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OVERSIGHT CONCERNS REGARDING TREASURY DEPARTMENT CONDUCT OF THE TROUBLED ASSETS RELIEF PROGRAM

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

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OVERSIGHT CONCERNS REGARDING TREASURY DEPARTMENT CONDUCT OF THE TROUBLED ASSETS RELIEF PROGRAM

Wednesday, December 10, 2008

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10:01 a.m., in room 2128, Rayburn House Office Building, Hon. Barney Frank [chairman of the committee] presiding.

Members present: Representatives Frank, Kanjorski, Waters, Maloney, Watt, Ackerman, Sherman, Meeks, Moore of Kansas, Capuano, Hinojosa, Clay, McCarthy of New York, Baca, Lynch, Miller of North Carolina, Scott, Green, Cleaver, Moore of Wisconsin, Davis of Tennessee, Hodes, Klein, Mahoney, Perlmutter, Murphy, Donnelly, Foster, Carson, Speier; Bachus, Castle, Royce, Manzullo, Biggert, Capito, Feeney, Hensarling, Garrett, Brown-Waite, Barrett, Neugebauer, Price, Campbell, Putnam, Bachmann, Roskam, McCotter, and Heller.

Also present: Representatives Issa and Pascrell.

The CHAIRMAN. The hearing will come to order. We have been asked by the Republican side to use the full 20 minutes on each side for opening statements, so we will go to that, but I was also asked to accommodate the gentleman from California. So, we will begin. The gentleman from California is recognized.

STATEMENT OF THE HONORABLE DARRELL E. ISSA, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. ISSA. Thank you, Mr. Chairman. I appreciate your indulgence in this. I know we are all on kind of a crazy schedule here in this extended, extended, extended Congress.

Mr. Chairman, Ranking Member Bachus—if he was here—and members of the committee, I want to thank you for this opportunity to speak today. There is no more important issue before Congress now than ending the financial crisis that besets our country, whether it is in fact the financial crisis that we believed we were dealing with only weeks ago or it is the auto companies that were before you this week.

As you know, I have been a critic of the bailout from its inception. I have stressed deliberate action and warned of potential failures. I think I have been vindicated in my objection to that spend-

ing of $700 billion of taxpayers' dollars, of which half already appears to have been spent.

I am not pleased with that. I wish I had been wrong. After all, these are not private funds that companies can use freely. These are, in fact, the future tax dollars of Americans, and our children will be paying not just the principal but the interest for generations to come.

To date, the oversight of the bailout has been severely lacking. Through no fault of the Congress, we were pushed to quickly pass a bill that only generally called for accounting. The Government Accountability Office—as we will hear more about today—the Washington Post and other media outlets, and most importantly, the American people have been critical of the lack of oversight and the inability to apply oversight. People want to know where their money is being spent and if it is having the impact that is intended, and few think that it is.

While we know there are many bad actors and causes of financial crisis from lack of lending practices to insufficient regulatory scrutiny, substantial questions regarding the root causes still remain. Yesterday, in our Committee on Government Reform we dealt with Freddie Mac and Fannie Mae, and we came away with more unanswered questions than answered questions.

Neither Congress nor officials within the Administration have sufficient expertise to gain a full understanding of the complex issues surrounding both how we got in and how we will get out of this. A Colombia University professor recently stated that any reform must begin with a dispassionate and informed assessment of what went wrong. And I agree.

We must pass legislation to create a bipartisan or nonpartisan blue-ribbon panel that can give the American people an objective assessment of the causes and the handling of the financial crisis. Although no one bill would be perfect, and certainly mine is no different, in November, I introduced H.R. 7275, the Financial Oversight Commission Act of 2008. Modeled after the 9/11 Commission, the Financial Oversight Commission is designed to have experts examine the causes of this crisis, evaluate corrective measures taken thus far, and make recommendations for alternative measures. The commission should examine the missteps of we as Congress, the Administration, the private sector, nonprofit organizations, certainly the GSEs and all others have taken, and then make recommendations on the next step forward. Had we done this in the original legislation, we would already be halfway through the commission process.

The commission could take up to a year to conduct its entire investigations, make findings, and report the recommendations to Congress and the President. However, as I am sure the Chair would agree, commissions in the first 90 days often accomplish a great deal of what they will accomplish in 1 year by bringing the type of focus and the type of individuals and the type of scrutiny that causes others to begin to volunteer changes.

As economic conditions in the financial sector itself are not static, the panel will continue its review and would evaluate ongoing circumstances. In a report to Congress, the commission shall make a complete accounting of the circumstances surrounding the crisis,

the private sector, the government role in causing the crisis, and the extent to which the United States preparedness for immediate response to a future crisis. The report should offer a conclusion and recommendations for corrective measures that can be taken to prevent further economic breakdown.

Mr. Chairman, Ranking Member Bachus, it is time that we realize that we are a partisan organization; the next President will be a partisan organization; that we had a hand in the creation of this problem, whether it was a large hand or a small hand; whether it was in fact things we told the financial institutions to do or, quite frankly, oversight we failed to assert over them at both the executive and the congressional level.

So Mr. Chairman, I strongly recommend that as you deliberate the current, you begin thinking about how we would put together, on a broad basis, a commission that would be a tool of this Congress. I thank you for this opportunity.

The CHAIRMAN. The gentleman from New Jersey.

Mr. PASCRELL. Thank you, Mr. Chairman.

The CHAIRMAN. I am going to try to hold Members as close as possible to 5 minutes. As close as possible means as long as I don't daydream, 5 minutes.

STATEMENT OF THE HONORABLE BILL PASCRELL, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW JERSEY

Mr. PASCRELL. Thank you, Mr. Chairman, Ranking Member Bachus, and members of the committee for allowing me to present testimony before this committee. I am here to talk about the need to use TARP funds to open up the credit market for consumers to start purchasing automobiles again.

Mr. Chairman, while I was back home in New Jersey this last week, I happened to pass the Port of Newark, and saw an endless stream of brand-new cars, just row upon row, sitting there, seemingly hoping to be moved by fate, if not by sale. I have never seen that many cars piled on top of each other—well, not unless you count D.C. traffic on a Friday afternoon when everyone is trying to get out of town.

Mr. Chairman, the fact is that no bridge loan or bailout of the auto industry or any other industry for that matter, no matter how well-structured or planned, will work unless credit is available to consumers to make these purchases. And purchasing power and credit is down 99 percent from last year.

