continued to be weak in recent months. To put the current lending trends in historical perspective, data from the Flow of Funds Accounts published by the Federal Reserve Board show that, aggregating across banks and other sources of debt, growth in borrowing by households and nonfinancial businesses has tended to slow significantly in periods of economic weakness, and generally has not strengthened until after the trough in economic activity (figures 6 and 7 respectively). Viewed against that backdrop, data through the second quarter of 2009 (the latest data available for the Flow of Funds Accounts) indicate that year-over-year growth in borrowing by households and nonfinancial business has decelerated more sharply than in other recessions.

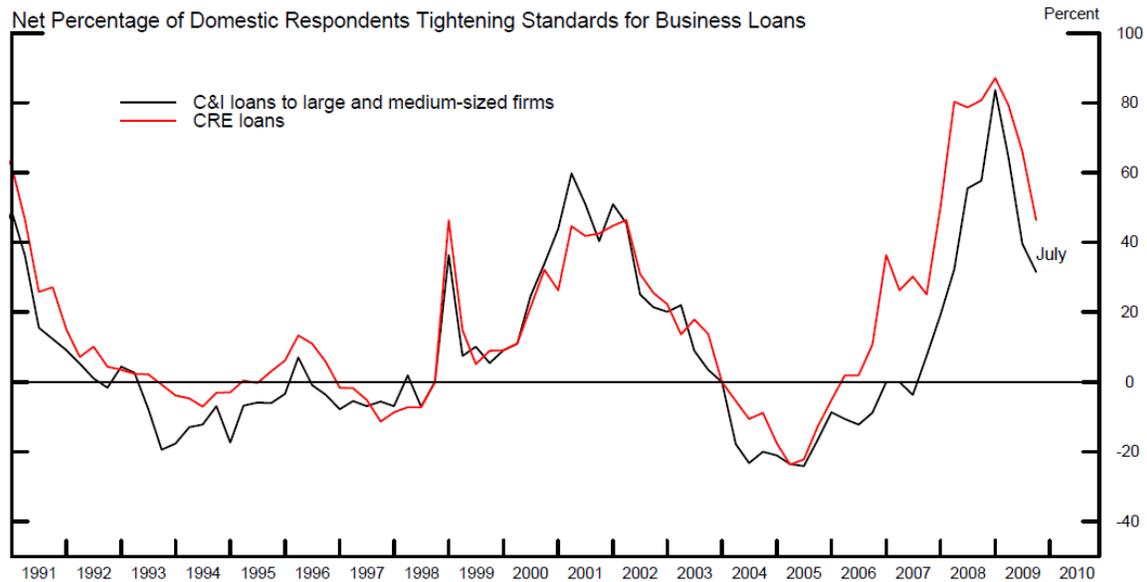
Identifying the effects of EESA programs on lending continue to present significant conceptual and practical challenges. Foremost among these challenges are the inherent difficulties in disentangling the relative importance of reduced demand for credit due to weaker economic activity, reduced supply of credit because borrowers appear less creditworthy and reduced supply of credit because lenders face pressures that restrain them from extending credit, such as possible concerns about their capital.

Figure 8



Source: Federal Reserve Board, Senior Loan Officer Opinion Survey.

Figure 9

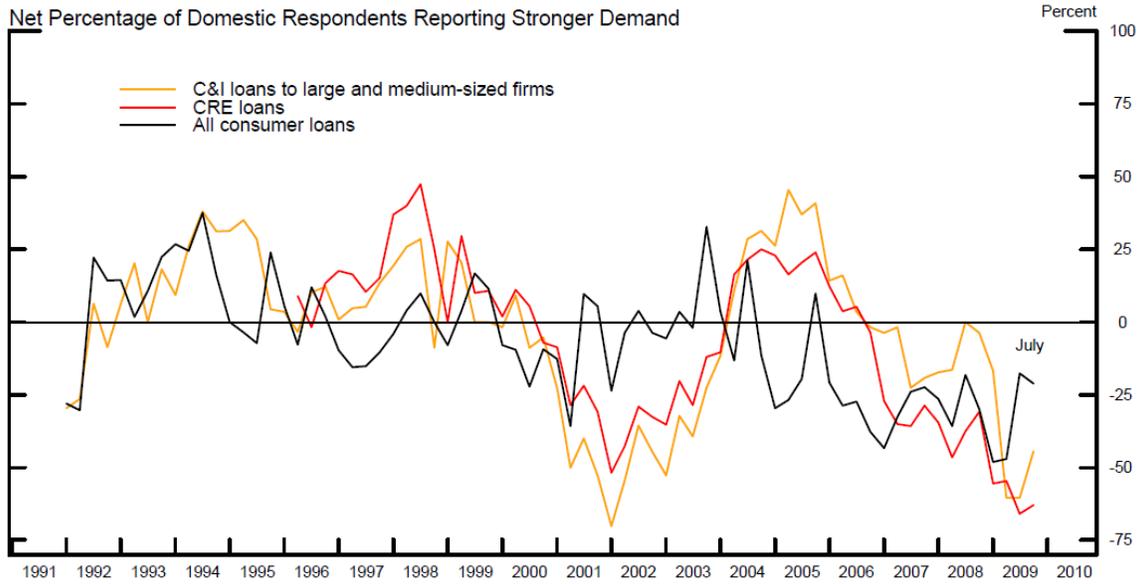


Source: Federal Reserve Board, Senior Loan Officer Opinion Survey.

The July 2009 Senior Loan Officer Opinion Survey on Bank Lending Practices conducted by the Federal Reserve provides useful insight into the salience and direction of these various influences on bank lending. The July survey results continue to suggest that banks believe demand factors and economic conditions have been more important in holding down lending activity than concerns about bank capital. Domestic banks have been tightening standards since early 2008 for consumer (figure 8), commercial and industrial (“C&I”), and commercial real estate (“CRE”) loans (figure 9), although the net percentage of banks that tightened standards has notably fallen in recent quarters. Almost all of the banks that tightened standards indicated that concerns about a weaker or more uncertain economic outlook were important in their decision to do so. Only about one-third of the banks surveyed cited concerns about deterioration in their own current or future capital position as an important reason for tightening standards or terms. This result suggests that the availability of TARP capital investments may have helped to prevent an even greater tightening of lending standards than has actually occurred. Banks also reported weaker demand for loans, which may help to explain recent weakness in borrowing, in particular for C&I and CRE loans (figure 10).<sup>3</sup>

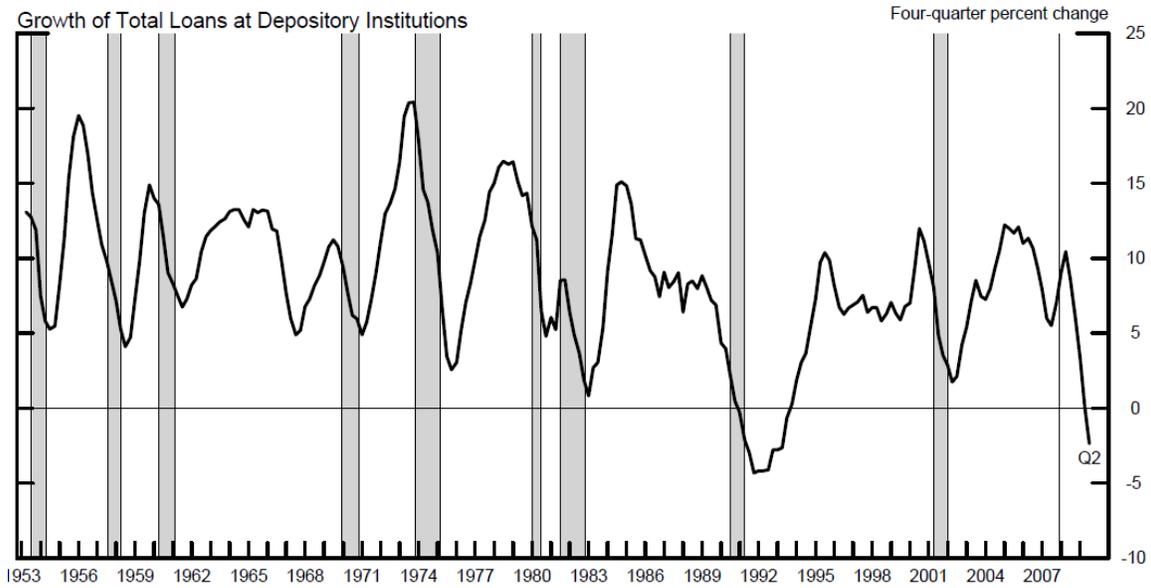
<sup>3</sup> The answers to survey questions about loans to small firms, not explicitly shown in figures 9 and 10, closely parallel the data about loans to large and medium-sized firms reported in those figures.

Figure 10



Source: Federal Reserve Board, Senior Loan Officer Opinion Survey.

Figure 11



Source: Federal Reserve Board, Flow of Funds.  
 Note: Shaded areas denote NBER recession periods. The solid line is the December 2007 business cycle peak identified by the NBER.

Consistent with these trends in supply and demand for bank credit, Flow of Funds data show that growth in total loans at depository institutions has fallen off since the most recent business cycle peak in December 2007, and loans outstanding contracted in the second quarter of 2009, the last quarter for which data are available (figure 11). Data from the weekly survey of banks summarized in the Federal Reserve’s H.8 Statistical Release provides evidence that growth in bank credit to households and to nonfinancial businesses has remained weak during the third quarter. As discussed further below, some of this weakness, however, reflects a substitution from loans on banks’ balance sheets to other forms of credit, which were in part made available through TALF.

Monthly reports collected by Treasury from CPP recipients provide similar indications. Treasury’s Monthly Lending and Intermediation Snapshot report for July 2009 shows deceleration in the pace of new loan originations for most loan types at the 22 banking organizations that received the largest amounts of capital under the CPP. The stock of loans at these organizations declined about 1 percent from June to July. Treasury’s CPP Monthly Lending Report, which provides total outstanding loan balances for all CPP recipients, indicated that total loans declined 0.8 percent in the month of July (adjusted to exclude CPP participants who repaid the Treasury), although the consumer loan portion of the total rose slightly.

Figure 12

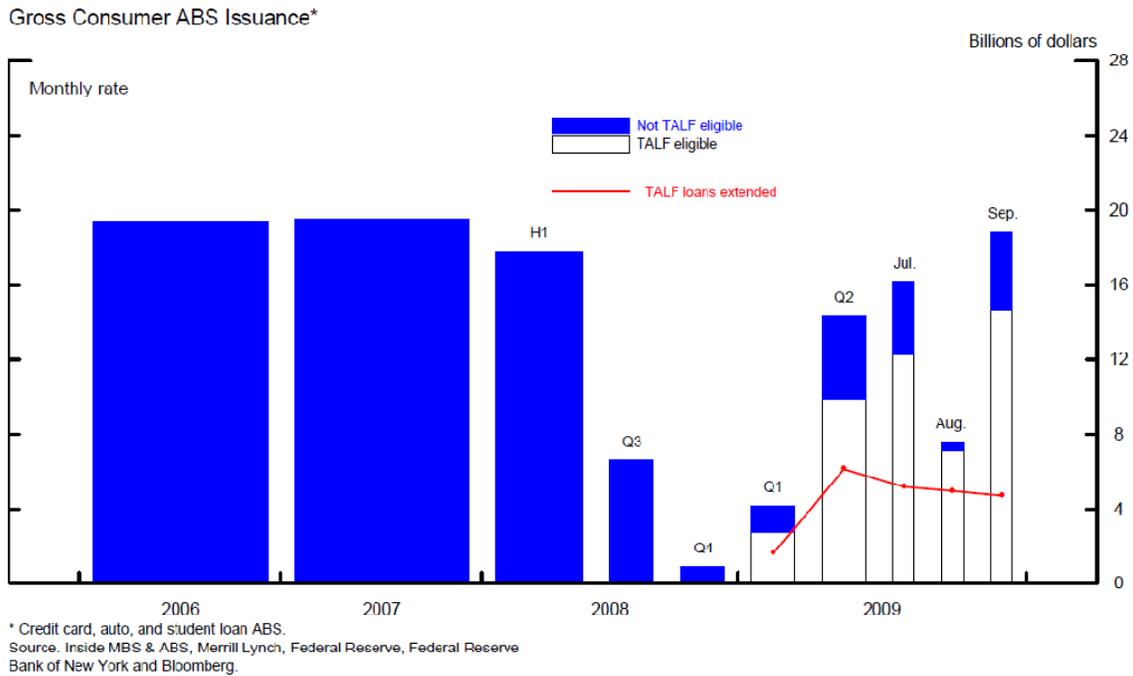
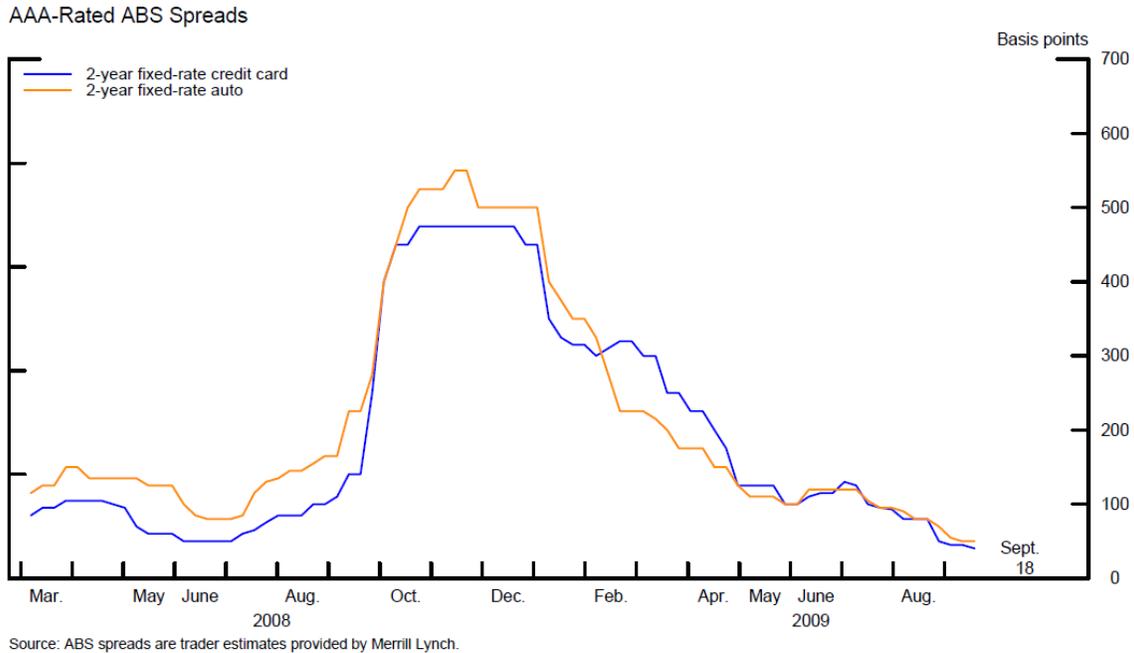
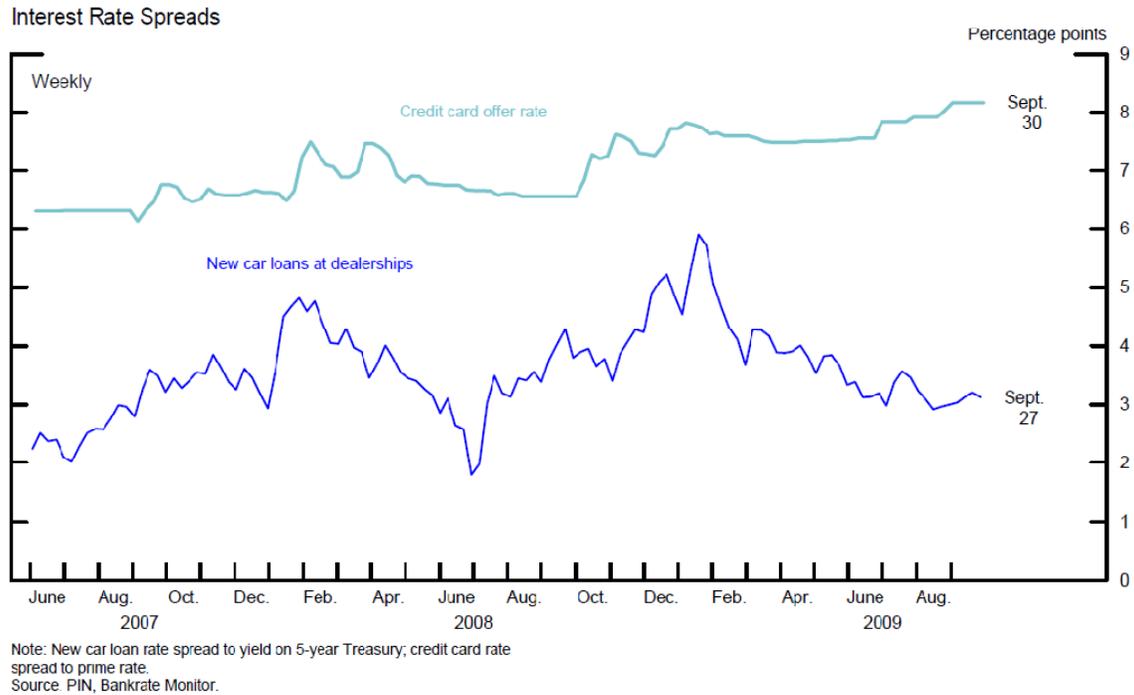


