

# U.S. DEPARTMENT OF THE TREASURY

## Press Center



### **Assistant Secretary for Financial Stability Herbert M. Allison, Jr. Written Testimony Senate Committee on Banking, Housing and Urban Affairs**

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Chairman Dodd, Ranking Member Shelby and members of the Committee, thank you for the opportunity to testify today. As we approach the one-year anniversary of the Troubled Assets Relief Program or TARP, I welcome this chance to update you about the progress we have made in restoring our financial stability.

A year ago, we were in the midst of one of the worst periods in our financial history. Fannie Mae and Freddie Mac were taken into federal conservatorship; Lehman Brothers went bankrupt and AIG nearly followed; Wachovia, Washington Mutual and Merrill Lynch were sold in distress; and weakness at a prominent mutual fund sparked a dangerous "run" on money market mutual funds. Credit markets froze as banks refused to lend, even to one another. Immediate, strong action was needed to avoid a complete meltdown of the system.

On October 3, 2008, Congress rose to this challenge by passing the Emergency Economic Stabilization Act of 2008. With the leadership in particular of many of you on this Committee, Congress recognized the need to take difficult but necessary action and gave the Treasury Department unprecedented authority to stabilize the U.S. economy by creating TARP.

Policy interventions executed last Fall by the Treasury Department and the federal banking regulators, succeeded in achieving the critical, but narrow objective of preventing a catastrophic collapse of our financial system. But when President Obama took office, the financial system remained extremely fragile and the Administration faced a rapidly evolving set of grave challenges.

In January 2009, what we faced was no longer just a financial crisis; it was a full-blown economic crisis. In January alone, 741,000 Americans lost their jobs, the largest single month decline in 60 years. Home foreclosures were increasing at a rapid rate. Businesses and families were struggling to find credit. It was feared that those banks that remained standing had too little capital and too much exposure to risky assets. Secondary markets for credit had essentially come to a halt; and liquidity in a broader range of securities markets had fallen sharply. In a matter of three months, American families had lost \$5 trillion in household wealth.

In short, the economy was in a free fall and there was increasing concern we were headed towards a second Great Depression.

The Obama Administration confronted this situation by taking forceful action on several fronts. Again, with the leadership of many of you on this Committee, a comprehensive strategy was put in place to stabilize the financial system and the housing market, to stimulate economic activity, and to provide help to those in most need. And as a result, we have stepped back from the brink. We still have a long way to go before true recovery takes hold, but we are now pointed in the right direction.

TARP has been vital to our achievements to date, and it will continue to be an important part of our recovery. Today, I want to discuss what Treasury has done under TARP and how we have measured our success or failure. I also want to discuss what we still need to do, because our situation requires continued action and vigilance. The recovery has just begun, the financial system remains fragile, and the credit markets are not fully functioning. And with unemployment still unacceptably high, home foreclosures still rising, and many Americans still suffering through no fault of their own, we still have work to do.

#### Overview

Although much remains to be done, we believe that TARP has worked to stabilize the financial system and lay the foundation for economic recovery. Treasury used its authority under EESA to make investments that have helped to stabilize our system, restore confidence in our banks and restart markets that are critical to financing American households and businesses. In addition, we have begun to stabilize the housing market and help people avoid foreclosure. These efforts are part of the Administration's Financial Stability Plan, designed to recapitalize our financial system with as much private capital and as little taxpayer funding as possible.

EESA authorized \$700 billion for TARP. As of September 21, 2009, Treasury has announced plans to provide \$644 billion for specific TARP programs. Of that amount, we have entered into commitments of \$444 billion, and we have disbursed \$365 billion.

A large part of the total activity to date occurred last fall under the Capital Purchase Program (CPP) following the adoption of EESA in October 2008. The more recent commitments include amounts extended under the Obama Administration's Financial Stability Plan.

Let me highlight some of the major support provided under TARP.

### Capital Purchase Program

CPP was the first of the programs implemented under TARP. Through CPP, Treasury has provided capital to 679 financial institutions across 48 states. This program was designed for financial institutions of all sizes and has invested in over 300 small and community banks. CPP has been essential to stabilizing our financial system. The capital provided has enabled banks to absorb losses from bad assets while continuing to lend to consumers and businesses. To encourage continued participation by small and community banks, the application window for CPP was reopened on May 13, 2009 for banks with fewer than \$500 million in assets. In addition, we continue to invest in smaller banks on a regular basis.