The reason why I voted, and I believe so many Members of Congress voted, to approve the $700 billion in October was so that the Treasury could open up the frozen credit market. This was supposed to help keep people in their homes, and make it possible for the American people to make large purchases, like automobiles, that could boost our ailing economy. Sadly, that does not seem to be occurring.

The economic health of our Nation depends on a robust automotive industry. Nearly 1 in 10 Americans rely on the automotive industry for their livelihood and their financial security. Auto sales constitute 20 percent of all retail spending in the United States

and generate up to 20 percent of the sales tax revenue for State and local governments. We know how hard-pressed they are today.

We have heard a lot of talk in the past few weeks about the bridge loan being a bailout for the Big Three or an economic stimulus intended just for Detroit. But I don't think one Main Street in America, I can't think of one that isn't affected when a local new-car dealer closes shop, takes good jobs and economic opportunity with them. When a new-car dealer goes out of business, they not only take away jobs and money, but they also become a blight upon the landscape, a visual reminder of the failures in our economy.

Nearly 700 mostly family-owned new-car retail businesses have closed in the past 11 months. That equates to some 20,000 newly unemployed Americans, just in time for this holiday season. The automobile retail industry is highly credit-dependent and has been hit especially hard by the recent financial crisis in flagging consumer confidence.

Although it is an opportune time to buy a new car, thanks to many industry deals and great incentives, the public cannot get the financing they need to bring that new car home. People who have the good credit necessary to get car loans can no longer gain approval for their purchases. In fact, for 2008, only an estimated 13.5 million new vehicles were likely to be sold, down from 16.1 million in 2007, which is a 15-year low.

The truth is that this crisis in the automobile industry goes far beyond the Big Three. Sales at Toyota and Honda are down more than 30 percent from last year, and are down more than 40 percent, roughly in line with the loss of sales for American automakers.

We need to stop making this an issue of blame and find the constructive solutions necessary to get the economy moving. It was my understanding, and I thought it was your understanding, Mr. Chairman, that the TARP was supposed to be one of the main solutions, but so far that has not come to fruition for the average American. TARP funds have been greatly mismanaged to date and they have not been used to help consumers purchase the goods that they need.

I believe that the TARP funds should go directly into helping consumers gain access to these loans which would provide a direct stimulus to the economy. Credit is essential in our economy. If loans don't get made, businesses don't expand, orders don't get placed, and workers don't get hired. As banks have restricted access to mortgages, auto loans, and credit cards, consumers have had to alter their spending behavior so rapidly that companies cannot adjust fast enough. The Treasury should use TARP funds to open a credit market for auto loans because, as I stated before, no amount of loans or bailout will work in the short or long term unless consumers are able to buy the cars in the first place.

Mr. Chairman, I would like to mention that I also believe we urgently need to consider new tax incentives for consumers. I would in closing say, as you know, I introduced the bill, we talked about it in the last meeting, the Auto Insurance Tax Assistance bill. I call on you, Mr. Chairman, and Mr. Ranking Member, to do something

about the TARP funds to get this economy moving. And automobiles have a lot to do with it.

Thank you, Mr. Chairman.

The CHAIRMAN. I thank both Members. I will now begin our opening statements. I will of course begin by—we had to sit through yours, but you don't have to sit through ours.

The gentleman from New Jersey well understands, as a member of the Ways and Means Committee, the last item he mentioned is not within the jurisdiction of this committee, but of the Ways and Means Committee.

While we are on the subject of jurisdiction, I want to be sure the new ranking member of the Oversight Committee, who apparently yesterday expressed some concern that we would screw his committee out of doing their job, nothing could be further from the truth. That was what was reported. The AP said they heard that.

Mr. ISSA. Thank you, Mr. Chairman. I will be glad to talk to you anytime. We don't have to use the AP.

The CHAIRMAN. Excuse me. I haven't yielded. We have rules here. I was responding to an AP comment. The gentleman said we could talk at any time. I don't remember hearing from him. I read it in the AP.

I want to just respond here in this way: Some of my Republican colleagues appear to believe that the world was created in January of 2007 when we became the Majority. I will tell you this: The relationship between this committee and what was then the Committee on Government Reform did not change in 2007. The notion that somehow there was some machination on the part of myself or others to diminish the role of that committee is: (a) wrong; and (b) completely ignores the history. There was literally no change in that relationship between the chairmanship of Mr. Oxley. So this notion that somehow in January of 2007 we began some change is wrong.

Secondly, I will say that I have at no point ever asked any member of that committee not to do anything. I worked with Mr. Kucinich, who is the chair of the appropriate subcommittee. At one of our most recent hearings, I read into the record a letter that he had done. I encouraged Mr. Waxman to go forward. So if there was not oversight to the gentleman's satisfaction, that was entirely the result of decisions made within that committee. During the 12 years of Republicans being in the Majority, and during the last couple of years, it did seem to me they began to do some things. So I did want to allay the gentleman's fears.

Mr. ISSA. If the chairman would yield?

The CHAIRMAN. I listened to the gentleman's statement, and read what he said in the paper.

Mr. BACHUS. May I ask the chairman, what is the order here?

The CHAIRMAN. I am making my opening statement.

Mr. BACHUS. This is your opening statement. Okay.

The CHAIRMAN. It is not my closing statement.

I said we were through with them and we would now go to opening statements. I said they didn't have to listen to ours. I would have preferred an opening statement that was more relevant to this hearing, but when things are said inaccurately, and reported

in the newspaper, and they cause some concern, I like to calm people down.

I have people worried that this committee is plotting to take away their jurisdiction. I don't want to ruin anybody's Christmas by thinking I am going to Grinch-like take away the jurisdiction of another committee.

I yield to the gentleman from California.

Mr. ISSA. I thank the chairman. As you know, we worked together very well while we were both on Judiciary together. The comments yesterday with an open mike quite candidly, taken properly, would have been a compliment to you and to Mr. Waxman.

The CHAIRMAN. I appreciate the compliment. I would say my advice—the gentleman is free to take it or not—is that I would shut off both the compliments and the mike next time.

I have to get back to the subject of this hearing, which is the TARP. I am not going to exceed my 5 minutes, and no one else is.

I did vote for this. I continue to think I was right to vote for this. One of the advantages that economists have over people in the public sector is that they can employ something called the counterfactual. They can—and Professor Warren is nodding her head; I appreciate the validation—compare what was happening to what would have happened in the absence of action. That is the counterfactual.

I have said before what people say to me, "Well, what do you think about the way that TARP is working?" I have invoked before the wisdom of the great 21st Century philosopher, Henny Youngman in his exchange, "How's your wife?" "Compared to what?" The metric of, "compared to what" is a very important one when you are doing this.