Figure 13



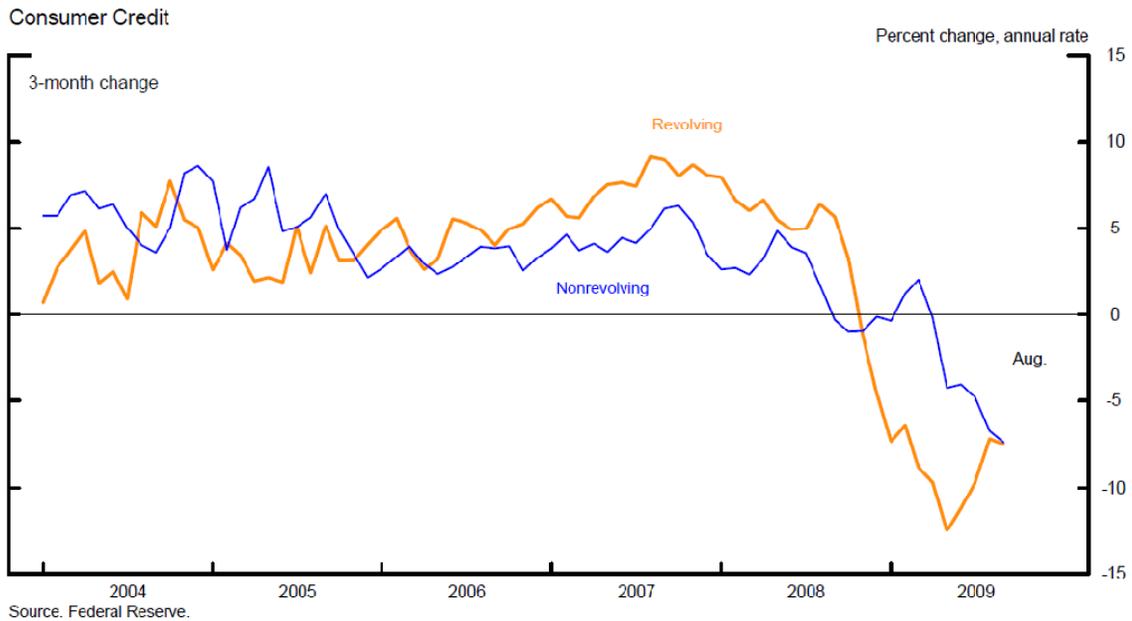
Securitization of household credit continues to be heavily facilitated by TALF. Issuance of consumer credit ABS was robust in the third quarter, totaling about \$42 billion, and TALF-eligible deals represented the majority of issuance, as they did in the first half as well (figure 12). While ABS backed by student loans continued to be purchased overwhelmingly by investors who utilize TALF loans, TALF loans actually dropped in the third quarter, as cash investors (that is, investors who are not making use of TALF to finance their ABS acquisitions) began to purchase a substantial amount of auto ABS and credit card ABS. Spreads in the secondary market on AAA-rated consumer ABS (both on credit card debt and on auto loans) narrowed further, falling to below 50 basis points by the end of the third quarter (figure 13). Given the decline in spreads, it seems reasonable to expect even less investor reliance on TALF loans going forward if economic conditions continue to improve.

Figure 14



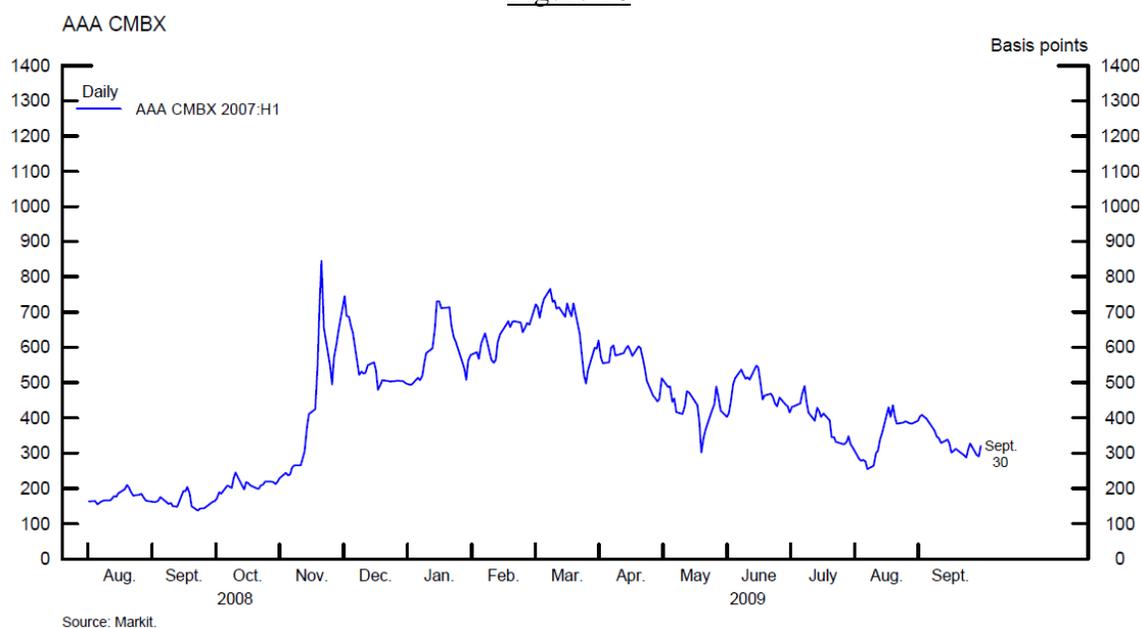
The effects of the improvements in ABS markets on the interest rates faced by households are more difficult to gauge, given that credit quality normally deteriorates during recessions and delinquency rates on consumer loans have risen. Interest rate spreads on new car loans at dealerships remained at the lower end of their recent range, as TALF-facilitated ABS issuance continued to alleviate lender funding pressures that had contributed to higher interest rates on auto loans at the end of 2008. Spreads on credit card interest rates for prime borrowers have edged up, reportedly influenced by the impending implementation of the Credit CARD Act in early 2010 (figure 14).

Figure 15



Overall, consumer credit continued to contract at a rapid pace in recent months, held down by a combination of sluggish consumer spending, high charge-off rates, and limited credit availability (figure 15). Conditions in the credit card market have remained extremely tight, reflecting in part deterioration in household credit quality. Call Report data show that unused commitments for credit cards at commercial banks fell at a 17 percent annual rate in the second quarter, following a remarkable 45 percent pace of contraction in the first quarter. In contrast to the credit card market, conditions in the auto finance market are not as tight as they were last fall, as noted above, reflecting the support provided by government programs.

Figure 16



In commercial mortgage markets, the expansion of TALF to CMBS appears to have reduced, on net, the interest rate spreads on CMBS. As can be seen from the AAA CMBX index, spreads declined (on net) further in the quarterly period (figure 16).

Overall, commercial real estate markets continued to exhibit considerable stress during the quarterly period, as commercial property prices appeared to have continued to decline and delinquency rates rose. Demand for permanent and interim financing may be large, with the potential for more than \$500 billion of commercial mortgage loans to mature in each of the calendar years 2009 and 2010, per industry analysts' reports and Federal Reserve staff estimates. The majority of those mortgages are held by commercial banks. In the current environment, some borrowers may have trouble refinancing their loans at maturity, especially shorter-term loans on construction properties. While CMBS typically fund only longer-term loans on existing properties, thus far the expansion of TALF has injected some needed liquidity into this market. The three legacy CMBS subscriptions during the quarterly period totaled \$4.36 billion. Together with future TALF subscriptions of legacy and new CMBS, these transactions should contribute to reduced uncertainty about liquidity and valuations. However, concerns remain because many of the construction loans that are expected to mature this year were originated in the elevated real estate markets of 2006 and 2007 and are on new properties that do not have a regular stream of rental payments. Potential refinance lenders may be less willing to provide the same financing amounts and terms for properties whose values have fallen and for which the amounts of incoming cash flow are subject to significant uncertainty.

Figure 17



In credit markets for corporate borrowers, corporate bond spreads have dropped and yields have declined in recent months (figure 17). Gross bond issuance by nonfinancial corporations, both investment and speculative grade, dropped a bit in the quarterly period following a robust second quarter pace; however, speculative grade issuance continues to be relatively strong in the third quarter, reflecting an apparent increase in appetite for risk among investors (figure 18). With declining yields, firms have reportedly used the proceeds of some of the newly issued bonds to pay down shorter-term debt, notably bank loans, which helps to explain, in part, the decline in C&I loans. Gross public equity issuance by nonfinancial firms declined a bit in the third quarter following a robust pace in the second quarter (figure 19). These developments indicate that nonfinancial businesses have taken advantage of some of the easing of financial strains and issued long-term debt and equity to improve their financial positions.

Figure 18

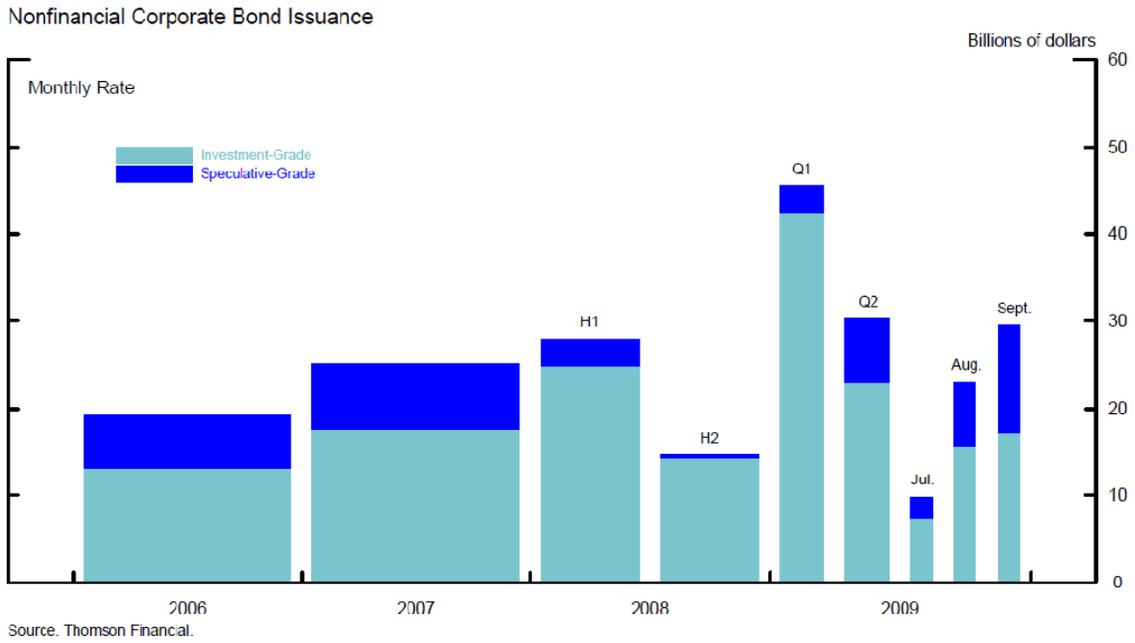
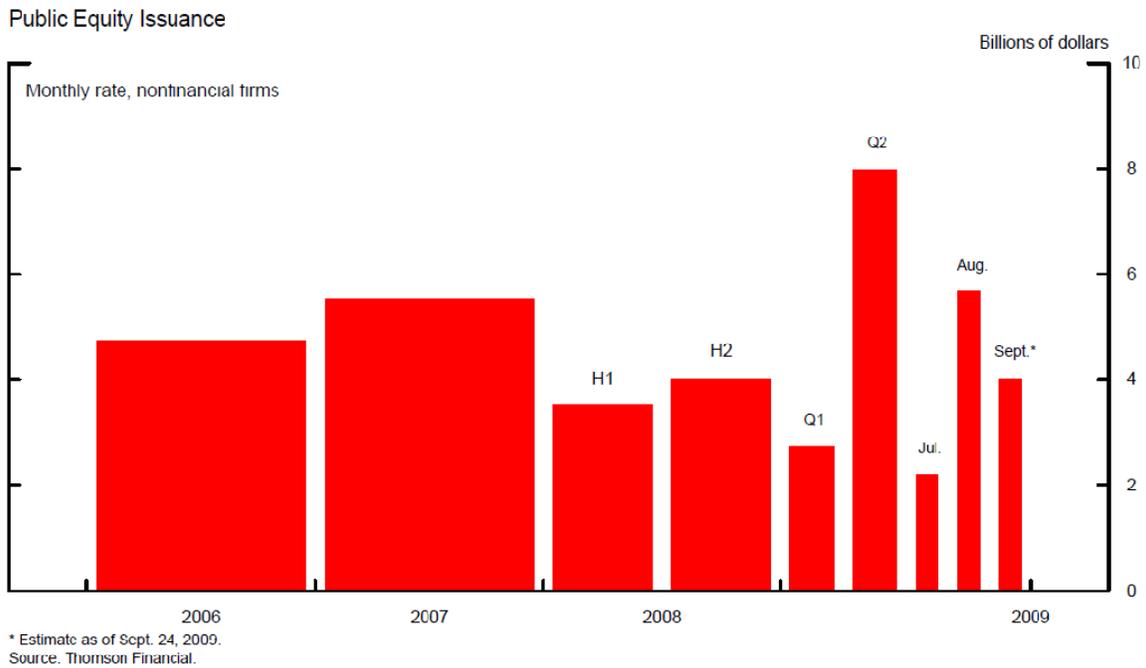


Figure 19



## b. Assessment of the effect of the actions taken by Treasury in stabilizing housing markets

The Oversight Board believes that actions taken by the Treasury under TARP, together with those taken by the Federal Reserve, HUD, and FHFA, continued to aid the housing market and mortgage borrowers during the quarterly period by helping to stabilize the credit markets, implementing efforts to mitigate foreclosures, and aggressively supporting the demand for MBS. Purchases of those securities by the Federal Reserve and Treasury pushed down the spread of the interest rates on 30-year fixed rate mortgages relative to yields on reference Treasury securities. Mortgage-Treasury yield spreads in the last few months were sharply narrower than in late 2008 and early 2009 and mortgage rates are significantly lower (figure 20).