In addition to the CPP, Treasury also worked with the federal banking regulators to develop a plan for "stress tests". This was a comprehensive, forward looking assessment of the capital held by the largest 19 US banks. The design of the tests and their results were made public, a highly unusual step that was taken because of the unprecedented need to reduce uncertainty and restore confidence. We also announced that we would be prepared to provide additional capital through the Capital Assistance Program.

Since the stress test results were released in early May, banks of all sizes have raised over \$80 billion in common equity and \$40 billion in non-guaranteed debt. Importantly, that capital raising has enabled more than 30 banks to repay the TARP investments made by Treasury. We have received over \$70 billion in principal repayments, and over \$6.5 billion in dividends, interest and fees from CPP participants.

In addition, several banks have repurchased the warrants issued to Treasury in connection with repaying the TARP investments. Treasury obtained warrants with each investment in order to provide the taxpayer with an opportunity to participate in the potential recovery of these financial institutions. To date we have received almost \$3 billion from the repurchase of warrants. The rate of return to the taxpayer on the investments made in all those institutions that have fully repaid the Treasury and repurchased the warrants to date is approximately 17%. I should note that our returns to date are not necessarily an indication of what our returns will be overall for this program, but this is a good beginning.

When President Obama took office, the Treasury had outstanding commitments to banks under the CPP and other programs of \$239 billion. Since mid-January, we have invested \$11 billion in more than 350 institutions, while receiving the repayments noted above of \$70 billion. Thus, since January, we have reduced the size of the Treasury's investments in the banking system by \$59 billion to \$180 billion. We now estimate that banks will repay another \$50 billion over the next 12 to 18 months.

### Public-Private Investment Partnership

To help clean up the balance sheets of major financial institutions and restore liquidity to key markets for financial assets, we proposed the creation of a public-private investment program for the purchasing of legacy loans and securities. Since the announcement of the program, non-agency mortgage-backed securities have gone up substantially in price. Prime fixed rate securities issued in 2006 that traded as low as \$60 in March have increased in value by over 40 percent as additional liquidity has come back to the markets. That improvement in financial market conditions has created the positive backdrop to enable us to proceed with the program at a scale smaller than initially envisioned.

Following a comprehensive application, evaluation and selection process, during which Treasury received over 100 unique applications to participate in PPIP, in July, Treasury pre-qualified nine fund managers to participate in the program. These managers have extensive experience with legacy assets. In addition, these firms have committed to utilizing small business and minority-owned firms in this process.

Treasury expects to provide approximately \$30 billion in equity and debt financing to special purpose entities formed by the fund managers in the initial phase of PPIP. Initial closings are currently scheduled for the end of this month.

Due to the possibility of actual or potential conflicts of interest inherent in any market-based investment program, Treasury has worked very closely with the Special Inspector General for the Troubled Assets Relief Program (SIGTARP) to develop a robust conflicts and compliance process.

### Term Asset-Backed Securities Loan Facility

One of the many lessons of this crisis is the importance of a properly functioning securitization market to the availability of credit for consumers and small businesses. The Term Asset-Backed Securities Loan Facility (TALF) has been a successful effort to help restart those markets after the crisis. Opened in March 2009, TALF is a lending facility operated by the Federal Reserve Bank of New York (FRBNY) under which FRBNY provides term non-recourse loans collateralized by certain types of AAA-rated asset-backed securities (ABS). Treasury has consulted in the design of the program and will provide up to \$20 billion for the purchase of ABS in the event of a default.

I am pleased to report that, since March, a total of \$ 79.6 billion of new TALF-eligible ABS has been brought to market, of which \$ 46.5 billion was funded using TALF loans. This aid to the securitization market has had a decided impact on liquidity, spreads, and the availability of consumer and small business credit.

### Making Home Affordable<sup>®</sup> Program

A central part of the President's Financial Stability Plan is our effort to stabilize the housing market. Announced on February 18, the Making Home Affordable Program (MHA) offers assistance to millions of homeowners by reducing mortgage payments and preventing avoidable foreclosures. MHA gives homeowners the opportunity to modify their mortgages as well as an opportunity to refinance GSE loans, which in each case can lower monthly payments and enable homeowners to avoid foreclosure.