I do believe that the counterfactual here, namely our failure to have done anything at all late last fall in the face of the credit crisis, would have left us in a worse situation. I would just cite, as I have done before, the treasurer of the State of Massachusetts, who reported he couldn't roll over short-term notes, meaning payroll for the Commonwealth of Massachusetts, paying vendors. Once the bill was passed, he was able to do it. The treasurer of California, Mr. Lockyer, I know has communicated similarly.

So the question is not whether we should or shouldn't have done that, in my mind; but having done it, could it have been executed better? I believe it can.

I would cite two things as I draw this to a close. In the legislation, indeed essential to the passage of the legislation was the language the gentlewoman from California worked on, among others, to ensure that some of these funds would be used to reduce foreclosures, not solely or even largely as a matter of compassion for individuals, but because in the macroeconomic sense foreclosure reduction is an essential part of the problem of getting us out of the problem we are in. The refusal so far to use the money for that purpose has been, I think, a violation of the intent and undermines the ability to get votes in the Congress to do things in the future.

Similarly, I was distressed when we were told we didn't have good oversight. The fact we are in this hearing, responding to a GAO report, shows that we did have good oversight. The GAO was in there from day one. We met with them. They have done a very

good job. There is a new board that will also be doing some oversight.

The point is that what troubled me was when Treasury was asked by GAO, "Do you know how much money each bank is lending out, those that have gotten capital infusion?", they appeared to say, "We are not going to try to find that out." Now, I am hoping and some indications are we are going to get a clarification of that. On those two issues, I was disappointed.

The gentleman from Alabama is recognized for how much time?

Mr. BACHUS. You took 7 minutes. If I could have an equal amount of time.

The CHAIRMAN. It is 20 minutes and 20 minutes. I am surprised he is acting as if there are new rules here; it is 20 and 20.

Mr. BACHUS. I will take just take 5 minutes. I am sure I will have other members.

First of all, and I didn't realize we were going to depart from the subject matter of the hearing, but I want to compliment you, Ranking Member Issa, for yesterday's hearing. I want to say to Members on both sides and to the general public that what you are hearing revealed yesterday was quite astounding, and that is that we had Fannie and Freddie—if I am characterizing this right, there were multiple warnings; people within those organizations which were warning that what they were doing was dangerous. They were being pushed by mandates, affordable housing mandates and mandates to make loans which should not have been made.

I hope this Congress will take a look at the various sometimes congressional-mandated, sometimes administrative-mandated, directives to loan money to people who, quite frankly, did not have the ability to pay them back. No document loans, stated income loans, just a smorgasbord of bad business decisions. And it wasn't as if people in the organizations were not sounding the alarm. I thank you and Scott Garrett on this committee who participated in that.

I listened to a great deal of that. People wondered where I was yesterday. I was following that hearing. It was a very important hearing.

As we attempt to pick up the pieces with you and not make mistakes of the past, I hope we won't let what went on at Fannie and Freddie go on in the future.

So I compliment you, Ranking Member Issa—Ranking Member-elect Issa.

Mr. ISSA. I think that is more appropriate.

Mr. BACHUS. And I compliment you, Mr. Garrett, for your, I think, very constructive role.

It has now been a little over 2 months since Congress passed legislation establishing TARP. A lot has happened in that time, some good and some bad. A particular concern of many members on this committee has been the Treasurer's ever-shifting strategies and explanations for its actions in implementing TARP, which have resulted in uncertainty among market participants and confusion among the American people. This has made it more difficult to achieve the goals that Congress has set in creating TARP and stabilizing the financial markets and increasing the flow of credit to Main Street.

There has been some semblance of order restored in certain segments of the credit markets and among the financial service industry, and that is a good thing. No one faults Treasury for trying to tailor its policy responses to changing market conditions and challenges. But as the GAO report clearly states, implementing its various initiatives, Treasury has often failed to explain to Congress and the public what it hoped to achieve or to clearly communicate its expectations for the institutions that receive funding.

For example, Treasury and the regulators have indicated recently that they expect the banks that have received an infusion of government money under the Capital Purchase Program to lend, rather than hoard, the cash. But the time to have thought about that, about what we expected banks to do with those funds, was before the money went out the door as a condition of investment rather than after the money was already in the banks' vault.

That is why some of us in the negotiations on TARP asked if there would be conditions, and we were told that would limit the program. We talked about clawbacks, we talked about restrictions on dividends, we talked about something that Mr. LaTourette has complained about, and that is these banks using those funds to acquire their competitors or other banks. We think that is a serious matter. It is not in the legislation. But if there is any way to undo that admission, it needs to be done.

Now I will close with this. I wonder whether Secretary Paulson or Mr. Kashkari, back when they were still working for Goldman Sachs, ever agreed to a deal in which billions of dollars changed hands, based on a 2-page application, without asking what the money was going to be used for or whether it was going to be paid back. For instance, the Uniform Residential Mortgage Application is 8 pages. The application for Federal Student Aid is 11 pages. When student lenders and mortgage companies ask more questions in lending thousands of dollars than the Federal Government does when it injects billions of dollars' worth of capital, we should all be concerned.

The application process for the Capital Purchase Program, consisting of a 2-page form in which the bank identifies itself as a bank and asks for money and little else is very surprising. Secretary Paulson and Mr. Kashkari, you cannot be faulted for not having all the answers and for not being able to predict the future. But when you are acting on behalf of the American taxpayer, the taxpayer has the right to expect they will exercise the same basic judgment, the same standard of care that they would have exercised when they were working for Goldman Sachs and its investors. They should be held to the standard of care that we would expect from a reasonable, prudent investment banker whom I hope would not agree to a deal without doing some minimal amount of due diligence and conditions.

Secretary Paulson and Mr. Kashkari should learn something from what we have seen in these past few weeks in connection with the committee's consideration of a possible bailout for the domestic auto industry. The CEOs of those automobile makers appeared before us to present detailed business plans showing how they intended to return their companies to profitability. They tried to justify their pleas for taxpayer help by admitting that their business

models were flawed and explaining how they are going to change them. While the jury is still out on whether they made their case successfully, the detailed explanations and documents they put before us and the American people stand in stark contrast to the lack of information we have received from Treasury or from the financial institutions that have received taxpayer money under TARP.