Figure 20



There was significant progress during the quarterly period in foreclosure mitigation efforts under TARP. With program terms and servicer agreements in place, HAMP accelerated the pace at which trial modification offers were extended to qualifying homeowners who could be at risk for foreclosure and for whom a loan modification with a reduced monthly payment appeared to present a lower-cost resolution. By the end of the quarterly period some 757,955 borrowers had been offered trial modifications under HAMP, and 487,081 of these trial plans were underway. Although it is likely too early to see effects of these developments reflected in housing market conditions, the Oversight Board will continue to monitor HAMP's progress and the eventual performance of modified loans (some of which may redefault).

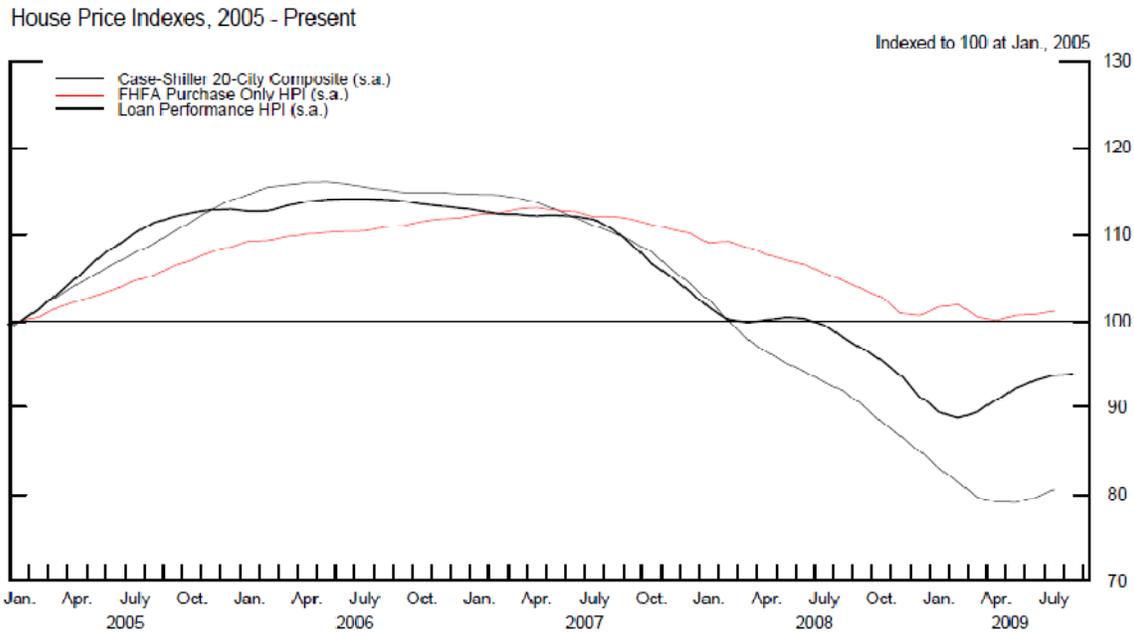
More generally, modestly lower borrowing costs in the quarterly period stimulated applications for refinance mortgages, as reported by the Mortgage Bankers Association, though not in volumes seen earlier this year. The Home Affordable

Refinance Program (a non-TARP program that, like HAMP, reaches directly to homeowners affected by the crisis) facilitates refinancing for non-delinquent borrowers whose loans are owned or guaranteed by Fannie Mae or Freddie Mac and have loan-to-value ratios between 80 and 125 percent. This program started slowly in the spring, as interest rates initially rose and originators needed time to alter systems to process the new loans. Over the past quarter the program has grown more rapidly, reaching nearly 115,000 loans. Recent mortgage rate declines may accelerate that expansion.

For its part, FHA continues to provide substantial support to credit flows in the housing market. After four consecutive quarters with single-family insurance volumes of over \$72 billion, volumes increased in the quarterly period to \$97 billion, which represents nearly 518,000 households. The total number of households served in the quarter was 57 percent higher than in the year-earlier quarter.

Housing markets continue to show signs of stability and even mild revival. Data from the National Association of Realtors and the Census Bureau indicate single-family home sales and housing starts remain well above their lows, while inventory-to-sales ratios have fallen further. The improved conditions are reflected in house price indexes. FHFA's purchase-only index has been generally unchanged since the end of 2008, with a small rise overall through July. The Loan Performance HPI began increasing in March, and the Case-Shiller index has shown two consecutive months of gains (figure 21).

Figure 21

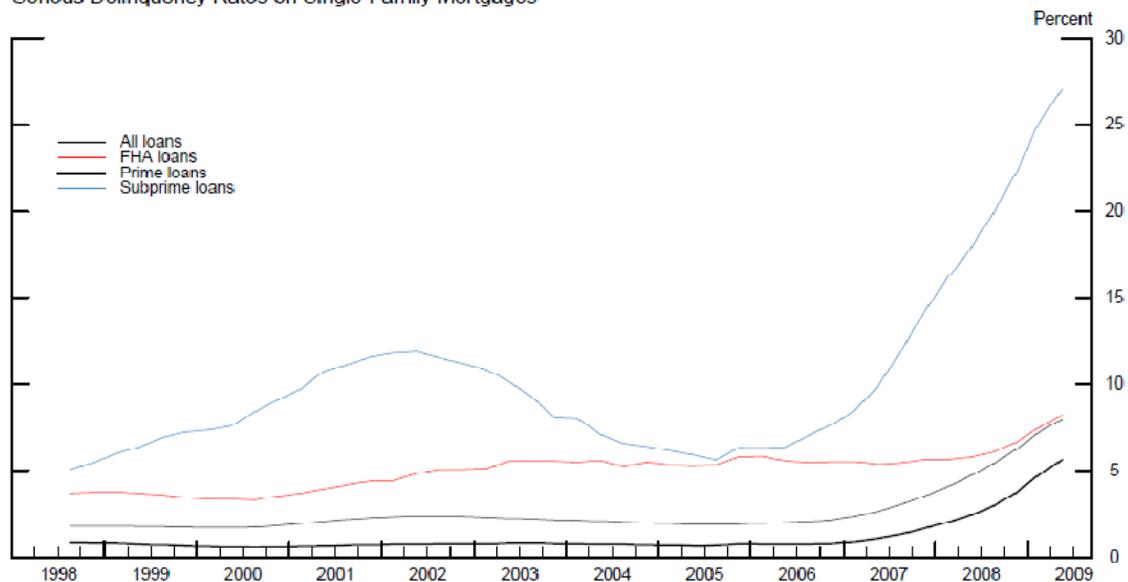


Despite these encouraging indicators, mortgage delinquency rates are still escalating. Fueled by continuing job losses in the broader economy, some 7.8 percent of single-family loans were 90 days overdue or in foreclosure at mid-year (figure 22). While subprime delinquencies are still a major part of the problem, delinquencies on

prime loans represent an increasing share of the total, in part reflecting the rise in unemployment. If not remedied through other means, including HAMP modifications and other TARP programs, these higher delinquencies point to some prospective increase in foreclosures. Trial modifications alone may not immediately affect delinquency totals, even if many individual modifications are ultimately successful in avoiding foreclosures, because delinquent loans operating under trial modifications will continue to be reported as delinquent or in the process of foreclosure during the trial period (HAMP loans are a clear example). Many delinquent loans will not be eligible for modification, however, and the resulting foreclosures may ultimately add significantly to the supply of houses on the market.

Figure 22

Serious Delinquency Rates on Single-Family Mortgages



These same forces have led to an increase in default and foreclosure rates for FHA. At the end of August, the seriously delinquent rate on FHA loans stood at 8.11 percent, having risen rather steadily since September 2008. The in-foreclosure component of the seriously delinquent rate first rose above 1.50 percent last December, and stood at 1.99 percent in August 2009. Insurance claims paid in the first eleven months of FY 2009 (Oct – Aug) are 31 percent above the number of claims paid during the same months of FY 2008.

FHA remains confident in the quality of the new loans it is originating. Borrower credit quality remains high, average FICO scores and incomes among new borrowers have risen significantly over the past year, and refinance loans generally start with more initial equity than do purchase loans. Once again there were virtually no insurance endorsements on loans with seller-funded down-payment assistance in the quarterly period, per a ban on such loans that took effect in October 2008. In addition, FHA reduced the maximum loan-to-value ratio on cash-out refinance loans earlier this year,

which also strengthens the business going forward. FHA 30- and 60-day delinquency rates peaked in November 2008, and have come down measurably since then, again suggesting that FHA insurance claims will peak by the end of 2009 and begin to decline in 2010.

The loss reserves booked by FHA in its FY 2008 financial statements and Management Report assumed that the number of claims paid in FY 2009 would be nearly double the number paid in 2008. Given that they are only up 31 percent from FY 2008 levels, to date, the FHA portfolio in FY 2009 is performing much better than anticipated.

#### **IV. DISCUSSION OF THE ACTIONS TAKEN BY TREASURY UNDER THE EESA DURING THE QUARTERLY PERIOD**

This part provides an overview of the various programs, policies, financial commitments and administrative actions taken by Treasury under the EESA during the quarterly period, subject to the review and oversight of the Oversight Board.

##### **a. Making Home Affordable and the Home Affordable Modification Program**

HAMP is one component of the MHA, which is designed to reduce the number of avoidable foreclosures by modifying mortgage loan agreements so that monthly payments are reduced to affordable levels for American homeowners who are delinquent or at-risk of imminent default on their mortgage payments.<sup>4</sup> HAMP offers “pay-for-success” incentives to borrowers, servicers, lenders, and investors and streamlined guidelines and procedures for first-lien mortgage modification. HAMP also includes an option for modifying second-lien mortgage loans and is developing additional incentives for foreclosure alternatives if modification of the loan is not a viable option. HAMP includes a planned allocation of \$50 billion in TARP funding, in addition to \$25 billion of resources drawn from other authorities.

Under the terms Treasury has established for HAMP, participating servicers must enter into program agreements with Fannie Mae, which is Treasury’s financial agent for the program, on or before December 31, 2009.<sup>5</sup> Borrowers may be accepted into the

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<sup>4</sup> MHA also includes a refinancing component funded outside of TARP that allows homeowners who have loans owned or guaranteed by Freddie Mac and Fannie Mae to refinance through the two institutions over time. The introduction of the MHA was described in the Oversight Board’s quarterly report for the quarter ending March 31, 2009, which is available at:

<http://www.financialstability.gov/docs/FSOB/FINSOB-Qrtly-Rpt-033109.pdf>.

<sup>5</sup> The Oversight Board’s quarterly reports for the quarters ending on March 31 and June 30, 2009 contain more information about these initiatives. Additional details regarding the program also are available at:

<http://www.financialstability.gov/roadtostability/homeowner.html>.

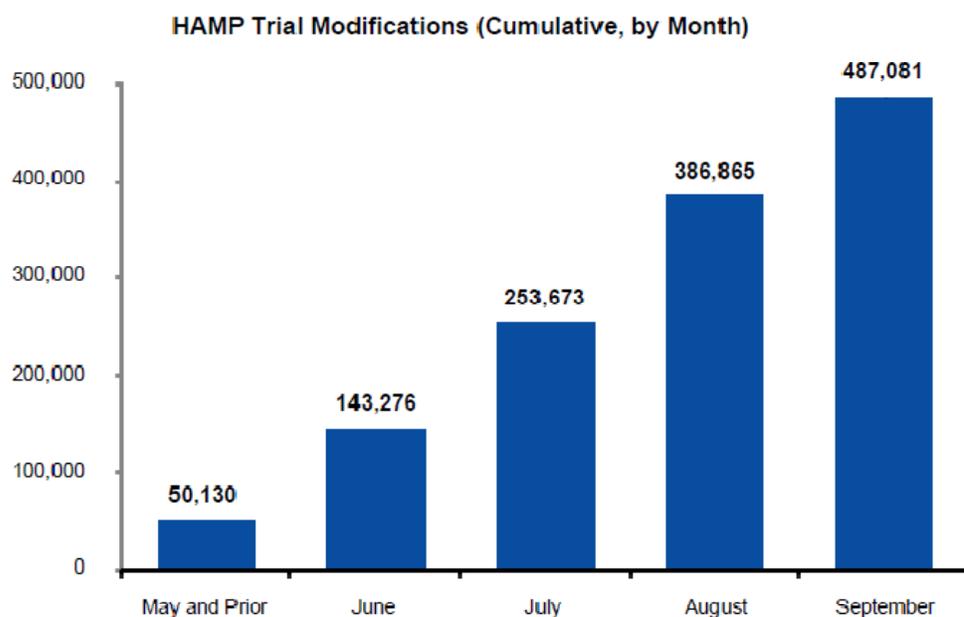
program if a fully executed Home Affordable Modification Trial Period Plan is in the related servicer's possession on or before December 31, 2012. Modifications will continue for five years from the start date of the modification, and incentive payments will continue to be paid out over that period.

*i. Program Updates*

During the quarterly period, Treasury took steps to increase the number of servicers and borrowers participating in HAMP. For example, at a meeting Treasury hosted with participating servicers on July 28, 2009, servicers committed to reaching a cumulative target of 500,000 trial modifications by November 1, 2009. Due to increases in the number of trial modifications initiated under the program since that meeting (figure 23), this goal was achieved shortly after the close of the quarterly period. Participating servicers also have agreed to work with Treasury to implement actions designed to improve program effectiveness, including the streamlining of application documents. During the quarterly period, servicer participation in HAMP increased to 63 servicers and included the 5 largest servicers. Taking account of loans covered by participating servicers and those loans owned or securitized by Fannie Mae and Freddie Mac, more than 85 percent of all first-lien mortgage debt in the United States was covered by HAMP as of September 30, 2009.

During the quarterly period, Treasury also continued its outreach effort to inform at-risk borrowers about their eligibility and options for participation in HAMP. For example, Treasury worked with an interagency team to establish an independent third-party call center for borrowers to reach HUD-approved housing counselors so that they can receive direct information and assistance in applying for the program. Working closely with Fannie Mae, Treasury also has held foreclosure prevention workshops and borrower outreach events in ten cities facing high foreclosure rates. The objective of HAMP remains to provide assistance to for up to some 3 to 4 million homeowners over the program's multi-year life.

Figure 23



Source: Trial and permanent modifications as of September 30, 2009; based on numbers reported by servicers to the HAMP system of record.

*ii. Results of Monthly Servicer Performance Reports*

As part of Treasury's ongoing efforts to ensure transparency and maintain servicer accountability, Treasury released two monthly Servicer Performance Reports during the quarterly period. These reports provided performance results for each participating servicer based on a performance metric measuring trial modification starts as a share of estimated HAMP eligible loans for each individual servicer.<sup>6</sup> The July 2009 Servicer Performance Report showed substantial variation in the performance metric with results varying from a low of 0 percent (for three servicers) to a high of 25 percent (for one servicer). In August, the results were similarly uneven for the performance metric by servicer, ranging from 0 percent (for three servicers) to 39 percent (for one servicer). These results indicated that some servicers have commenced no trial modification starts for any of their HAMP eligible loans, while other servicers have begun to implement trial modification starts for their HAMP eligible loans, denoting an uneven pace of modification starts from servicer-to-servicer. As discussed above, Treasury has taken several steps to increase the participation rate at all participating servicers.