The mortgage modification program is known as Home Affordable Modification Program<sup>SM</sup>, or HAMP<sup>SM</sup>, and is funded through TARP and the Housing and Economic Recovery Act of 2008 (HERA). It is designed provide assistance to up to 3-4 million eligible homeowners before the end of 2012. We have signed contracts with 57 servicers, including the five largest. Between loans covered by these servicers and loans owned or guaranteed by the GSEs, more than 85 percent of all mortgage loans in the country are now covered by the program. As of September 9, more than 360,000 trial modifications are underway and 570,000 trial modifications have been offered under this program. We have frequent contact with the servicers to discuss ways of increasing borrower participation in HAMP. At a meeting with participating servicers on July 28, servicers committed to reaching a cumulative target of 500,000 trial modifications by November 1, 2009. I am pleased to report that we are on pace to meet this goal, potentially even ahead of schedule. The participating servicers also agreed to work with Treasury to implement actions designed to improve program effectiveness, including the streamlining of application documents. In addition, we have focused on transparency and servicer accountability by publicly reporting servicer-specific results on a monthly basis. Treasury is also working to establish specific operational metrics to measure the performance of each servicer. We will be meeting with the servicers again next month to review progress and address ongoing concerns. Treasury realizes that the housing market is vital to the ongoing economic recovery and that many people are still in dire circumstances. We will continue to work to make sure that these programs provide relief to those affected.

#### Automotive Industry Financing Program

The Automotive Industry Financing Program (AIFP) was developed in December 2008 to prevent a significant disruption of the U.S. automotive industry, because of the risks such a disruption posed to the financial system and the economy as a whole. To date, Treasury has provided approximately \$76 billion in loans and equity investments to General Motors, Chrysler and their respective financing entities.

After the previous Administration provided initial assistance last year, the Obama Administration required the companies to develop long-term reorganization and viability plans before Treasury would provide additional assistance. Moreover, Treasury rejected the initial plans proposed by the automakers and required the companies to develop plans to become leaner and more efficient. We believed this was the only way the companies could become more competitive and the only way to protect the taxpayers' investment. The assets of both GM and Chrysler were sold to newly created entities through the bankruptcy courts in exceptionally fast and efficient proceedings. The new companies are now leaner and more efficient and poised to help further the ongoing economic recovery and the competitiveness of the American automotive industry.

#### Treasury's Role as Shareholder

As a result of the financial crisis, the government has had to intervene in the economy in unprecedented ways, and I know many people have questions concerning the role of the government as a shareholder in private companies. The Obama Administration has given this subject careful thought, and I would like to explain the fundamental principles that govern our actions as a shareholder.

First, the U.S. government is a shareholder reluctantly and out of necessity. We intend to dispose of our interests as soon as practicable, with the dual goals of achieving financial stability and protecting the interests of the taxpayers.

Second, we do not intend to be involved in the day-to-day management of any company. Our responsibility is to protect the taxpayers' investment. Government involvement in the day-to-day management of a company might actually reduce the value of these investments, impede the ability of the companies to return fully to being privately owned, and frustrate attainment of our broader economic policy goals.

Third, consistent with these goals, we will take a commercial approach to the exercise of our rights as a shareholder. We 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.

#### Daily Concerns

I also want to discuss three concerns that I focus on every day, that are central to our duty to protect the taxpayer. The first is, do we have the proper controls in place to ensure accountability? Second, are we being good stewards of the taxpayers' money? And third, are we communicating what we are doing in a transparent and timely manner?

First, we know that proper controls are critical to protecting the taxpayers' interest. In addition to review by this and other Congressional committees, EESA provides for oversight of TARP by four oversight bodies, and Treasury takes its responsibilities to these oversight bodies very seriously. Treasury personnel spend a significant amount of time meeting and communicating with these four oversight bodies (the Special Inspector General for TARP (SIGTARP), the Congressional Oversight Panel, the Financial Stability Oversight Board and the Government Accountability Office (GAO)), as well as with Congress. I meet weekly with SIGTARP to discuss our current activities and their concerns, and my staff is in constant contact with the SIGTARP staff. Treasury has fully or substantially implemented over 75 percent of the recommendations made by SIGTARP. We have also involved them early in the process of design of a program or investment so that we get the benefit of their suggestions at the outset.

Personnel from the Office of Financial Stability meet regularly with the other oversight bodies as well, and Treasury has given careful consideration to each of their recommendations. The GAO has consistently noted the progress Treasury has made in meeting its recommendations.

In the unusual cases where we have declined to implement a recommendation, we have sought to reach the recommendation's objectives by other means that we consider to be more practical, effective or supportive of achieving financial stability, and have explained our approach to the oversight bodies. In those unusual situations, we have explained our reasons to the oversight body and to Congress in detail.

In addition, OFS is audited by the GAO and will publish its first set of annual financial statements on November 16<sup>th</sup>.

Second, we have been both careful and assertive stewards of the taxpayers' money. We do not make an investment unless it complies with the statutory requirements, is necessary to restoring or maintaining financial stability and is made on terms that protect the taxpayer. Since the Obama Administration took office, Treasury has provided \$144.42 billion in TARP assistance, and has received repayments, dividends, interest and other payments in the amount of \$70.56 billion. In the attached report is a chart detailing TARP investments made by month. You will note the general downward trend in the gross amount of capital expended.