Let me close by thanking Chairman Frank for holding today's hearing, giving me the opportunity to focus on yesterday's hearing before the Oversight and Government Reform Committee, which was very important, and for inviting our colleague, the gentleman from Texas, Mr. Hensarling, to testify on the important work being done by the TARP Congressional Oversight Panel. He has some concerns. I share those concerns, and I look forward to his testimony. I look forward to his insights and those of the other witnesses.

Thank you.

The CHAIRMAN. Given the concern about time, how much time did the gentleman consume? Someone tell me how much time. The gentleman consumed 7½ minutes, so the gentleman has 12½ minutes left to allocate. We have consumed 5½ minutes, so we have 14½ minutes left.

The gentleman from Pennsylvania is recognized for 5 minutes.

Mr. KANJORSKI. Thank you, Mr. Chairman. The oversight of the Troubled Assets Relief Program is inadequate and must quickly improve. Where it takes time to establish an appropriate oversight program, we have run out of time. Of the $350 billion allocated to Treasury to date, $335 billion has been spent or obligated.

The Emergency Economic Stabilization Act became law on October 3rd and called for strong oversight. However, the first members of the Congressional Oversight Panel were not named until 6 weeks later, on November 14, 2008, and the Senate confirmed the special inspector general of TARP a mere 2 days ago. It was difficult to have quality oversight when the overseers did not exist.

Surely Americans are baffled that corporations have, to date, been given taxpayer money with no strings attached and without transparency. The dire need for improvement is evident to everyone who reviewed the Government Accountability Office study released last week. It is full of examples of failed supervision. According to GAO, the Treasury has implemented TARP by directly investing $150 billion in 52 financial institutions. While the Treasury claims its purpose behind the Capital Purchase Program is to increase financing and to incur mortgage modifications, it makes no such demands that the capital recipient actually engage in those activities.

The GAO also reports that institutions have no reporting requirements, and while the Treasury asks the companies to comply with executive compensation limits, no compliance mechanism is in place. Further, conflicts of interest have not been adequately addressed. According to GAO, the Treasury must prove its communication with both the Congress and the public. We deserve to know why and how the Treasury is implementing this program.

Two of the members of the Congressional Oversight Panel are here with us today. We know that from press reports that Ms. Warren is dissatisfied with Treasury's lack of a clear sense of its funda-

mental purpose with regard to TARP, for what began as a troubled assets relief program has morphed into something entirely different.

I look forward to learning more about the Congressional Oversight Panel's findings from today's testimony and its report. My hope is that greater oversight, transparency, and accountability will be pursued with the utmost urgency. If necessary, Congress should consider legislation to provide the special inspector general with broader powers.

Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Castle, for 1½ minutes.

Mr. CASTLE. Thank you, Mr. Chairman. Thanks for continuing to hold hearings on the Troubled Asset Relief Program.

I am concerned that when we passed the Emergency Economic Stabilization Act, we developed layers of oversight for the Troubled Asset Relief Program and not a capital injections program, which is what we actually have been carrying out. I am pleased that GAO and Treasury have published these recent reports, which are very insightful on TARP's progress, but I would like to ask the witnesses today if they believe the regulations we have implemented need to be modified due to the Treasury's switch from a troubled asset buying plan to the capital purchase program.

Additionally, Mr. Chairman, I am equally concerned about the almost $1 trillion in emergency loans and private asset purchases recently made by the Federal Reserve, and the absence of oversight we are dedicating to these expenditures. Section 129 of the Emergency Economic Stabilization Act requires oversight of decisions made by the Federal Reserve Board when acting pursuant to section 13–3 of the Federal Reserve Act. However, I believe the EESA requirements could go farther. The details of these emergency acts by the Fed are not subject to the same rigorous scrutiny that Congress required of Treasury actions made under the TARP.

While I respect the long-established history of the Fed to keep intervention of institutions confidential under other sections of the Federal Reserve Act, these emergency actions have been widely reported in the press and subject to very limited review. I would welcome a hearing by this committee in consideration of the Government Accountability Office's review of the expenditures made by the Federal Reserve.

Mr. Chairman, I would like to submit for the record a letter raising these concerns, which was given to your staff yesterday.

The CHAIRMAN. Without objection, it is so ordered.

Mr. CASTLE. Thank you. I yield back.

The CHAIRMAN. The gentlewoman from California is recognized for 4 minutes.

Ms. WATERS. Thank you very much, Mr. Chairman. If there is one thing I regret, I regret attempting to be cooperative in providing to Treasury the flexibility to deal with our economic crisis. Not only, again, did I work very hard with members of this committee, but the Congressional Black Caucus, and the Hispanic Caucus, showing just how homeowners would be helped, how the loans would be modified, and ensuring them that I trusted the Treasury to do what it claimed it would do when they came to us to request this extraordinary amount of money without a lot of strings at-

tached. And so here we are, and we don't have any systematic way of helping homeowners to modify these loans. The Treasury has refused to use their dollars to buy up the nonperforming assets. And the money has basically gone as equity investment in banks that are not putting the money back out so that our consumers can have access to credit.

Take a look at what is happening in Chicago, where you have poor workers who are sitting in a Republic Windows and Door factory because Bank of America—to whom we gave $15 billion in TARP funds—refused a line of credit and refused to follow through on its commitment to finance the company.

Now I don't know who the Treasury—I, too, don't know who they believe we are and what we can or cannot do, but I am sure, I am just sure that Mr. Kashkari, who is here today, has come to tell us how they are going to correct this. If he is not here to tell us how they are going to correct it, I am going to have to proceed with a bill that I am introducing that will basically place into law the program that Ms. Sheila Bair has put into place to do loan modifications, a proposal or program that she has shown can work because of what she has done with the takeover of IndyMac.

And so the world is watching. Many communities are disadvantaged. We are losing the value of homes in communities across this country. The foreclosures continue to rise. And we sit here twiddling our thumbs, trusting Treasury to do what they said they were going to do.

I want to hear from Mr. Kashkari today. They told us that this Interim Assistant Secretary for Financial Stability would come with a program and plans that would help us out of this economic crisis—that he was a genius and we could expect great things from him. So far, I have seen nothing. And I know that in addition to what Sheila Bair has done, there are other proposals that have been brought to the Treasury for the modification of these loans so that we can stem the tide of foreclosures.

Mr. Chairman, I appreciate everything that you have done, but I am not going to even cooperate with you anymore when you try to be reasonable. Now don't come back with a fast answer. I know you are about to do that. I just want you to know, as much as I respect you and do everything that I can to be supportive, you have been too kind, you have been too good, and you have allowed them to walk all over us. It doesn't feel good. These footprints on my back are just too tough. And we have to do something to make sure that the money that we are signing off on is used appropriately to help the consumers and homeowners of this country.