<sup>6</sup> The July Monthly Servicer Performance Report is available at: [http://www.treas.gov/press/releases/docs/MHA\\_public\\_report.pdf](http://www.treas.gov/press/releases/docs/MHA_public_report.pdf).

The August Monthly Servicer Performance Report is available at: [http://www.financialstability.gov/docs/MHA-Public\\_090909.pdf](http://www.financialstability.gov/docs/MHA-Public_090909.pdf).

*iii. “Second Look” Process*

During the quarterly period, Treasury directed Freddie Mac in its role as compliance agent for HAMP to ensure that eligible homeowner applications are not overlooked and that homeowners are not inadvertently denied a modification. Under the program’s guidelines, servicers cannot choose which loans to modify or deny assistance to borrowers but are required to service all eligible loans in their portfolio and make reasonable efforts to obtain waivers of any limits on participation. Freddie Mac is developing a “second look” process to audit a sample of applications which have been denied and ensure that the denials were proper. The “second look” program also evaluates non-performing loan portfolios of participating servicers to identify eligible borrowers that should have been solicited for a modification. Based on the audit results, Freddie Mac is working with servicers, where problems arise, to address deficiencies and work with servicers to make operational improvements where errors in application rejections prove to be systemic.

*iv. Home Price Decline Protection Incentives*

On July 31, 2009, as part of its ongoing effort to expand relief to struggling homeowners, Treasury released a Supplemental Directive for its HPDP program, a component of HAMP. HPDP provides additional incentive payments for modifications on properties located in areas where home prices have recently declined. The purpose of the program is to encourage additional lender participation and HAMP modifications in areas with recent price declines by helping to offset any incremental collateral loss on modifications that do not succeed. HPDP will help to ensure that borrowers in areas with recent home price declines have the opportunity to stay in their homes, thereby minimizing foreclosures, which further depress home values. The HPDP Supplemental Directive released by Treasury in July addresses the following key areas:<sup>7</sup>

- ***Eligibility guidelines for related investors:*** A mortgage loan must have been modified under HAMP for the related investor to be eligible for HPDP incentive payments and HPDP incentive payments will be made only with respect to HAMP modifications with Net Present Value (“NPV”) dates on or after September 1, 2009.<sup>8</sup> However, no incentives of any kind will be paid if: (i) the servicer has not executed a Servicer Participation Agreement to participate in HAMP, (ii) the borrower did not successfully complete the trial period and execute a HAMP modification agreement, or (iii) the HAMP modification did not

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<sup>7</sup> The HPDP Supplemental Directive is available at:  
<http://www.financialstability.gov/docs/press/SupplementalDirective7-31-09.pdf>.

<sup>8</sup> In order to determine eligibility for HAMP, servicers are required to apply a standardized NPV test comparing the net present value of estimated cash flows from a mortgage modified under HAMP with estimated cash flows from the mortgage without modification. If the test is positive, HAMP requires the servicer to modify the loan. Additional details are available in the Oversight Board’s quarterly report for the quarter ending March 31, 2009.

reduce the borrower's monthly mortgage payment by at least six percent. Moreover, HPDP incentive compensation will discontinue if: (i) the borrower loses good standing by missing three payments under HAMP, or (ii) the mortgage loan is paid in full.

- **HPDP Calculation:** HPDP incentive payments will be linked to the rate of recent home price decline in a local housing market, as well as the unpaid principal balance and mark-to-market loan-to-value ratio of the mortgage loan. HPDP incentive payments are calculated by multiplying together the following characteristics of the mortgage loan receiving a HAMP modification:
  - (i) **Home Price Decline Value:** An estimate of the cumulative projected home price decline over the next year, as measured by changes in the home price index over the previous two quarters in the applicable local market (MSA or non-MSA region) in which the related mortgaged property is located and expressed in percentage points;
  - (ii) **Unpaid Principal Balance Quintile Payment:** Based on the unpaid principal balance ("UPB") of the mortgage loan prior to modification under HAMP, the loan is assigned to one of five UPB quintiles which determine the dollar payment per percentage point of projected price decline by UPB; and
  - (iii) **Mark-to-Market Loan-to-Value Ratio Weighting Factor:** The mark-to-market loan-to-value ratio of the mortgage loan based on the UPB of the mortgage loan prior to modification under HAMP.
- **Incentive Payments:** The potential HPDP incentive payable for a HAMP modification will accrue over a two-year period, and an investor will accrue 1/24th of the total HPDP incentive payment for every month in which the borrower remains in good standing. The accrued HPDP incentive payments to the investor will include payments for each trial period month for each trial period completed successfully. HPDP incentive payments will cease to accrue once a borrower loses good standing under HAMP or the mortgage loan is paid in full; however, investors will be entitled to all accrued but unpaid HPDP incentive payments on an annual basis. The amount of funds available to pay HPDP and all other incentive compensation in connection with each servicer's HAMP modifications will be capped pursuant to each servicer's Servicer Participation Agreement, which Treasury will establish based on an estimate of the number of modifications expected to be performed by each servicer during the term of HAMP.

- ***Compliance:*** As compliance agent for HAMP, Freddie Mac will conduct independent compliance assessments of the HPDP.

Treasury has allocated a total of up to \$10 billion for the HPDP program, but the actual amount spent will depend on home price trends. As of September 30, 2009, 63 servicers have begun implementation of the HPDP program.

v. *Second Lien Program*

On August 13, 2009, Treasury released a Supplemental Directive for the Second Lien Modification Program with additional guidance regarding the program's implementation.<sup>9</sup> The program will provide incentives for second-lien holders to modify or extinguish a second-lien mortgage when a modification has been initiated on the first lien mortgage for the same property under HAMP.<sup>10</sup> The Supplemental Directive provides additional guidance to servicers for adoption and implementation of the program for second-liens not owned or guaranteed by Fannie Mae or Freddie Mac.

**b. Legacy Securities Public-Private Investment Program**

The Legacy Securities Public-Private Investment Program, or "S-PPIP," is part of the broader FSP announced by Treasury in February 2009. The S-PPIP is designed to support market functioning and facilitate price discovery in the ABS markets, allowing banks and other financial institutions to re-deploy capital and extend new credit to households and businesses. Under the terms of the program, Treasury will partner with pre-qualified fund managers who will invest in legacy CMBS and non-agency RMBS through a Public-Private Investment Fund ("PPIF") for which the fund manager will serve as general partner and make a minimum equity capital contribution of \$20 million, an amount which cannot exceed 9.9 percent of the total private capital contribution. The fund manager also is responsible for raising a minimum of \$500 million in additional private equity capital from private investors, an investment which Treasury will match subject to a maximum cap. As a result of these investments, Treasury and the private investors will receive equity interests in the fund. Treasury also will provide debt financing up to 100 percent of the total equity of each PPIF.

On July 8, 2009, following a comprehensive two-month application, evaluation and selection process, Treasury pre-qualified nine U.S. headquartered fund managers to participate in the program based, in part, on a demonstrated ability to invest in legacy

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<sup>9</sup> The Supplemental Directive for the Second Lien Program is available at: [https://www.hmpadmin.com/portal/docs/second\\_lien/sd0905.pdf](https://www.hmpadmin.com/portal/docs/second_lien/sd0905.pdf).

<sup>10</sup> Additional details regarding the Second Lien Program are discussed in the Oversight Boards' prior quarterly report, which is available at: <http://www.financialstability.gov/docs/FSOB/FINSOB-Qtly-Rpt-063009.pdf>.

assets and to raise private capital for such investments.<sup>11</sup> Treasury conducted extensive legal, compliance and business due diligence on each pre-qualified S-PPIP fund manager, which included, among other things, in-person management presentations and limited partner reference calls. Most of the fund managers selected by Treasury have established partnerships with small-, minority-, and women-owned businesses involving roles in asset management, capital raising, broker-dealer, investment sourcing, research, advisory, cash management and fund administration services.<sup>12</sup> As of the close of the quarterly period, the nine pre-qualified S-PPIP fund managers had established 10 such partnerships in five different states.

During the quarterly period, Treasury negotiated equity and debt term sheets with the pre-qualified S-PPIP fund managers and made a sample term sheet available to the public.<sup>13</sup> Under these terms, PPIFs may purchase legacy CMBS and non-agency RMBS issued prior to January 1, 2009, which originally received a AAA-rating, or an equivalent rating, by two or more Nationally Recognized Statistical Rating Organizations (“NRSROs”) without ratings enhancement and that are secured directly by actual mortgage loans, leases, or other assets and not other securities. At least 90 percent of the underlying loans and other assets must be situated in the United States. PPIFs can purchase these assets from financial institutions eligible to sell troubled assets to Treasury under TARP.<sup>14</sup>

At the initial closing of a PPIF, the fund manager may elect to receive debt financing from Treasury in an aggregate amount of up to either 50 percent (“half-turn election”) or 100 percent (“full-turn election”) of a fund’s total committed capital (including that provided by Treasury and the private investors). Treasury’s senior debt will be evidenced by a note and will receive interest at an annual rate specified by the terms and secured by the assets purchased by the fund, as well as other forms of acceptable collateral. If the fund elects a half-turn election, other sources of debt financing can be utilized, subject to maximum leverage limits.

Treasury expects to provide up to \$30 billion in equity and debt capital to the PPIFs formed by these nine fund managers for the purposes of investing in legacy

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<sup>11</sup> Additional details regarding the fund manager selection criteria used by Treasury under the S-PPIP are discussed in the Oversight Boards’ prior quarterly report, which is available at: <http://www.financialstability.gov/docs/FSOB/FINSOB-Qrtly-Rpt-063009.pdf>.

<sup>12</sup> A complete list of the small-, minority-, and women-owned financial services businesses involved in those partnerships is available at: [http://www.financialstability.gov/latest/tg\\_07082009.html](http://www.financialstability.gov/latest/tg_07082009.html).

<sup>13</sup> The equity and debt term sheets for the S-PPIP are available at: [http://www.financialstability.gov/docs/S-PPIP\\_LOI\\_Term-Sheets.pdf](http://www.financialstability.gov/docs/S-PPIP_LOI_Term-Sheets.pdf).

<sup>14</sup> See section 101(a)(1) of EESA (12 U.S.C. § 5211(a)(1)).

securities as part of the initial phase of the S-PPIP. As of the close of the quarterly period, two PPIFs had completed initial closings, each with at least \$500 million of committed equity capital from private investors. Treasury expects the remaining initial closings to occur throughout October 2009. Following an initial closing, each fund manager will have up to six months to raise additional private capital to receive the full allocation of the \$3.3 billion in matching equity and debt capital from Treasury.

To protect taxpayers, rigorous disclosure requirements and conflict of interest provisions established by the Public-Private Improvement and Oversight Act of 2009 pertain to these funds.<sup>15</sup> Due to the potential for actual or potential conflicts of interest, which are inherent in any market-based investment program, Treasury has worked very closely with the SIGTARP and others, including the Federal Reserve, to develop robust conflict of interest and compliance rules and a process for ensuring adherence to these rules.<sup>16</sup>

### **c. The Capital Programs**

The CPP is the largest and most significant financial stability program Treasury has established under EESA. The CPP, together with the Capital Assistance Program (“CAP”) and the SCAP are collectively referred to as the “capital programs”. These programs recognize that broad economic recovery is not possible without reviving confidence in the strength of the U.S. financial system. An update on the developments which occurred during the quarterly period with respect to these programs is provided below.

#### *i. Update on the Capital Purchase Program*

The CPP was established by Treasury in October 2008 to address severely deteriorated conditions in credit markets and to stabilize the financial system by providing capital to a broad range of viable U.S. financial institutions. Under the CPP, Treasury has purchased senior preferred shares from a variety of publicly-traded and private institutions. Treasury also has purchased subordinated debentures from institutions that have elected to be taxed under Subchapter S of Chapter 1 of the Internal Revenue Code (“S-Corps”), and certain institutions organized in mutual form. In connection with each investment, Treasury receives warrants to purchase common equity, additional preferred shares or additional subordinated debentures, allowing taxpayers to participate in the “upside” of an institution’s recovery. The preferred equity provides dividends of 5 percent per year for the first five years and 9 percent thereafter. The subordinated debentures pay an equivalent rate of 7.7 percent per year, with a step up to

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<sup>15</sup> See section 402 of the Helping Families Save Their Homes Act of 2009 (12 U.S.C. § 5231a)

<sup>16</sup> Additional details on the S-PPIP compliance regime and other terms and conditions applicable to the fund managers are provide in the Limited Partnership Agreement, which is available at: <http://www.financialstability.gov/roadtostability/publicprivatefund.html>. .

13.8 percent after five years. Currently, Treasury only is accepting applications under the CPP from small banks.<sup>17</sup> Since the CPP was announced in October 2008, \$204.62 billion has been disbursed to 685 institutions under the program. During the quarterly period, Treasury invested \$1.42 billion in 37 banks through the CPP.<sup>18</sup>

*ii. Repayment of CPP Investment, Dividends on CPP Investments, and Withdrawals of CPP applications.*

An institution may repay its CPP investment to Treasury under the terms of the Securities Purchase Agreement, which applies to all CPP participants, subject to section 7001 of the American Economic and Recovery Act (“ARRA”), which requires the Secretary to consult with the appropriate Federal Banking Agency (“FBA”) of any qualified financial institution (“QFI”) seeking to repay any investment provided under the CPP. In order to redeem a CPP investment, a financial institution must first obtain approval from its primary FBA, which then forwards approved applications to Treasury.<sup>19</sup> After the CPP capital is repaid, the QFI can opt to repurchase any other equity securities of the QFI held by Treasury, including warrants.

As of September 30, 2009, Treasury has received more than \$6.8 billion in dividends, interest, and fees under the program and \$70.72 billion in total repayments. Treasury also has received \$2.9 billion in warrant proceeds, which includes proceeds from the repurchase of shares Treasury received through the exercise of warrants. For those banks that have elected not to repurchase their warrants, Treasury intends to begin auctioning those warrants later in 2009. During the quarterly period, over 50 institutions withdrew their CPP applications, bringing the total number of withdrawals under the program to more than 530 since the program was announced in October 2008.

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<sup>17</sup> As noted in Oversight Board’s previous quarterly report, in May 2009, Treasury announced the re-opening and expansion of the CPP with new terms to support small and community banks. The application deadline for small institutions under the reopened and expanded CPP program is November 21, 2009.

<sup>18</sup> Additional details on the Capital Purchase Program are available at: <http://www.financialstability.gov/roadtostability/capitalpurchaseprogram.html>.

<sup>19</sup> The terms and conditions for repayment are described in the Oversight Board’s prior quarterly report, which is available at: <http://www.financialstability.gov/docs/FSOB/FINSOB-Qtly-Rpt-063009.pdf>.

*iii. Update on the Capital Assistance Program and the Supervisory Capital Assessment Program*

Beginning in the first quarter of 2009, the Federal Reserve, in conjunction with other FBAs, engaged in a comprehensive forward-looking Supervisory Capital Assessment Program (“SCAP” or “stress test”) of the 19 largest U.S. bank holding companies (“BHCs”). The primary purpose of the stress test was to determine how much of an additional capital buffer, if any, each of the 19 largest BHCs, which hold two-thirds of the assets in the U.S. banking system, would need to establish to ensure that they could withstand losses and continue lending in 2009 and 2010, even in a more challenging economic environment than was projected for those years. In designing the stress test, the FBAs applied a historically high set of loss estimates on securities and loans, as well as a conservative view towards potential earnings that could act as a buffer against those losses.