Third, as I committed in my confirmation hearing, we have taken many steps to communicate in a fully transparent and timely manner. We have never missed a deadline for a report. As of September 18, 2009, Treasury has published 83 Transaction Reports, 10 Section 105(a) monthly Congressional Reports, 7 Tranche Reports, 3 dividend and interest reports and 2 MHA Program Reports, all of which are posted on our website. We have recently completely revised the format of our monthly Section 105(a) report, a copy of which is attached. As you will see, it presents updates on our investments and programs as well as background information in a far clearer, more concise manner. It answers basic questions that many Americans have, such as: how are TARP monies invested?

We have also published a monthly lending survey that contains detailed information on the lending and other activities of over 500 banks that have received TARP funds, as well as separate information for the largest 22 banks. These reports are intended to help the public easily assess the lending and intermediation activities of participating banks. More broadly, they also help answer the question of what banks are doing with their TARP funds. We believe the detailed quantitative information contained in these reports addresses the fundamental concern underlying that question, which is whether TARP has helped restore our banks to health so that they can lend to creditworthy families and businesses. Beginning next month, we will be expanding the report in response to suggestions from SIGTARP for reporting on use of funds.

Additionally, we post program guidelines on our website, [www.financialstability.gov](http://www.financialstability.gov), within two business days of any program launch. We also post for public review all obligations made under TARP as well as all contracts with Treasury service providers involved with these programs. We recognize that transparency is paramount when managing taxpayer funds.

#### Exit Strategy

TARP was designed as an emergency response to a major financial crisis, and I would like to address what Treasury sees as some of the next steps for TARP. Because financial conditions have started to improve, Treasury has already begun the process of exiting from some emergency programs. But how and when we exit will vary by program. For example, as I noted earlier, Treasury has received over \$70 billion in principal repayments from CPP participants. Treasury has also almost \$3 billion in warrant proceeds from the repurchase of warrants by banks that have already repaid the principal investment. For those banks that have elected not to repurchase their warrants, Treasury intends to begin auctioning those warrants later this year. It will, however, be some time before all CPP participants have fully extinguished their obligations to the taxpayers.

Certain TARP programs have a defined life. For example, new lending under TALF is scheduled to cease in mid 2010, even though Treasury's credit support of the TALF facility will continue for a number of years. Although PPIP is just being launched, the investment period for the fund managers is limited to three years.

The Administration has established clear principles to ensure that our investments in the automobile industry and other companies that have received exceptional assistance are limited and temporary. Chrysler Financial has already repaid its assistance, and an initial public offering for GM is expected next year.

At the same time, we must remember that our economic recovery has just begun and significant parts of the financial system remain impaired. Declining prices in the commercial real estate market could put additional pressure on bank balance sheets and capital positions, while continued downward pressure on housing prices could stall a nationwide recovery. In this context, it is prudent to maintain capacity to address new developments. By bolstering confidence, having such capacity may actually reduce the need to use it.

As we look ahead, we must also not forget the lessons we have learned from this period. Reforming our regulatory system in a way that is stronger and better-suited to manage risk and ensure safety and soundness must be our highest priority. The Administration has proposed a number of measures in this regard that I know you are already considering as you work to address this important issue.

#### Conclusion

Financial stability is a necessary precondition to the resumption of economic growth. Treasury and other institutions of government have accomplished a great deal in a short amount of time to achieve this goal. However, we recognize that we have more work ahead of us on both the regulatory reform and economic fronts. TARP, the Office of Financial Stability, and the Office of Domestic Finance have been essential to President Obama's and Secretary Geithner's plans for financial stability and economic recovery.

Ending the financial crisis is not primarily about helping banks, but about restoring the flow of credit to consumers and businesses and alleviating the real hardships that Americans face every day. Healthy and vibrant financial institutions are critical for this, as they are the key sources of a range of financial services that we depend on every day. Without healthy banks, consumers cannot access the credit they need to buy a home, finance an education, manage everyday expenses or make other financial commitments. Small businesses cannot buy the new equipment, raw materials and inventory that they need to expand. Larger businesses cannot make the continuous adjustments required to function in a changing global marketplace.

It is with these goals in mind that we have created the programs under the TARP and the Financial Stability Plan. As I work with my dedicated colleagues in Treasury on these programs, I will strive to continue to be a prudent investor on behalf of the American people.

Thank you.

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