Thank you. And please do not use your microphone.

The CHAIRMAN. The gentlewoman doesn't have to worry about much further communication between us.

The gentleman from California for 1½ minutes.

Mr. ROYCE. Thank you, Mr. Chairman. The question of modifying these mortgages is one that I think we are all concerned with. I am interested in hearing the Comptroller General's comments and the Assistant Secretary's comments here.

This week a new issue has sort of come to light, and one that I think all of us should be concerned about. The least expensive way for the taxpayers for these modifications of loan agreements to

occur is by the loan servicers to concur that if you have, let's say, a 5-year ARM that is going to shoot up to 8 percent, it makes more sense to modify that loan and convert it into a 30-year loan at 6 percent and leave it on the books on the basis of the original term of the loan.

What is it that keeps the loan servicers from modifying these agreements? The answer is a class action lawsuit last week has done exactly what some of us have counseled against, warned about. We need to have legislation in order to stop the chilling effect on mortgage servicers of bringing these class action lawsuits.

This one last week, targeting 400,000 loan workouts, which kept borrowers in their homes and, frankly, worked to the benefit also of those who had lent the money; because at the end of the day, you lose 30 percent to 50 percent during a foreclosure in terms of the value of that asset.

So many presume that this wasn't required by the way of legislation. Clearly it is. And if we do that, then arguably the 2.7 million loan workouts that we have seen—that haven't cost the taxpayers anything—done in concurrence with the work of our Treasury Department and attorneys general across the United States as these workouts have proceeded, that number can grow enormously. Those in the industry tell me the one thing that is keeping loan servicers from coming to the table is this issue.

Thank you, Mr. Chairman.

The CHAIRMAN. The gentlewoman from New York for 2 minutes.

Mrs. MALONEY. Thank you, Mr. Chairman, for having this hearing. Regrettably, the report from GAO today makes clear that Treasury is not taking responsibility for making sure that the moneys are used consistently with the purposes of the Act. We will have to legislate that we want accountability, transparency, a systemic system with regulators so that we can track and find out where this money is going. A prime purpose of this Congress was to help people stay in their homes. I completely support FDIC Commissioner Sheila Bair's program, and am willing to legislate it with my colleagues. But we urge Treasury to put it in place.

We do not know what banks are doing with their money because Treasury will not tell us. But the press tells us that they are buying highways in Europe, that they are buying other banks, or that they are holding on to the money. What my constituents tell me is they cannot have access to capital. We have put $7.8 trillion of taxpayers' money out there for the purpose of creating credit, and it has been a dismal failure.

The car dealers were in my office yesterday from New York State. Americans want to buy their cars in New York State, but they cannot get credit from banks.

What I am getting calls on is the proposed 4.5 percent interest rate to get new homes in the pipeline and get our economy moving. We need to get credit out in our communities in order to revive our economy. Economist after economist has told us we will not solve this crisis until we solve the problem of keeping people in their homes and getting the housing market moving again.

I look forward to your proposal on the 4.5 percent interest rate—my phone has been ringing off the hook in support of it—or any

ideas or programs you have to get credit out into our economy to get our economy moving again.

Thank you.

The CHAIRMAN. The gentlewoman from Illinois is recognized for 1½ minutes.

Mrs. BIGGERT. Thank you Mr. Chairman, and thank you for holding this hearing today. Briefly, I would like to say that I am disappointed in several findings of the GAO report.

First, Treasury has yet to establish an insurance program, which I think is critical to the matter of determining the value of the liquid assets on the books of the financial institutions, not to mention helping us to understand the magnitude of the problem.

Second, Treasury has yet to set up a loan modification program to help worthy borrowers stay in their homes.

Third, and most importantly, it baffles me that there are no reports about where American tax dollars are going once a TARP check is written to a financial institution. With billions of dollars at stake, taxpayers deserve regular reports on how their money is being used to keep both financial institutions and our economy afloat. There must be far more accountability and transparency weaved into the implementation of this program.

I hope that today's hearing will give us an opportunity to hear Mr. Kashkari outline a concrete timetable as to when these items will be addressed.

With that, let me say I look forward to today's hearing, and I yield back.

The CHAIRMAN. The gentleman from Texas has asked for 1 minute.

Mr. GREEN. Thank you, Mr. Chairman. I want to be as concise as I can and make this very clear. We live in a world where it is not enough for things to be right; they must also look right. And it may have been right to convince the American public that we would spend some of this $700 billion on mortgage-backed securities by way of a reverse mortgage process; it may have been right, but it doesn't look right when that kind of course change takes place and the American public is left without a clear and concise understanding of what happened. That has to be explained sufficiently to the public or it does create some harm as we move forward and make attempts to do the just thing in a time of economic crisis.

I yield back the balance of my time.

The CHAIRMAN. The gentlewoman from West Virginia for 1½ minutes.

Mrs. CAPITO. I want to thank you for holding this hearing today, and I look forward to learning the progress of the TARP program. As many of my colleagues did, I opposed the creation of the TARP for three basic reasons: It was too fast; had too much risk for the taxpayers; and it did not contain enough oversight.

Since the creation of the TARP, we have seen several iterations of the plan. My major question today is, you keep shifting the plan, the plan keeps going to different facets of the financial markets, and is this working and is it accounted for?

The recent GAO report expresses concern that there is not sufficient oversight of the TARP within the Treasury. That, to me, is

alarming. Proper oversight is needed to assure that the Treasury is being good stewards of the taxpayer dollars, but also to guarantee that institutions participating in the new Capital Purchase Program are complying with the limitations that are within those programs.

I can assure you the American taxpayers were certainly leery of this program to begin with. We must work together to make sure companies utilizing the TARP and the Capital Purchase Program follow important guidelines and find out the status of those initiatives.

I look forward to this hearing today. I am really astounded that as we move forward, the oversight portion of this huge program has not been one of the most detailed and most communicated parts of the program with the initiative that certainly I felt in my constituency, and felt in the constituency across the country, questioning the expenditure of $700 billion of taxpayers' dollars.

Thank you.

The CHAIRMAN. We will go to the gentleman from New Jersey for 1½ minutes, so we can balance it off.

Mr. GARRETT. I thank the chairman and the ranking member as well.

When Congress passed the Economic Stabilization Act, which created TARP, I also did not support the legislation, and I voiced many serious concerns that it was not the best solution to address the credit crisis. I advocated that Congress take a little bit more time to examine other alternatives, consider possible unintended consequences, and put in proper safeguards to make sure the money is actually spent appropriately. Had that been done, maybe members today who voted in favor of it would not have regrets.