The results of the stress test, which were considered by the Oversight Board, were made public in May 2009, a highly unusual step taken to reduce uncertainty and restore confidence. When combined with the losses already recognized by the firms participating in the SCAP since mid-2007, the results of the stress test indicated that losses at the 19 largest BHCs could total nearly \$950 billion by the end of 2010, if the economy were to follow a deeper-than-expected recession. After taking account of losses, revenues and loan loss reserves needs, in the aggregate, the FBAs concluded that these firms needed to add \$185 billion to their capital buffers to reach the target SCAP capital buffer at the end of 2010 under the more adverse economic scenario. Specifically, 10 of the 19 largest BHCs needed to increase their capital buffers by approximately \$75 billion.

Following the release of the SCAP results, the 19 participating BHCs were able to raise more than \$61 billion of common equity through public offerings and \$69 billion of non-TLGP debt. While each BHC participating in the SCAP was encouraged to raise any needed capital from private investors, Treasury also offered a backstop through the CAP, which provides eligible banking organizations with capital in the form of a preferred security that is convertible to common equity. As of the close of the quarterly period, Treasury has not funded any investments through the CAP.

*iv. Update on Bank Lending Surveys*

Each month, Treasury asks banks participating in the CPP to provide information about their lending activities and publishes the results in two reports, referred to as the Monthly Lending and Intermediation Snapshot (the “Snapshot”) and the Monthly Lending Report. These two reports are intended to help the public easily assess the lending and intermediation activities of participating banks. During the quarterly period, Treasury released three new Snapshots and three Monthly Lending Reports, covering the period from May through July 2009.

*(a) Monthly Lending and Intermediation Snapshots*

Treasury’s monthly Snapshot provides data on the lending and other intermediation activities for the 22 largest financial institutions that received TARP investments under the CPP.<sup>20</sup> In October, Treasury released the following information on August lending—

- The overall outstanding loan balance (of all respondents) fell one percent from July to August at the top 22 participants in the CPP, due mainly to decreased demand from borrowers, payment of outstanding debt, charge-offs by banks, and some seasonal patterns.
- Total origination of new loans at the 22 surveyed institutions decreased seventeen percent from July to August. In August, the 22 surveyed institutions originated approximately \$235 billion in new loans. Total originations of loans by all respondents rose in one category (other consumer lending products – caused by “Cash for Clunkers” and student loans), and fell in the other seven loan categories.

*(b) CPP Monthly Lending Report*

Treasury’s Monthly Lending Report provides data on consumer lending, commercial lending, and total lending for all CPP participants.<sup>21</sup> The chart in Figure 24 summarizes total loan activity among CPP participants.

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<sup>20</sup> In July 2009, the Hartford Financial Service Group began reporting Snapshot information to Treasury, which included results from April 2009 to June 2009, thereby increasing the total number of institutions covered by the Snapshot to 22 institutions.

<sup>21</sup> Additional details on Treasury’s Bank Lending Surveys are available at: <http://www.financialstability.gov/impact/surveys.htm>.

Figure 24

Summary of CPP Monthly Lending Report Data (5 millions)				
All CPP recipients (excluding top 22)*				
Date	Number of Respondents*	Total Average Consumer Loans	Total Average Commercial Loans	Total Average Total Loans
2/28/2009	498	\$285,063	\$574,601	\$859,664
3/31/2009	532	\$283,966	\$580,571	\$864,537
4/30/2009	519	\$267,074	\$563,500	\$830,574
5/31/2009	590	\$268,227	\$580,922	\$849,149
6/30/2009	582	\$258,721	\$688,117	\$946,838
7/31/2009	587	\$272,382	\$628,993	\$901,375
7/31/2009 (Adjusted)	580	\$266,616	\$619,318	\$885,934
8/31/2009	607	\$270,831	\$631,841	\$902,672
8/31/2009 (Adjusted)	580	\$265,379	\$618,942	\$884,321
Change (July Adjusted to August Adjusted)		-0.46%	-0.06%	-0.18%
Top 22 CPP Recipients				
Date	Number of Respondents	Total Average Consumer Loans	Total Average Commercial Loans	Total Average Total Loans
2/28/2009	21	\$2,612,968	\$1,806,091	\$4,419,059
3/31/2009	21	\$2,601,696	\$1,778,446	\$4,380,142
4/30/2009	22	\$2,585,627	\$1,766,037	\$4,351,665
5/31/2009	22	\$2,575,301	\$1,765,699	\$4,341,000
6/30/2009	22	\$2,553,504	\$1,741,814	\$4,295,318
7/31/2009	22	\$2,531,032	\$1,719,149	\$4,250,181
8/31/2009	22	\$2,514,781	\$1,691,557	\$4,206,338
Change (July to August)		-0.64%	-1.60%	-1.03%
All CPP Recipients*				
Date	Number of Respondents*	Total Average Consumer Loans	Total Average Commercial Loans	Total Average Total Loans
2/28/2009	519	\$2,898,031	\$2,380,692	\$5,278,723
3/31/2009	553	\$2,885,662	\$2,359,017	\$5,244,679
4/30/2009	541	\$2,852,651	\$2,329,537	\$5,182,189
5/31/2009	612	\$2,843,528	\$2,346,621	\$5,190,149
6/30/2009	604	\$2,812,225	\$2,429,931	\$5,242,156
7/31/2009	609	\$2,803,414	\$2,339,348	\$5,142,762
7/31/2009 (Adjusted)	602	\$2,797,648	\$2,338,467	\$5,136,115
8/31/2009	629	\$2,785,612	\$2,323,398	\$5,109,010
8/31/2009 (Adjusted)	602	\$2,780,160	\$2,310,499	\$5,090,659
Change (July Adjusted to August Adjusted)		-0.63%	-1.20%	-0.89%

\* See attached "reporting groups" table

CPP Monthly Lending Report: Reporting Groups

Date	Data	Includes	Excludes*
2/28/2009	2/28/09 data received by 7/31/09	Institutions that were funded on or before 4/30/09	Institutions that repaid CPP funds on or before 4/30/09
3/31/2009	3/31/09 data received by 7/31/09	Institutions that were funded on or before 5/31/09	Institutions that repaid CPP funds on or before 4/30/09
4/30/2009	4/30/09 data received by 7/31/09	Institutions that were funded on or before 6/30/09	Institutions that repaid CPP funds on or before 5/31/09
5/31/2009	5/31/09 data received by 7/31/09	Institutions that were funded on or before 6/30/09	Institutions that repaid CPP funds on or before 6/30/09
6/30/2009	6/30/09 data received by 7/31/09	Institutions that were funded on or before 7/31/09	Institutions that repaid CPP funds on or before 7/31/09
7/31/2009	7/31/09 data received by 8/31/09	Institutions that were funded on or before 8/31/09	Institutions that repaid CPP funds on or before 8/31/09
7/31/2009 (Adjusted)	7/31/09 data received by 8/31/09	Institutions that reported both 7/31/09 data and 8/31/09 data (using consistent reporting methodology)	Institutions that did not report both 7/31/09 data and 8/31/09 data (using consistent reporting methodology)
8/31/2009	8/31/09 data received by 9/30/09	Institutions that were funded on or before 9/30/09	Institutions that repaid CPP funds on or before 9/30/09
8/31/2009 (Adjusted)	8/31/09 data received by 9/30/09	Institutions that reported both 7/31/09 data and 8/31/09 data (using consistent reporting methodology)	Institutions that did not report both 7/31/09 data and 8/31/09 data (using consistent reporting methodology)

\* All reporting groups exclude institutions that did not submit a conforming CPP Monthly Lending Report by the reporting deadline.

*(c) The Quarterly Capital Purchase Program Report*

To understand better how the CPP and other initiatives launched by the Treasury may have effected financial institutions and their activities, an interagency group was formed to determine and conduct appropriate analyses. This interagency group consists of representatives from Treasury, the Federal Reserve Board and other FBAs. In August, Treasury released the first Quarterly Analysis of Institutions in the CPP for the first quarter of 2009, which was undertaken by this interagency group (the “Quarterly CPP Report”).

The Quarterly CPP report analyzes the financial data submitted by depository institutions to their primary federal regulator in Call Reports and Thrift Financial Reports, as well as the Y-9C Reports submitted by large BHCs each quarter to the Federal Reserve with consolidated financial data. The report distinguishes between the 21 largest CPP participants as of March 2009; CPP participants that received funds in the fourth quarter of 2008; CPP participants that received funds in the first quarter of 2009; and the remaining institutions who also submitted reports, but were not participants in the CPP as of the end of March 2009. In the future, Treasury also intends to publish an analysis along with its results from the Quarterly CPP Report. Beginning in October, Treasury will expand the report in response to suggestions from SIGTARP for reporting on use of funds.<sup>22</sup>

**d. Term Asset-Backed Securities Loan Facility**

TALF, which was announced by the Federal Reserve and Treasury in November 2008, helps market participants meet the credit needs of households and businesses by lending to investors in highly rated ABS and CMBS. Under TALF, the Federal Reserve provides non-recourse funding to any eligible borrower owning eligible collateral, including ABS backed by TALF auto loans, student loans, credit card loans, equipment loans, floorplan loans, insurance premium finance loans, loans guaranteed by the Small Business Administration (“SBA”), residential mortgage servicing advances, or commercial mortgage loans. On fixed days each month, borrowers can request one or more three-year or, in certain cases, five-year TALF loans. If the borrower does not repay the loan, the Federal Reserve will enforce its rights to the collateral and sell the collateral to a special purpose vehicle (“SPV”) established specifically for the purpose of purchasing and managing such assets. Treasury provides a subordinated loan to the SPV but does not directly provide loans to TALF borrowers.<sup>23</sup>

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<sup>22</sup> Additional details on the Quarterly Capital Purchase Program Reports are available at: <http://www.financialstability.gov/impact/CPPreport.html>.

<sup>23</sup> Detailed terms and conditions for TALF are made available on the website of the Federal Reserve Bank of New York at: <http://www.newyorkfed.org/markets/talf.html>.

During the quarterly period, several updates were announced in connection with TALF. The Federal Reserve announced, on August 17, 2009, that no additional asset classes would be added as eligible collateral under TALF and that TALF will be extended through March 31, 2010, for newly-issued ABS and legacy CMBS, and through June 30, 2010, for newly issued CMBS. The Federal Reserve had previously authorized making TALF loans only through December 31, 2009.

During the quarterly period, the Federal Reserve also considered two changes to the procedures for evaluating ABS pledged to TALF, which were announced on October 5, 2009. First, the Federal Reserve announced a proposed rule that would establish criteria for the Federal Reserve Bank of New York to determine the NRSROs whose ratings are accepted for determining the eligibility of ABS to be pledged as collateral under TALF. The proposed rule would require, among other things, that an NRSRO have a certain minimum level of experience in rating deals of any particular type, and would likely result in an expansion of TALF-eligible NRSROs for ABS.<sup>24</sup> Second, the Federal Reserve announced a change to the collateral review process, beginning with the November subscription, that is designed to enhance the Federal Reserve's ability to ensure that TALF collateral complies with its existing high standards for credit quality, transparency, and simplicity of structure. Under this change, in addition to continuing to require that collateral for TALF loans receive two AAA ratings from TALF-eligible NRSROs, the Federal Reserve will conduct a formal risk assessment of all ABS proposed as collateral, in addition to CMBS, which are already subject to a formal risk assessment. To facilitate the risk assessment, each issuer wishing to bring a TALF-eligible ABS transaction to market will be required to provide, at least three weeks prior to the subscription date, information including, but not limited to, all data on the transaction the issuer has provided to any NRSRO.<sup>25</sup>

As of September 30, 2009, there have been a total of \$79.6 billion of TALF-eligible ABS new issuances in the capital markets. Of that total, as of September 30, 2009, approximately 55 percent or \$46.5 billion has been financed using TALF loans. TALF had six subscriptions during the quarterly period, three for CMBS and three for ABS collateral. For ABS operations, subscriptions were held on July 7, August 6, and September 3, during which \$5.4 billion, \$6.8 billion and \$6.5 billion in TALF loans were requested respectively, reflecting a nearly constant rate of ABS TALF loan requests during the quarterly period. TALF loans extended during the quarterly period supported the issuance of 54 percent of all TALF-eligible ABS.

During the October TALF subscription, which occurred immediately following the close of the quarterly period, \$6.6 billion in ABS was brought to market, supported by only \$1.6 billion in TALF lending. The steady increase in the share of ABS that is

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<sup>24</sup> Additional details regarding the Federal Reserve's proposed rule are available at: <http://www.federalreserve.gov/newsevents/press/monetary/monetary20091005b1.pdf>.

<sup>25</sup> Additional details regarding the Federal Reserve's risk assessment are available at: [http://www.ny.frb.org/markets/talf/Risk\\_Assessment\\_Principles.pdf](http://www.ny.frb.org/markets/talf/Risk_Assessment_Principles.pdf).

financed by cash during TALF subscriptions illustrates the continued recovery of the ABS market. Moreover, a variety of issuers sold non-TALF deals in recent weeks outside of TALF subscriptions. Another \$0.9 billion in lending in October was backed by seasoned ABS including \$0.3 billion for ABS guaranteed by the SBA, a new high. Although TALF lending against SBA ABS makes up a fairly small part of TALF lending, market participants have reported that the inclusion of SBA ABS in the program has contributed to investor interest in the asset class. In addition, many types of ABS eligible for TALF financing are backed by loans to small businesses. As of September, in total nearly 400,000 loans to small businesses were supported in part by TALF financing, which includes only about 5,500 SBA loans. Nearly 3 million loans to households, excluding credit card loans, were financed in part through TALF.

The July 2009 subscription for CMBS was the first subscription for eligible legacy CMBS and only the second CMBS subscription held.<sup>26</sup> In July, \$669 million in TALF loans backed by legacy CMBS were requested. At the CMBS subscriptions in August and September, the amount of loans requested backed by legacy CMBS increased substantially to \$2.3 billion for the August 20, 2009, subscription and \$1.4 billion for the September 17, 2009, subscription. Newly-issued CMBS loans were not requested at any of the subscriptions during the quarterly period. Overall, \$4.4 billion in TALF loans backed by eligible legacy CMBS have been requested during the quarterly period.

#### **e. Targeted Investment Program and Asset Guarantee Program**

The TIP and the AGP are exceptional assistance programs established by Treasury, during the fourth quarter of 2008, to prevent a loss of confidence in systemically important financial institutions, which could result in significant financial market disruptions, threaten the financial strength of similarly situated financial institutions, impair broader financial markets, and undermine the overall economy. TIP provides Treasury with the necessary flexibility to provide additional or new funding to financial institutions that are critical to the functioning of the financial system. As with the TIP, the AGP is aimed at maintaining the stability of systemically important financial institutions by providing guarantees against unexpectedly large credit losses on certain assets held by QFIs on their balance sheets. During the quarterly period, several updates were announced in connection with the TIP and AGP.