Unfortunately, Congress rushed ahead, passed an open-ended bill that was sold to members as an asset purchasing plan, but was instead used to inject capital into the banking industry. Because the capital injection authority was really buried throughout the several different sections of the text and very little discussion was given during the debate to the strategy, apparently none of the appropriate safeguards—to include necessary provisions to guarantee the banks would actually lend the money and not hoard the capital or use it to pay dividends or buy other assets—were included in the bill.

If you had taken that legislation through the regular legislative process and had a committee markup, allowed amendments, perhaps we would have addressed some of the concerns that are being raised today.

I am also worried that we are making the same mistake right now with the auto bailout legislation being drafted. Democrat leadership and the Administration do not have a monopoly on good ideas. I think it would be very helpful for more members to have an opportunity to present ideas on how to improve that piece of important legislation as well.

Also, I am also concerned with the amount of time it has now taken for the Congressional TARP Oversight Committee to be established, before hiring staff.

With that, I yield back.

The CHAIRMAN. The gentleman from California, Mr. Sherman, for 1 minute.

Mr. SHERMAN. There are not just those who supported the bill and those who rejected it, but many of us who wanted to adopt a very different bill. Among those appear to be Secretary Paulson himself, who testified on September 18th that he would use the TARP bill only to buy toxic assets and not to buy preferred stock; then, by October 3rd, had changed his mind, buttoned his lips, and had us vote on what we thought was a toxic asset plan, only to have the Treasury implement its preferred stock asset plan.

I might have voted for the preferred stock investment plan, not because it is all that effective, but because it is far less expensive than the original toxic asset purchase plan. Being a basically nice guy, let me use this opportunity not to praise the frugality of the Treasury, rather than to disparage its duplicity.

While we talk about the cost of the bill, let us recognize it would cost the Treasury even less if we had negotiated tough with the banks. Instead, we got half the yield and one-sixth the warrants that private investors were able to get on similar transactions. Had we not played Santa Claus, had we not accepted the same number of warrants from those banks that posed very large risk to the Treasury as we accepted from those who posed less risks, we would have a smaller Federal debt to pass on to our children.

I yield back.

The CHAIRMAN. The gentlewoman from Florida for 1½ minutes.

Ms. BROWN-WAITE. Thank you, Mr. Chairman. Thank you for holding this hearing today. Over the past 2 months, a number of my constituents have contacted me about problems they are having with foreclosures and also obtaining loans. One of them is a small, very successful businessman in my district, who has had an account with his bank, which is the same bank, by the way, that received billions in bailout money. They are now blaming the financial crisis on the fact that they are substantially curtailing his line of credit. What does that mean? It means he is going to have to lay off people. It means he may very well be closing his business because right now he is operating it on his retirement funds that he is using to keep his employees employed.

Far from using the money from the Capital Purchase Program to increase the flow of financing to businesses, homeowners, and consumers, banks are actually hoarding the cash in their vaults. And if they are not hoarding it, they are using that cash for mergers and acquisitions. This should have been foreseen.

I voted against the bailout because it lacked a very clear plan and enough oversight to prevent our current situation. Let me be clear, I didn't support the bailout programs proposed by Secretary Paulson. However, many of my colleagues did. I believe that they thought that it would help the consumers. With this lack of oversight, clearly we have been sold a pig in a poke and a bait-and-switch has occurred. That is not fair to the taxpayers who are funding this massive bailout.

I hope we hear more about plans to protect not the banks, not the investors, but the taxpayers today. Thank you.

I yield back.

The CHAIRMAN. The gentleman from Georgia for 1 minute.

Mr. SCOTT. Thank you, Mr. Chairman. What we have here, quite honestly, is one big mess. That is exactly what we have. The people sitting at that table looking at us ought to be Secretary Paulson and the Treasury Department and the banks. We have been lied to; the American people have been lied to. We have been bamboozled; they came to us to ask for money for one thing, then used it for another. They said we would have oversight, and no oversight is in place. We have given these banks $290 billion for the sole purpose of so-called buying these toxics. They change it, and all of a sudden now they are not lending it but using it for acquisitions, using it for salaries. These are lies. We have been bamboozled. The Secretary of the Treasury owes us an explanation about this, owes the American people an explanation about this.

We have the auto companies coming to us. In a few days, we are going to give them a $15 billion loan. When they were here, we asked them, why can't you go to the banks? The banks won't lend it. Here we have sent them $290 billion, but they won't lend it.

Why won't the banks lend the money to small businesses and the American people? That is the question.

The CHAIRMAN. The gentleman from South Carolina for 1 minute.

Mr. BARRETT. Thank you, Mr. Chairman. In the interest of time, I will submit my statement for the record. This is about oversight; this is about accountability; this is not about writing a blank check and forgetting about it. This is the taxpayers' money, and we need some answers.

I yield back.

The CHAIRMAN. The gentleman from North Carolina for 2 minutes.

Mr. WATT. Thank you for convening this very important hearing. I really want to focus in on some very practical issues related to the use of the money that has been approved. When toxic assets were proposed to be purchased, a set of professionals were hired to administer that program. We received the announcement of who those professionals were. Then, right after, the whole focus of the program shifted from purchase of toxic assets to investments in banks, purchase of equity positions or preferred stock positions, or whatever. The professionals who had been hired under contract to administer that program, the toxic asset program, continued under contract and have continued to be paid. I would be interested in knowing, if they were hired to do the administration of toxic assets, what exactly are they doing now with taxpayer money?

These are multimillion-dollar contracts that we entered into, or at least hundreds of thousands of dollars of contracts that we entered into to administer a program that was never put in place. And it seems to me that we have a responsibility to know what those people who were under contract to do are now doing with taxpayer money. So that is one of the focuses that I will be pursuing today.

Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman from Michigan for 1½ minutes.

Mr. MCCOTTER. Thank you, Mr. Chairman. At the risk of being counterfactual, let me be clear, I appreciate the way that you have

held these oversight hearings and expect them to continue into the future.

We saw recently the auto companies appear right at that table because they requested tens of billions of dollars of taxpayer money. And yet as we continue to go through this process, we see no CEO or anyone from the financial institutions that have, to date, received hundreds of billions of dollars of taxpayer money. I hope that in the future, we can correct that. I don't care if they take a yacht, I don't care if they hitchhike; I think they should be here to account for what they did to put us where we are, how they will get us out of this, what they will do with the money they have received, and how it will help working Americans.

Thank you.

The CHAIRMAN. The gentleman from Texas for 1½ minutes.

Mr. NEUGEBAUER. Thank you, Mr. Chairman. Just recently, the budget deficit numbers for the first 2 months of this October-November were released, and it is half-a-trillion dollars. At that clip, that means we are on tap to do a $6 trillion deficit if things continue. One of the things that actually boggles my mind is that we are passing out billions of dollars without a plan.

The Treasury Secretary and the Chairman of the Federal Reserve have come to this group and they have talked about how we are trying to stabilize the markets. But we really don't have a defined plan with stated results so that the oversight board can actually monitor what is going on.

You can't go borrow money, as small businessmen in America, on the basis that the money is being passed out by the Treasury. What we need and what the oversight board needs is, we need to have some measurements that we are at some expectations, and we need an overall plan because we can't keep just throwing money at this problem until it gets better, because there is not an unlimited supply of money because we are spending money that we don't have. We are spending the next generation's money on the basis that we are operating now.

The numbers people are throwing are anywhere from $4 trillion to $7 trillion. I think that is a number that the oversight board needs to know. I think we need to know what the direct and contingent liabilities of all of the entities that are involved in this process have committed the American taxpayers to. But, more importantly, if you are going to have oversight, you have to have a plan to oversee, and there is no plan, and that should be of great concern to the American people because it is a great concern to me.

The CHAIRMAN. The gentleman from Nevada for 1 minute.

Mr. HELLER. I appreciate the opportunity to spend a few minutes here in this hearing to discuss what I am hearing as frustration in the community banking, especially the small community banks across this country. As they go to the Web site, they fill out these applications and wait. They literally wait, wondering when and if these TARP funds will become available.

I think this frustration, as I continue to get these phone calls—they want to know what the criteria are. "We filled out the 2-page application, and we heard nothing." What are the thresholds, what are the expectations, what are the criteria to know the difference—is it assets, is it deposits? What is the threshold that is going to

determine between a small bank and a big bank whether they receive assistance? Because these small community banks are not lending, they are saying they are not lending. In fact, most of them are just wondering if we are sitting around, waiting to be acquired by people who do receive TARP funds. So I am hoping that we can get answers to some of these questions.

Thank you, Mr. Chairman. I yield back.

The CHAIRMAN. This side has 30 seconds remaining. I am just going to use it to respond to a very important point made by the gentleman from California, Mr. Royce, about the lawsuits interfering with servicers. The gentleman from California has consistently raised that. This committee is determined next year to change the legislation defining legal rights here, so that we will not have this continuing ambiguity about servicers.

I will say, though, that acting on the initiative of the gentleman from Pennsylvania, Mr. Kanjorski, and the gentleman from Delaware, Mr. Castle, we did include in the legislation that we passed as good a clarification as we could have going forward that servicers who do what is economically in the best interest of the holders of those loans should not be sued.

The only further step we could take would be to indemnify them. The problem there is you would be using taxpayer dollars. And if the holder of the loan could sue the servicer and we then indemnified the servicer, you would put taxpayer dollars in the hands of the people who made these bad loans. I don't believe there would be any support for that.

The last thing I would say is the gentleman from California correctly mentioned a class action lawsuit. Of all the outrageous acts of social irresponsibility I have ever seen, it is the lead plaintiff in that lawsuit who bought paper solely for the purpose of doing it. We are not talking here of an owner who, having made the loans or having acquired the loans, subsequently ran into this problem. He bought that paper after the fact, I believe solely for the purpose of lawsuits. It is greatly irresponsible.

I have spoken to Treasury, and I think it is very important that we encourage Bank of America, which is the target of this suit, to stand up and fight that lawsuit. I hope there will be amicus briefs filed by the United States Government, by ourselves and others, because I think this is a scurrilous, socially irresponsible effort by someone who has no legitimate problem, because he is not talking about loans that had been previously been made.

I do think that the gentleman from California hit on an important problem. It is important that we deal with it at every level.

With that, we call up our witnesses. We have the Acting Comptroller General and the Interim Assistant Secretary. One of these days, we will get back into actual people. But we do appreciate the very hard work that both gentlemen are doing in their status.

Mr. Dodaro is the Acting Comptroller General of the Government Accountability Office. And I would just say, for people who want to know whether the Government Accountability Office puts its principles into practice, they are for saving money. We changed the name from the Government Accounting Office to a more descriptive name, the Government Accountability Office. But you will notice that we did it in a way that does not require them to change their

towels; it is still the GAO. So we all deserve credit for that efficiency.

And Mr. Neel Kashkari, who is the Interim Assistant Secretary for Financial Stability.

Mr. Dodaro, we will begin with you.

STATEMENT OF THE HONORABLE GENE L. DODARO, ACTING COMPTROLLER GENERAL OF THE UNITED STATES, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Mr. DODARO. Thank you very much, Mr. Chairman. Good morning to you and to the members of the committee. I am pleased to be here today to discuss GAO's efforts to evaluate the TARP program to date.

Soon after the legislation was enacted on October the 3rd, we moved quickly to put our team in place. And, as mentioned, we issued our first report within the 60-day requirement under the legislation last week, on December the 2nd. Now, that report outlines the actions that the Treasury Department has taken to date to implement the program and recognizes the challenges that they faced in starting a new program from scratch.

The report also, however, points out several critical issues that are not yet addressed. And, as a result, we made a series of recommendations that we think are very important and that, if properly implemented, can improve the integrity, the accountability, and the transparency of this very important program. Those recommendations fell into four general categories.

The first dealt with ensuring that the funds are being used in compliance with the legislation and that requirements, such as limits on executive compensation and payment of dividends, are complied with. To date, Treasury hadn't finalized its strategy for monitoring these very important initiatives. So we recommended that the Treasury Department work with the financial regulators which are already in place to develop a systematic means for ensuring that there is monitoring and reporting on the use of the funds to ensure that it is consistent with the Act and that it is being done in a timely fashion, and that there be an effective monitoring program put in place to ensure that the program requirements are adhered to by the institutions receiving the funds.

The second area had to do with the communications strategy. As has been pointed out this morning in virtually every member's opening comments, the program has undergone a lot of changes. And, in addition to that, the economic situation has been rather fluid. Because of all these changes, that really put a premium on having effective communications to not only explain by Treasury as to what they were doing but why they were undertaking the initiative. So we recommended that they give this area and the communications strategy some additional attention.