##### *i. Update on Citigroup*

On November 23, 2008, Treasury agreed to acquire \$20 billion of preferred shares of Citigroup and related warrants under the TIP. The preferred shares carry dividend rates of 8 percent per annum. This TIP investment is in addition to the \$25 billion of preferred stock of Citigroup that Treasury acquired under the CPP in October 2008. In addition, Treasury, the FDIC and the Federal Reserve agreed to provide Citigroup with certain loss protection and liquidity supports with respect to a designated asset pool of up

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<sup>26</sup> No loans were requested for the first CMBS subscription held in June for which only newly-issued CMBS were eligible.

to \$301 billion of loans and securities backed by residential and commercial real estate and other assets.

In December 2008, Treasury consummated its acquisition of the additional preferred shares and related warrants of Citigroup under the TIP and, in January 2009, announced finalization of the terms of the loss protection arrangements with Citigroup under the AGP. Subsequently, on February 27, 2009, Treasury announced that it would participate in a planned exchange offering announced by Citigroup to bolster Citigroup's tangible common equity capital (a key financial metric), thus improving its ability to withstand ongoing market turbulence without requiring any new commitment of TARP funds.<sup>27</sup>

In July 2009, Treasury exchanged a total of \$25 billion of the cumulative perpetual preferred stock Treasury had acquired under the CPP. As of September 11, 2009, Treasury had converted these shares into 7,692,307,692 of common shares in Citigroup. Treasury also has exchanged all of the Citigroup cumulative perpetual preferred stock it received under the TIP and AGP on a "dollar for dollar" basis for \$24 billion of trust preferred securities of greater structural seniority, which pay the same 8 percent interest.

*ii. Update on Bank of America*

On January 15, 2009, Treasury, the Federal Reserve and the FDIC agreed to provide Bank of America Corporation ("Bank of America") with a package of capital, liquidity access, and loss-sharing protection on a designated pool of more than \$118 billion in assets. As part of this transaction, Treasury acquired \$20 billion of preferred shares of Bank of America and related warrants under the TIP, which supplemented the \$25 billion of preferred shares Treasury received from Bank of America under the CPP in October 2008.<sup>28</sup>

On May 6, 2009, Bank of America formally requested to withdraw from the liquidity and loss-protection portions of the agreements entered into in January 2009. On, September 21, 2009, following completion of the SCAP and associated capital raises by Bank of America, an agreement was entered into with Bank of America under which

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<sup>27</sup> The terms of this exchange are discussed in the Oversight Board quarterly report for the quarter ending March 31, 2009, which is available at: <http://www.financialstability.gov/docs/FSOB/FINSOB-Qtly-Rpt-033109.pdf>.

<sup>28</sup> As part of the CPP, on October 28, Treasury acquired \$15 billion of preferred stock of Bank of America and committed to purchase \$10 billion of preferred stock of Merrill Lynch; with the settlement deferred pending completion of the firm's planned acquisition by Bank of America, which was consummated on January 1, 2009. Additional details regarding this investment are provided in the Oversight Board's quarterly report for the quarter ending March 31, 2009, which is available at: <http://www.financialstability.gov/docs/FSOB/FINSOB-Qtly-Rpt-033109.pdf>.

the term sheet previously entered into between Treasury, the Federal Reserve and the FDIC, with respect to the designated pool of \$118 billion in assets, was terminated. In connection with this termination, Bank of America agreed to pay a \$425 million termination fee to Treasury, the Federal Reserve and the FDIC. The termination fee is based on (1) the Federal Reserve's pro-rated loan commitment fee plus expenses (\$57 million); (2) the pro-rated \$4 billion preferred stock that Treasury and FDIC were to receive under the arrangement (\$159 million); (3) the foregone dividends of 8 percent to be received on those preferred shares (\$69 million); and (4) the warrants to purchase common stock that Treasury and FDIC were to receive (\$140 million). The termination fee was pro-rated for the first three components for the period between January 16 and May 6, 2009, compared to the original expected life of 5.4 years. The fee was also adjusted to reflect the removal of certain assets from the portfolio after January 15 due to eligibility filters and disputes with the bank regarding the quality of loss coverage for certain remaining assets.

**f. American International Group, Inc.**

Since September 2008, the Federal Reserve and Treasury have taken a series of actions related to AIG in order to promote financial stability, a necessary prerequisite to the resumption of economic growth. These measures focused on addressing the liquidity and capital needs of AIG, thereby helping to stabilize the company and prevent a disorderly failure, which would have severely disrupted financial markets and contributed to a further worsening of economic conditions.<sup>29</sup>

As part of these actions, in November 2008, Treasury purchased \$40 billion in preferred stock from AIG. The preferred stock pays a dividend of 10 percent per year. In April 2009, Treasury also created an equity capital facility, under which AIG may draw up to \$29.8 billion as needed in exchange for issuing additional preferred stock to Treasury. As of September 30, 2009, AIG has drawn \$3.2 billion from the facility. Treasury does not have voting rights except in certain limited circumstances (such as amendments to the charter) or in the event dividends are not paid for four quarters, in which case Treasury has the right to elect up to three directors to the board.

On August 7, 2009, AIG reported its first quarterly profit since the third quarter of 2007, as certain of its businesses stabilized and the company's results reflected positive valuation changes. During the quarterly period, AIG entered into several agreements to sell or complete the sale of certain operations and assets. Noteworthy asset divestiture transactions in July 2009 included: the sale of 21st Century Insurance Group for \$1.9 billion; the sale of a majority of the U.S. life insurance premium finance business of AIG Credit Corp. and A.I. Credit Consumer Discount Company for approximately \$679.5 million; and the combination of AIG's consumer finance business in Poland into the Polish consumer finance business of Santander Consumer Finance S.A. ("SCB") in exchange for a 30 percent equity interest in SCB. In August 2009, AIG announced that it

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<sup>29</sup> For a discussion of this restructuring, see the Oversight Board's quarterly report for the quarter ending December 31, 2008, which is available at: <http://www.financialstability.gov/docs/FSOB/FINSOBQrtly-Rpt-123108.pdf>.

had entered into an agreement to sell 100 percent of its shares of AIG Finance (Hong Kong) Limited to China Construction Bank Asia for \$70 million in cash, subject to typical closing adjustments, plus the repayment of intra-group indebtedness and deposits of approximately \$557 million in U.S. dollars.

AIG's Financial Products business unit ("AIGFP") continues to engage in a multi-step process designed to unwind its businesses and portfolios. In connection with this process, certain assets have been sold, or are under contract to be sold. For example, on August 11, 2009, AIG announced that AIGFP completed the sale of its energy and infrastructure investment assets, realizing aggregate net proceeds in excess of \$1.9 billion. The proceeds from these sales will be used to fund AIGFP's wind-down.

AIG also underwent several management changes during the quarterly period. For example, On August 4, 2009, AIG announced that its Board of Directors had elected Robert H. Benmosche President and Chief Executive Officer following the retirement of Chairman and Chief Executive Officer Edward M. Liddy. On August 6, 2009, AIG announced that its Board of Directors had elected AIG Director Harvey Golub Non-Executive Chairman of the Board also following Mr. Liddy's retirement.

**g. Automotive Industry Financing Program**

Treasury created the AIFP, in December 2008, to prevent a significant disruption of the U.S. automotive industry because of the risk such a disruption could pose to financial market stability and the U.S. economy. The loans and other sources of funding provided by Treasury under the program have helped GM and Chrysler to become leaner and more efficient companies.

Under the AIFP, Treasury has provided approximately \$76 billion in loans and equity investments to GM, GMAC, Chrysler, and Chrysler Financial. Short-term funding was initially provided to GM and Chrysler on the condition that they develop plans to achieve long-term viability. In cooperation with Treasury's auto team, GM and Chrysler developed satisfactory viability plans and successfully conducted bankruptcy proceeding sales of their assets to new entities. Chrysler's sale process was completed in 42 days and GM's was completed in 40 days. Treasury provided additional financial assistance during these respective periods. Subsequently, on July 13, 2009, Treasury announced the scaling back of the auto team's involvement in the auto industry.

*i. Update on Chrysler*

On January 2, 2009, Treasury provided a \$4 billion loan to Chrysler to give the company time to implement a viable restructuring plan. On March 30, the Auto Task Force and the National Economic Council determined that the business plan submitted by Chrysler failed to demonstrate viability and announced that in order for Chrysler to receive additional taxpayer funds, it needed to find a partner with whom it could establish a successful alliance. Chrysler made the determination that forming an alliance with Fiat was the best course of action for its stakeholders. Treasury continued to support Chrysler as it formed an alliance with Fiat. In connection with Chrysler's bankruptcy proceedings

filed on April 30, 2009, Treasury provided an additional \$1.9 billion under a debtor-in-possession (“DIP”) financing agreement to assist Chrysler in an orderly restructuring.

On June 10, 2009, pursuant to a court-approved order, substantially all of Chrysler’s assets were sold to New Chrysler. Treasury committed to loan \$6.6 billion to New Chrysler in working capital funding, and, as of September 30, 2009, New Chrysler has drawn \$4.6 billion of this amount. New Chrysler also assumed \$500 million of old Chrysler’s initial loans from Treasury. When the sale to New Chrysler was completed, Treasury acquired the rights to 9.9 percent of the common equity in New Chrysler.

The original loans made by Treasury to old Chrysler remain outstanding and are in default (less than \$500 million of that debt that was assumed by New Chrysler). In July 2009, old Chrysler agreed to pay the greater of \$1.375 billion or 40 percent of the equity value of Chrysler Financial to Treasury should old Chrysler receive certain distributions from Chrysler Financial and Treasury agreed to certain forbearance with respect to old Chrysler’s loans.

As of September 30, 2009, Treasury owned 9.9 percent of the equity in New Chrysler and has \$5.1 billion of loans outstanding to New Chrysler. Current equity ownership in New Chrysler is as follows: the Chrysler Voluntary Employee Benefit Association (“VEBA”) (67.7 percent), Fiat (20 percent), Treasury (9.9 percent) and the Government of Canada (2.5 percent).

*ii. Update on Chrysler Financial*

On January 16, 2009, Treasury announced that it would lend up to \$1.5 billion to a special purpose vehicle created by Chrysler Financial to enable Chrysler Financial to finance the purchase of Chrysler vehicles by consumers. To satisfy the EESA warrant requirement, the special purpose vehicle created by Chrysler Financial issued additional notes entitling Treasury to an amount equal to five percent of the maximum loan amount. Twenty percent of those notes vested upon the closing of the transaction, and additional notes were to vest on each anniversary of the transaction closing date. The loan was fully drawn by April 9, 2009. On July 14, 2009, Chrysler Financial fully repaid the loan, including the vested additional notes and interest.

*iii. Update on General Motors*

On December 31, 2008, Treasury established a \$13.4 billion facility to provide GM with working capital. Under the terms of the loan agreement, GM also was required to implement a viable restructuring plan by March 30, 2009. The first plan GM submitted failed to establish a credible path to viability, and the deadline was extended to June 1, 2009. Treasury loaned an additional \$6 billion to fund GM during this period. To achieve an orderly restructuring, GM filed bankruptcy proceedings on June 1, 2009. Treasury provided \$30.1 billion under a DIP financing agreement to assist GM through the restructuring period. New GM began operating on July 10, 2009, after purchasing most of the assets of old GM.

When the sale to New GM was completed on July 10, Treasury converted most of its loans to 60.8 percent of the common equity in New GM and \$2.1 billion in preferred stock. New GM assumed a portion of the DIP financing loan in the amount of \$7.1 billion of which \$361 million relating to the warranty program amount has been repaid. As of September 30, 2009, New GM has the following ownership: Treasury (60.8 percent), GM VEBA (17.5 percent), the Canadian Government (11.7 percent), and old GM's unsecured creditors (10 percent).

*iv. Update on GMAC*

On December 29, 2008, Treasury purchased \$5 billion in senior preferred equity from GMAC LLC, and received an additional \$250 million in preferred shares through warrants that Treasury exercised at closing. At the same time, Treasury also agreed to lend up to \$1 billion of TARP funds to GM (one of GMAC's owners), to enable GM to purchase additional ownership interests in GMAC's rights offering. GM drew \$884 million under that commitment on January 16, 2009. On May 21, 2009, Treasury purchased \$7.5 billion more of preferred shares from GMAC and received warrants that Treasury exercised at closing for an additional \$375 million in preferred shares.

On May 29, 2009, Treasury exercised its option to exchange the \$884 million loan it had made to GM in January 2009 for about 35 percent of the common membership interests in GMAC. As of September 30, 2009, Treasury owns \$13.1 billion in preferred shares in GMAC, through purchases and the exercise of warrants, in addition to 35 percent of the common equity in GMAC. At the option of the Federal Reserve, it is possible that additional preferred shares could be converted in the future to permit GMAC to increase its tangible common capital ratio. If all of such preferred shares were converted, Treasury would own up to a maximum of a 79.8 percent voting interest in GMAC.

*v. Warranty Commitment Program*

On March 30, 2009, Treasury announced a Warranty Commitment Program designed to give consumers who are considering new car purchases from domestic manufacturers the confidence that warranties on those cars will be honored regardless of the outcome of the current restructuring process. During the preceding quarter, Treasury provided \$280 million to Chrysler and \$361 million to GM to finance their participation in the program. The program was terminated by Treasury on July 10, 2009, after GM and Chrysler each fully repaid the principal amounts advanced under the programs by Treasury.

## **h. Corporate Governance**

### *i. Update on executive compensation*

On June 15, 2009, Treasury published the Interim Final Rule on executive compensation (“Interim Final Rule”), promulgated under the EESA as amended by the ARRA. The Interim Final Rule contains distinct requirements for recipients of TARP funding under certain programs, including CPP participants and recipients of exceptional assistance. The exceptional assistance recipients include the following firms: AIG; Bank of America; Citigroup; GM; GMAC; Chrysler Financial; and Chrysler.

The Interim Final Rule requires that each firm receiving exceptional assistance submit a proposal with respect to the compensation structures within each firm for senior executive officers and certain highly-compensated employees (as defined in the Interim Final Rule). The Special Master is responsible for the review and approval of a proposed compensation structure for each employee. The Office of the Special Master has established the following processes for both the submission and review of information related to those proposals.

In July 2009, the Office of the Special Master requested information submissions from each of the exceptional assistance recipients with respect to proposed compensation structures for the senior executive officers and 20 next most highly-compensated employees of each exceptional assistance recipient. Each recipient provided submissions with respect to those employees to the Office of the Special Master on or before August 14, 2009. Following a review of those submissions and subsequent discussions with each recipient, on August 31, 2009, the Special Master determined that the submissions were “substantially complete” for purposes of the Interim Final Rule. Under the Interim Final Rule, the Special Master’s initial determinations with respect to these employees must be issued no later than 60 days following the Special Master’s receipt of a substantially complete submission.

In addition to establishing the Office of the Special Master, the Interim Final Rule provided the Special Master with specific powers designed to ensure that executive pay at these firms is in line with long-term value creation and financial stability. The Interim Final Rule gives the Special Master four important responsibilities for—

- *Review of Payments:* As described above, for recipients of exceptional assistance, the Special Master is required to review and approve compensation structures, including payments made pursuant to those structures, for the senior executive officers and 20 next most highly paid employees.
- *Review of Structures:* For each exceptional assistance recipient, the Special Master is required to review and approve compensation structures for all executive officers and the 100 most highly compensated employees.

- *Interpretation:* The Special Master has interpretive authority over the executive compensation provisions of EESA and the Interim Final Rule. Accordingly, the Special Master will make all determinations as to the application of those provisions to particular facts.
- *Review of Prior Payments:* The Special Master is required to review any bonuses, retention awards, and other compensation paid to the five senior executive officers and 20 next most highly-compensated employees of each TARP recipient prior to February 17, 2009, to determine whether the payments were contrary to the public interest. If the payment is determined to be contrary to the public interest, the Special Master will be responsible for negotiating for reimbursements of such payments.

All TARP recipients, including exceptional assistance recipients, are required to adopt a luxury expenditure policy consistent with the requirements of the Interim Final Rule, provide the policy to Treasury and post the policy on their website within 90 days following publication of the Interim Final Rule. These policies are generally required to address expenses including entertainment or other events, office and facility renovations, aviation or other transportation services. Compliance personnel within Treasury's Office of Financial Stability ("OFS") are currently conducting the receipt, recording, and review of these luxury policies.

Separately, the Interim Final Rule requires that the compensation committee and the CEO and CFO of each TARP recipient provide certain certifications to Treasury with respect to compliance with the Interim Final Rule. These certifications are due within 120 days of the completion of the TARP recipient's fiscal year. Processes regarding certifications are currently being developed.

*ii. Treasury's voting rights*

As a result of the unusual policies and programs that have been put in place to ameliorate the effects of the financial turmoil of the past two years, the U.S. Government has acquired a substantial portion of the outstanding common equity of certain institutions. As of the close of the quarterly period, the U.S. Government retained equity ownership in New Chrysler (9.9 percent), New GM (60.8 percent), GMAC (35 percent), Citigroup (33 percent) and AIG (79.8 percent). In each case, Treasury maintains the goal of keeping the period of government ownership as temporary as possible and encouraging the return of private capital to replace the government's investment. The following are the fundamental principles that govern Treasury's actions as a shareholder—

- The U.S. government is a shareholder reluctantly and out of necessity. Treasury intends to dispose of its interests as soon as practicable, with the dual goals of achieving financial stability and protecting the interests of the taxpayers;

- Treasury does not intend to be involved in the day-to-day management of any company and its responsibility is to protect the taxpayers' investment; and
- Treasury will take a commercial approach to the exercise of its rights as a shareholder. Treasury will vote only on four core matters: board membership; amendments to the charter and by-laws; liquidations, mergers and other substantial transactions; and significant issuances of common shares.

**i. Administrative Activities of the Office of Financial Stability**

The Oversight Board has continued to review and monitor the progress made by OFS in ensuring that the necessary infrastructure is in place to design and implement all programs established under EESA. This infrastructure includes hiring staff and establishing the necessary internal controls and compliance and monitoring programs for the programs treasury has established under TARP. The following outlines the progress that OFS has made in the areas of staffing, procurement, reporting, and internal controls during the quarterly period.

Treasury maintained an active dialogue with the Oversight Board, as well as the other bodies with oversight responsibility over TARP, including Congress, SIGTARP, GAO and the Congressional Oversight Panel ("COP"). For example, Assistant Secretary Allison meets weekly with SIGTARP to discuss Treasury's current activities and their concerns. During the quarterly period, Treasury provided the Oversight Board with updates on the progress Treasury has made in implementing several of these recommendations. In the cases where Treasury has declined to implement a recommendation or sought to reach the recommendation's objectives by other means that Treasury considered to be more practical, effective or supportive of achieving financial stability, Treasury has explained its reasons to the relevant oversight body and to Congress in detail.

*i. Staffing*

As of September 30, 2009, OFS has 196 full-time employees who support TARP. These employees include 19 employees who report through Treasury's Office of General Counsel and 12 detailees. In addition to the 196 full-time staff, approximately 40 Treasury employees outside of OFS continue to provide support to OFS on an as-needed basis. Treasury's organizational plans, as of September 14, 2009, call for a total of 225 full-time employees, indicating that OFS was 87 percent staffed as of September 14, 2009. Treasury continues to use direct-hire and other appointments to expedite hiring of highly-qualified candidates, which has enabled Treasury to reduce the number of temporary and contract staff and strengthen the continuity and institutional knowledge of the workforce.

*ii. Procurement*

Treasury utilizes private sector expertise to support the execution of TARP and FSP programs. For example, during the quarterly period, Treasury continued to engage private sector firms to assist with the significant volume of work associated with TARP in the areas of accounting and internal controls, administrative support, facilities, legal advisory, financial advisory, and information technology.

Treasury awarded eight new contracts during the quarterly period. Treasury retained the firms of Cadwalader, Wickersham & Taft L.L.P; Debevoise & Plimpton, L.L.P; and Fox Hefter Swibel Levin & Carrol L.L.P for restructuring legal services. Treasury also retained Price Waterhouse Coopers to provide compliance support services on the PPIP. Treasury obtained executive search services from Korn/Ferry International for the OFS Chief Investment Officer position. Treasury subscribed to data services from Mercer, Inc. and Equilar, Inc. related to executive compensation and from Knowledge Mosaic, Inc. for SEC filings and associated data.

In addition to contracts, during the quarterly period, Treasury identified seven emerging asset managers for engagement under financial agency agreements for asset management services. These engagements are consistent with Treasury's intentions and announcement to select a group of smaller asset managers to serve as financial agents in managing the portfolio of assets issued by banks and institutions participating in the CPP and other programs under EESA.

*iii. Conflict of Interest Mitigation*

Conflict issues that arise with new and existing contracts and financial agent agreements are principally handled through the OFS's Risk and Compliance Office ("CRCO"). The CRCO takes a standard approach to evaluating the potential conflicts of interest and the feasibility of mitigation measures and documents and tracks all formal decisions on conflict of interest inquiries

On January 21, 2009, Treasury published an interim final regulation designed to address actual or potential conflicts of interest among contractors and financial agents performing services in conjunction with TARP (the "Interim COI Regulations"). These regulations describe, among other things, the formal steps for identifying, monitoring, and mitigating conflicts of interest during the procurement process and over the contracts' terms. The comment period for the Interim COI Regulations ended on March 23, 2009. Treasury has reviewed all public comments received on the Interim COI Regulations, and is in the process of drafting revisions to the existing regulations.

Treasury is actively renegotiating the contracts and financial agent agreements ("FAAs") in place before the Interim COI Regulations became effective and that remained active after April 30, 2009. As of September 30, 2009, Treasury has successfully renegotiated the conflicts of interest provisions and approved the conflicts mitigation plans for five of the eight contracts and FAAs that required modifications and

the remaining renegotiations are ongoing. The complex nature of these contracts and the complicated business structure of the contractors and financial agents require significant time to develop mitigation plans that appropriately meet the provisions of the regulation.

CRCO works with the contractors at the outset of a contract or financial agency agreement to identify conflicts mitigation plans that meet Treasury's requirements under the Conflict of Interest regulations. In accordance with the regulations, the contractors and financial agents must provide documentation related to conflicts of interest throughout the term of the contract. Contractors and Financial Agents self-report any actual or potential conflicts of interest and provide proposed mitigation plans. OFS reviews these disclosures and mitigation plans to ensure compliance with the Conflict of Interest regulations. In addition, Contracting Officer's Technical Representatives and members of the Office of Financial Agents report any discussions regarding conflicts of interest with their contractors or financial agents as part of their systematic monitoring of assigned contracts and FAAs, and promptly raise any perceived or potential conflicts of interest to the attention of CRCO for evaluation.

To facilitate execution of the Conflict of Interest regulations, Treasury has developed processes related to personnel training and implementing tools and software, for data collection and retention, drafting and reporting, decision flow and document retention.

#### *iv. Reporting*

Treasury is committed to transparency in all TARP programs and improving its external communications about those programs. In this regard, Treasury has met all of its EESA-mandated reporting requirements on time since the establishment of TARP. Treasury makes all of its reports, which detail the objectives, structure, and terms of each TARP program and investment, available on its web site ([www.financialstability.gov](http://www.financialstability.gov)) and shares these reports with Congress and other oversight bodies.

As of September 30, 2009, Treasury has filed—

- 86 transactions reports, in accordance with section 114 of the EESA, which include key details of the acquisition and, beginning March 31, 2009, the disposition of TARP investments;
- 8 tranche reports, in accordance with section 105(b) of the EESA, which outline the details of transactions that relate to each \$50 billion incremental investment made under TARP, along with the pricing mechanism for each relevant transaction, a description of the challenges that remain in the financial system, and an estimate of the additional actions that may be necessary to address such challenges; and
- 10 monthly reports, in accordance with section 105(a) of the EESA, describing, among other things, financial data concerning administrative

expenses, projected administrative expenses and a detailed financial statement with respect to TARP investments.

In addition to these reports, Treasury continues to make available information concerning the objectives and terms of programs established under TARP and recent and upcoming initiatives through numerous press releases, testimonies, speeches, and briefings to Congressional staff.

*v. Governance and Internal Controls*

Treasury has developed a framework and plan for internal control over TARP. The Internal Control Framework serves as a guide to the establishment of internal controls for new programs (e.g., applied to HAMP and PPIP). Treasury continues to work with program management to identify initial program objectives, risks, control objectives, and control activities. This work includes the preparation and maintenance of process flows and related controls documentation, as well as evidence of control execution. Treasury continues to monitor the operational controls related to program asset acquisition, asset management, and asset disposition activities.

As noted above, the financial year for TARP operations ended on September 30, 2009. Treasury will publish audited annual financial statements under Federal financial reporting standards that will provide detailed information on the value of the TARP portfolio.

OFS is on schedule to meet its A-123 Program implementation plan and continues to assess the ongoing effectiveness of internal controls over financial reporting and operations. The Interim Assurance Statement for OFS' internal control over financial reporting as of June 30, 2009 was completed in mid-July 2009.

In support of the broader fiscal year-end management assurance statement, OFS is actively evaluating its management controls, internal controls over financial reporting and operations, and compliance with federal financial systems standards. This work is on track for completion by the scheduled due date. The Senior Assessment Team continues to guide OFS' efforts to meet the statutory and regulatory requirements for a system of internal controls for TARP.

**APPENDIX A**

Minutes of Financial Stability Oversight Board Meetings  
During the Quarterly Period

## Minutes of the Financial Stability Oversight Board Meeting July 29, 2009

A meeting of the Financial Stability Oversight Board (“Board”) was held at 3:30 p.m. (EDT) on Wednesday, July 29, 2009, at the offices of the Department of the Treasury (“Treasury”).

### MEMBERS PRESENT:

Mr. Bernanke, Chairperson  
Mr. Geithner  
Mr. Donovan  
Ms. Schapiro  
Mr. Lockhart

### STAFF PRESENT:

Mr. Treacy, Executive Director  
Mr. Fallon, General Counsel  
Mr. Gonzalez, Secretary

### AGENCY OFFICIALS PRESENT:

Mr. Allison, Counselor to the Secretary and Assistant Secretary for Financial Stability, Department of the Treasury

Mr. Wheeler, Deputy Assistant Secretary for Federal Finance, Department of the Treasury

Mr. Bloom, Lead Advisor to the Secretary on the Automotive Industry, Department of the Treasury, Member of Presidential Task Force on the Automotive Industry

Mr. Miller, Director of Investments, Office of Financial Stability, Department of the Treasury

Mr. Massad, Chief Counsel, Office of Financial Stability, Department of the Treasury

Ms. Abdelrazek, Senior Advisor to the Counselor to the Secretary and Assistant Secretary of the Treasury for Financial Stability, Department of the Treasury

Mr. Wilcox, Deputy Director, Division of Research & Statistics, Board of Governors of the Federal Reserve System

Ms. Liang, Associate Director, Division of Research & Statistics, Board of Governors of the Federal Reserve System

Mr. Covitz, Assistant Director, Division of Research & Statistics, Board of Governors of the Federal Reserve System

Mr. Stevens, Assistant Secretary for Housing and Commissioner of the Federal Housing Administration, Department of Housing and Urban Development

Mr. Apgar, Senior Advisor to the Secretary, Department of Housing and Urban Development

Ms. Nisanci, Chief of Staff, Securities and Exchange Commission

Mr. Delfin, Special Counsel to the Chairman, Securities and Exchange Commission

Mr. DeMarco, Chief Operating Officer and Deputy Director for Housing Mission and Goals, Federal Housing Finance Agency

Mr. Lawler, Chief Economist, Federal Housing Finance Agency

Chairperson Bernanke called the meeting to order at approximately 3:35 p.m. (EDT).

Using prepared materials, officials from the Department of the Treasury (“Treasury”) provided an update on the programs established by Treasury under the Troubled Asset Relief Program (“TARP”). Discussion during the meeting focused on the Capital Purchase Program (“CPP”), Capital Assistance Program (“CAP”) and the Supervisory Capital Assistance Program (“SCAP”); the Public-Private Investment Partnership (“PPIP”) program; the Home Affordable Modification Program (“HAMP”); the Unlocking Credit for Small Businesses (“UCSB”) program; and the Automotive Industry Financing Program (“AIFP”). Materials and updates concerning the other programs established by Treasury under the TARP, including the most recent data gathered as part of the Treasury’s Monthly Lending and Intermediation Snapshots and Reports, were included in the materials prepared for the meeting. During the meeting, Members also raised and discussed various matters with respect to the development and ongoing implementation of other policies and programs under the TARP.

Treasury officials first provided the Members with an update on the SCAP, a comprehensive capital

assessment exercise conducted by the Federal Reserve and the other Federal banking agencies, in consultation with Treasury, which is designed to ensure that the largest domestic bank holding companies have a capital buffer sufficient to withstand losses and sustain lending even in a significantly more adverse economic environment than is currently anticipated. As part of this discussion, Members and officials reviewed the status of the efforts of institutions subject to the SCAP in raising capital from private sources, issuing nongovernmental guaranteed debt, and taking other steps to improve their capital position.

Mr. Bloom and other Treasury officials then reviewed and discussed the AIFP and the recent actions taken under the program to assist the domestic automotive industry in becoming financially viable. During this discussion, Treasury officials provided an update on developments relating to the recent emergence of the new General Motors (“New GM”) and the new Chrysler (“New Chrysler”) from bankruptcy and each company’s continued progress in meeting the goals and conditions for restructuring set by the Presidential Task Force on the Auto Industry. For example, Members and officials discussed the status of the financing previously provided by Treasury to General Motors and Chrysler; the recent meeting of New GM’s board of directors; the status of Chrysler Financial and the loan previously provided to Chrysler Financial; the recent actions taken by Treasury under the Auto Supplier Support Program; and Treasury’s termination of the Warranty Commitment Program.

Using prepared materials, Treasury officials then provided the

Members with an update on the legacy securities component of the PPIP program. As part of this discussion, Members and officials reviewed and discussed Treasury's recent pre-qualification of 9 fund managers to raise private capital under the program; the 10 unique partnerships established by these fund managers to encourage participation in the program by small-, veteran-, minority-, and women-owned financial services businesses; the manner in which capital would be allocated to each pre-qualified fund manager under the program; and the potential form and structure of the public-private investment funds to be formed by each fund manager. During this discussion, officials also discussed the efforts being made by Treasury to develop conflict of interest and ethical standards and a reporting and compliance framework for the program.

Using prepared materials, Treasury officials then provided the Members with an update on the CPP. As part of this discussion, Treasury officials and Members reviewed and discussed the process used by Treasury to value the warrants that Treasury has acquired under the program in the event a CPP recipient exercises its right to repurchase the warrants, including the steps taken by Treasury to estimate the fair market value for these warrants using models and other data, including input from market participants. Officials also discussed Treasury's plans for selling the warrants in the event a recipient does not repurchase them. Officials also reviewed and discussed the number of applications received, approved and withdrawn under the CPP, and the amount of funds requested, disbursed and repaid to Treasury.

During the meeting, officials and Members also discussed the steps being taken or proposed to be taken by certain participating financial institutions to further strengthen their financial positions by raising private capital or otherwise restructuring their business.

Using prepared materials, Treasury officials then provided the Members with an update on Treasury's continued efforts to implement the UCSB program in order to help restore the flow of credit to small businesses through the purchase of securities backed by loans guaranteed and originated under certain Small Business Administration programs.

Following this discussion, Treasury officials provided an update regarding the HAMP. As part of this discussion, Members and officials reviewed and discussed the number of first-lien mortgage loans that had been or may be modified under the program; the amount of funds requested and disbursed from TARP in support of the program; and the progress Treasury has made in establishing formal guidelines under the program to facilitate the modification or extinguishment of second-lien mortgages. Members and officials also discussed potential ways the program could be further enhanced or expanded. Mr. Geithner and Mr. Donovan briefed the Members on the meeting held on July 28, 2009, with participating servicers in the program. During this discussion, officials from the Housing and Urban Development ("HUD") also provided an update on the work by HUD, in consultation with Treasury, to integrate the HOPE for Homeowners program into the HAMP framework and to implement additional changes to the HOPE for Homeowners program.

Treasury officials then provided the Members with an update regarding the recent share exchange conducted by Citigroup, Inc. (“Citigroup”) under which Treasury exchanged \$25 billion of the Citigroup preferred stock Treasury acquired under the CPP into mandatorily convertible preferred shares that will convert into common stock upon receipt of certain shareholder approvals. As part of the exchange offer, Treasury will also exchange the Citigroup preferred shares received under the Targeted Investment Program and the Asset Guarantee Program for trust preferred shares of greater structural seniority with the same 8 percent dividend rates as the existing preferred shares. During this discussion, Members and officials reviewed, among other things, the timeline for completion of the exchange offer.

Members and officials then reviewed and discussed the Board’s quarterly report for the period ending June 30, 2009, which was released on July 20, 2009, and briefings related thereto. Members and officials also discussed potential topics for future meetings.

The meeting was adjourned at approximately 4:20 p.m. (EDT).

[Electronically Signed]

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Kieran J. Fallon  
General Counsel

## Minutes of the Financial Stability Oversight Board Meeting August 31, 2009

A meeting of the Financial Stability Oversight Board (“Board”) was held at 2:30 p.m. (EDT) on Monday, August 31, 2009, at the offices of the Department of the Treasury (“Treasury”).

### MEMBERS PRESENT:

Mr. Bernanke, Chairperson  
Mr. Geithner  
Mr. Donovan  
Ms. Schapiro  
Mr. DeMarco

### STAFF PRESENT:

Mr. Treacy, Executive Director  
Mr. Fallon, General Counsel

### AGENCY OFFICIALS PRESENT:

Mr. Allison, Counselor to the Secretary and Assistant Secretary for Financial Stability, Department of the Treasury

Mr. Wheeler, Senior Advisor to the Secretary, Department of the Treasury

Mr. Miller, Director of Investments, Office of Financial Stability, Department of the Treasury

Mr. Massad, Chief Counsel, Office of Financial Stability, Department of the Treasury

Ms. Ochs, Senior Advisor to the Counselor to the Secretary and Assistant Secretary of the Treasury for Financial Stability, Department of the Treasury

Ms. Aveil, Special Assistant to the Secretary, Department of the Treasury

Mr. Morse, Chief Compliance and Risk Officer, Office of Financial Stability, Department of the Treasury

Ms. Liang, Senior Associate Director, Division of Research & Statistics, Board of Governors of the Federal Reserve System

Mr. Lehnert, Assistant Director, Division of Research & Statistics, Board of Governors of the Federal Reserve System

Mr. Astrada, Attorney, Legal Division, Board of Governors of the Federal Reserve System

Mr. Apgar, Senior Advisor to the Secretary, Department of Housing and Urban Development

Mr. Davidson, General Deputy General Counsel, Department of Housing and Urban Development

Mr. Herold, Deputy General Counsel for Housing Programs, Department of Housing and Urban Development

Mr. Delfin, Special Counsel to the Chairman, Securities and Exchange Commission

Mr. Cross, Acting Senior Deputy Director and Chief Operating Officer, Federal Housing Finance Agency

Chairperson Bernanke called the meeting to order at approximately 2:37 p.m. (EDT).

The Board first considered draft minutes for the meeting of the Board on July 29, 2009, which had been circulated in advance of the meeting. Upon a motion duly made and seconded, the Members unanimously voted to approve the minutes of the meeting, subject to such technical revisions as may be received from the Members.

Using prepared materials, officials from the Department of the Treasury (“Treasury”) then provided an update on the programs established by Treasury under the Troubled Asset Relief Program (“TARP”). Discussion during the meeting focused on the Legacy Securities Public-Private Investment Partnership (“S-PPIP”) program; the Capital Purchase Program (“CPP”); the Term Asset-Backed Securities Loan Facility (“TALF”); and the Home Affordable Modification Program (“HAMP”). Also included in materials prepared for the meeting were updates concerning the other programs established by Treasury under the TARP, including the most recent data gathered as part of Treasury’s Monthly Lending and Intermediation Snapshots and Reports; recent recommendations made by the U.S. Government Accountability Office (“GAO”) concerning the HAMP; and the aggregate level and distribution of commitments and disbursements under the TARP, repayments of TARP funds, and the level of resources that remain available under the TARP. During the meeting, Members raised and discussed various matters with respect to the development and ongoing implementation of the policies and programs under the TARP.

Treasury officials first provided the Members with an update on the S-PIPP. As part of this discussion, Members and officials reviewed the progress made by the program’s pre-qualified fund managers in raising private capital and the expected date for initial closings for Public-Private Investment Funds (“PPIFs”) under the program. Members also discussed the expected composition of assets in PPIFs, both initially and thereafter; the impact of recent pricing trends on the expected composition of purchased assets; and the potential effect of purchases on participating financial institutions. Officials also discussed Treasury’s progress in establishing internal controls and an external reporting framework for the program.

Using prepared materials, Treasury officials then provided the Members with an update on the CPP. As part of this discussion, Treasury officials reviewed the number of applications received, approved, and withdrawn under the CPP, and the amount of funds requested from, disbursed by, and repaid to Treasury. Members also reviewed and discussed Treasury’s exchange of preferred shares in Popular Inc. acquired under the CPP for a like-amount of trust preferred securities. Treasury officials noted that Popular Inc. paid Treasury a fee of \$13 million in connection with the exchange and that the transaction resulted in Treasury moving to a more senior position in Popular Inc.’s capital structure while maintaining its dividend rate on the CPP investment.

Using prepared materials, Treasury officials then provided the Members with an update on the TALF. As part of this discussion, Treasury officials reviewed the recent announcement made by the Federal Reserve and Treasury that no additional asset classes would be added as eligible collateral under the TALF and that the TALF will be extended through March 31, 2010, for newly issued asset-backed securities (“ABS”) and legacy commercial mortgage-backed securities (“CMBS”), and through June 30, 2010, for newly issued CMBS. Members also discussed recent issuance and purchases of ABS completed without TALF funding.

Following this discussion, Treasury officials provided an update regarding the HAMP. As part of this discussion, Members and officials reviewed and discussed the progress of servicers participating in the program in commencing and completing modifications, the reasons why homeowners successfully completing trial modifications might choose not to finalize permanent modifications, and the current and projected number of trial and final modifications under the program. Members also discussed developments in the second lien modification program and the expected impact of second lien modifications on the overall program and the performance of first lien modifications. Members and officials also reviewed the GAO’s recommendations on the HAMP and upcoming announcements regarding the short sale and deed-in-lieu programs under the HAMP.

Members and officials then discussed potential ways to provide

additional assistance to small businesses and banks, and potential topics for future meetings.

The meeting was adjourned at approximately 3:10 p.m. (EDT).

[Signed Electronically]

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Kieran J. Fallon  
General Counsel

## Minutes of the Financial Stability Oversight Board Meeting September 28, 2009

A meeting of the Financial Stability Oversight Board (“Board”) was held at 2:30 p.m. (EDT) on Monday, September 28, 2009, at the offices of the Department of the Treasury (“Treasury”).

### MEMBERS PRESENT:

Mr. Bernanke, Chairperson  
Mr. Geithner  
Mr. Donovan  
Ms. Schapiro  
Mr. DeMarco

### STAFF PRESENT:

Mr. Treacy, Executive Director  
Mr. Fallon, General Counsel  
Mr. Gonzalez, Secretary

### AGENCY OFFICIALS PRESENT:

Mr. Allison, Counselor to the Secretary and Assistant Secretary for Financial Stability, Department of the Treasury

Mr. Wheeler, Senior Advisor to the Secretary, Department of the Treasury

Mr. Massad, Chief Counsel, Office of Financial Stability, Department of the Treasury

Ms. Ochs, Senior Advisor to the Counselor to the Secretary and Assistant Secretary of the Treasury for Financial Stability, Department of the Treasury

Mr. Morse, Chief Risk and Compliance Officer, Office of Financial Stability, Department of the Treasury

Mr. Tae, Director of Investments, Office of Financial Stability, Department of the Treasury

Ms. Liang, Senior Associate Director, Division of Research & Statistics, Board of Governors of the Federal Reserve System

Mr. Gallin, Section Chief, Division of Research & Statistics, Board of Governors of the Federal Reserve System

Mr. Apgar, Senior Advisor to the Secretary, Department of Housing and Urban Development

Mr. Herold, Deputy General Counsel, Department of Housing and Urban Development

Mr. Delfin, Special Counsel to the Chairman, Securities and Exchange Commission

Ms. Nasanci, Chief of Staff, Securities and Exchange Commission

Mr. Lawler, Chief Economist, Federal Housing Finance Agency

Chairperson Bernanke called the meeting to order at approximately 2:35 p.m. (EDT).

The Board first considered draft minutes for the meeting of the Board on August 31, 2009, which had been circulated in advance of the meeting. Upon a motion duly made and seconded, the Members unanimously voted to approve the minutes of the meeting,

subject to such technical revisions as may be received from the Members.

Using prepared materials, officials from the Department of the Treasury (“Treasury”) then provided an update on the programs established by Treasury under the Troubled Asset Relief Program (“TARP”). Discussion during the meeting focused on the Legacy Securities Public-Private Investment Partnership (“S-PPIP”) Program; the Asset Guarantee Program (“AGP”); the Small Business and Community Lending Initiative; the Home Affordable Modification Program (“HAMP”); and the Automotive Industry Financing Program (“AIFP”). Also included in materials prepared for the meeting were: updates concerning the other programs established by Treasury under the TARP, including the Capital Purchase Program (“CPP”); the Term Asset-Backed Securities Loan Facility (“TALF”); the most recent data gathered as part of Treasury’s Monthly Lending and Intermediation Snapshots and Report; an update on Treasury’s progress in responding to the recommendations made by the U.S. Government Accountability Office (“GAO”) and the Special Inspector General for the TARP (“SIGTARP”); and the aggregate level and distribution of commitments and disbursements under TARP, repayments of TARP funds, and the level of resources that remain available under TARP. During the meeting, Members raised and discussed various matters with respect to the development and ongoing implementation of the policies and programs under TARP.

Treasury officials first provided the Members with an update on the S-PPIP. As part of this discussion, Members and officials reviewed and discussed Treasury’s recent selection of a

compliance agent for the program and Treasury’s progress in establishing internal controls and an external reporting framework for the program. Members and officials also reviewed the expected date and capital allocation amounts for the initial closing of the Public-Private Investment Funds (“PPIFs”) under the program.

Using prepared materials, Treasury officials then reviewed with the Members the agreement entered into with Bank of America on September 21, 2009, under which the term sheet previously entered into between Treasury, the Federal Reserve and the Federal Deposit Insurance Corporation (“FDIC”) and Bank of America in January 2009, with respect to a designated pool of up to \$118 billion in assets, was terminated. As part of this discussion, officials and Members reviewed and discussed the methodology used to calculate the \$425 million termination fee that Bank of America paid to Treasury, the FDIC and the Federal Reserve, on September 21, 2009, in connection with the termination of the term sheet and the allocation of this fee amongst the government parties.

Treasury officials then provided the Members with an update on the Small Business and Community Lending Initiative, which is designed to help restore the flow of credit to small businesses. As part of this discussion, Members and officials reviewed and discussed Treasury’s progress in establishing a pilot program under which Treasury would purchase securities backed by guaranteed portions of loans made under the 7(a) loan program established by the Small Business Administration.

Using prepared materials, Treasury officials then provided the Members with an update regarding HAMP. As part of this discussion, Members and officials reviewed and discussed the rising number of trial modifications initiated under the program and the number of servicers participating in the program. Officials and Members also discussed the challenges to the successful conversion of trial modifications to permanent modifications, potential ways of addressing these challenges, and the current and potential use of counselors to assist borrowers in successfully completing the modification process. Members and officials also discussed the relative performance of servicers under the program and estimates of the number of borrowers potentially eligible for loan modifications under HAMP.

Using prepared materials, Mr. Tae and other Treasury officials provided the Members with an update on the AIFP and the steps taken under the program by Treasury and the Presidential Task Force on the Auto Industry (“Auto Task Force”). As part of this discussion, officials reviewed the recent repayment made by Chrysler Financial LLC (“Chrysler Financial”), in full, of the \$1.5 billion loan made by Treasury in January 2009 and the recent termination of the Warranty Commitment Program following the repayments made, in full, by General Motors Corp. (“GM”) and Chrysler Holding LLC (“Chrysler”) of the loans made by Treasury under the program. Officials also reviewed with the Members significant restructuring and business developments at GM, Chrysler and GMAC.

Using prepared materials, Treasury officials then provided the Members with an update on the CPP. As part of this discussion, Treasury officials reviewed the number of applications received, approved and withdrawn under the CPP, and the amount of funds requested from, disbursed by, and repaid to Treasury. Members and officials also discussed the process Treasury has established for the repurchase or disposal of the warrants Treasury has received under the program.

Following briefings from officials of the Federal Reserve and the Federal Housing Finance Agency, Members and officials then engaged in a roundtable discussion regarding the current state of the U.S. housing and financial markets. Information presented and discussed included data related to corporate bond spreads, stock prices, credit default swap spreads for selected financial institutions, debt growth among household and nonfinancial businesses, conditions in the commercial paper and asset-backed securities markets, issues financed under the TALF, and data related to credit demand and standards drawn from the Federal Reserve’s Senior Loan Officer Opinion Survey. As part of this discussion, Members discussed the extent to which TARP has been a key stabilizing factor for the financial system, noting, among other things, apparent improvements across many financial markets. In considering the state of the housing and housing finance markets, Members and officials reviewed, among other things, data related to mortgage rates, delinquencies and housing prices. During this discussion, Mr. DeMarco provided an update on the Making Home Affordable Refinance Program, a component of the Financial Stability Plan,

which is designed to assist homeowners who have difficulty refinancing due to declining house prices. As part of this update, Members discussed the recent increase in the potential number of homeowners eligible for this refinancing program resulting from the expansion of the program announced by the Federal Housing Finance Agency in July 2009, which increased the loan-to-value ceiling under the program from 105 percent to 125 percent.

Members and officials then engaged in a discussion regarding the Board's quarterly report to Congress for the quarter ending September 30, 2009, that will be issued by the Board pursuant to section 104(g) of the EESA. Members and officials discussed, among other things, the timing and potential contents of the report.

The meeting was adjourned at approximately 3:05 p.m. (EDT).

[Signed Electronically]

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Jason A. Gonzalez  
Secretary