The third area has to do with people, having the right numbers and skills necessary to effectively carry out this program. To date, Treasury has made many efforts to try to bring people onboard on an interim status. But they have yet to bring on the full complement of people that they need in order to effectively manage the program over time. We recommended that they expedite their hiring practices and also put in place a comprehensive plan to ensure

a smooth transition to the next Administration. Right now, they only have a very limited number of people who are committed to make that change going forward.

The fourth area has to do with a comprehensive system of internal controls. Treasury recognizes that they need internal controls. In fact, one of the contractors that was hired was brought in to help them craft the system. And so, you know, we gave them credit for acknowledging that they need to do this. But the system needs to be fully designed and put into place.

And a couple of areas that are really important, one is overseeing contractors. To date, the contractors that have been hired have been on a time and materials basis, which puts the onus more on the government to manage the contractors, so that they need additional people to be able to do that properly. We recommended also that, in the future, to the extent that the Department can, they put in place fixed-price contracts to provide the necessary support for them going forward.

We also recommended that the Department finalize their regulations on conflict of interest and put in place a robust monitoring effort to make sure that the conflict-of-interest provisions and the associated mitigation plans that are put in place are properly implemented going forward so that there are proper safeguards in place.

In summary, in our first report and set of recommendations, we believe—or have very important suggestions for the Treasury Department to implement, to ensure that this program has the accountability, has the transparency necessary and what the expectations are going forward. We plan to continue to work with the Treasury Department to monitor their implementation of those recommendations and also the TARP program, as it continues to unfold in the coming months.

I would ask, Mr. Chairman, that our detailed report of December 2nd be submitted into the record, since it was statutorily required, along with my testimony today, if that would be permissible. And I would be happy to answer any questions members may have at the appropriate period of time. Thank you very much.

[The prepared statement of Mr. Dodaro can be found on page 103 of the appendix.]

Mr. KANJORSKI. [presiding] Thank you very much, Mr. Dodaro. Without objection, the gentleman's request is agreed to.

Mr. Kashkari?

STATEMENT OF THE HONORABLE NEEL KASHKARI, INTERIM ASSISTANT SECRETARY FOR FINANCIAL STABILITY AND ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS, U.S. DEPARTMENT OF THE TREASURY

Mr. KASHKARI. Good morning, Mr. Chairman, Ranking Member Bachus, and members of the committee. Thank you for asking me to testify before you today regarding oversight of the Troubled Asset Relief Program.

We are in an unprecedented period, and market events are moving rapidly and unpredictably. We at Treasury have responded quickly to adapt to events on the ground. Throughout the crisis, we have always acted with the following critical objectives: One, to sta-

bilize financial markets and reduce systemic risk; two, to support the housing market by avoiding preventable foreclosures and supporting mortgage finance; and three, to protect the taxpayers. The authority and the flexibility granted to us by the Congress has been essential to developing the programs necessary to meet those objectives.

Today, I will describe the many steps we are taking to ensure compliance with both the letter and the spirit of the law and what measurements we look at to gauge our success.

A program as large and complex as the TARP would normally take many months or years to establish. Given the severity of the financial crisis, we must build the Office of Financial Stability, we must design our programs, and we must execute our programs all at the same time. We have made remarkable progress since the President signed the law only 68 days ago.

The first topic I will address is oversight of the TARP. We first moved immediately to establish the Financial Stability Oversight Board. The board has already met 5 times in the 2 months since the law was signed, with numerous staff calls between meetings. We have also posted bylaws and minutes from those board meetings on the Treasury Web site.

Second, the law requires an appointment of a Senate-confirmed special inspector general to oversee the program. We welcome the Senate's confirmation, just on Monday, of Mr. Barofsky as special IG. I spoke with him just yesterday, and we look forward to working closely with his office.

In the interim, pending his confirmation, we have been coordinating closely with the Treasury's inspector general. We have had numerous meetings with Treasury's Inspector General to keep them apprised of all TARP activity. And we look forward to continuing our active dialogue with both the Treasury IG and the special IG as he builds up his office.

Third, the law calls for the GAO to establish a physical presence at Treasury to monitor the program. We have had numerous briefings with GAO, and our respective staffs meet or speak on an almost daily basis to update them on the program and review contracts.

The GAO published its first report on the TARP, as Mr. Dodaro said, on December 2nd. They provided a thorough review of the TARP program and progress to date, essentially a snapshot in time at the 60-day mark of a large, complex project that continues to be a successful work in progress.

We are pleased with our auditors' recommendations, because the GAO has identified topics that we are already focused on. The report was quite helpful to us because it provided us with thoughtful, independent verification that we are, indeed, focused in the right topics. And we agree with the GAO on the importance of these issues. Our work continues.

Finally, the law called for the establishment of a congressional oversight panel, the fourth oversight body to review the TARP. That oversight panel was recently formed, and we had our first meeting with them on Friday, November 21st. We look forward to having additional meetings with the congressional oversight panel.

Now, people often ask, how do we know our programs are working? First, and this is very important, we did not allow the financial system to collapse. That is the most important information that we have.

Second, the system is fundamentally more stable than it was when Congress passed the legislation. While it is difficult to isolate one program's effects, given the numerous steps that policymakers have taken, one indicator that points to reduced risk among default of financial institutions is the average credit default swap spread for the eight largest U.S. banks. That CDS spread has declined 200 basis points since before Congress passed the law.

Another key indicator of perceived risk in the financial system is the spread between LIBOR and OIS. The 1-month and 3-month LIBOR–OIS spreads have each declined 100 basis points since the law was signed and 180 basis points from their peak before the CPP was announced on October 14th.

People also ask, when will we see banks making new loans? First, we must remember that just over half the money allocated to the Capital Purchase Program is out the door. Although we are executing at report speed, it will still take a few months to process all of the remaining applications. The money needs to get into the system before it can have the desired effect.

Second, we are still at a point of low confidence, both due to the financial crisis and due to the economic downturn. As long as confidence remains low, banks will remain cautious about extending credit, and consumers and businesses will remain cautious about taking on new loans themselves. As confidence returns, we expect to see more credit extended.

We are actively engaged with regulators to determine the best way to monitor these capital investments in bank lending. We may utilize a variety of supervisory information for insured depositories, including the Home Mortgage Disclosure Act data, the Community Reinvestment Act data, call report data, examination information contained in CRA public evaluations, as well as broader financial data and conditions.

In conclusion, while we have made significant progress, we recognize that challenges lie ahead. As Secretary Paulson has said, there is no single action the Federal Government can take to end the financial market turmoil or the economic downturn, but the new authorities that you provided, you and your colleagues provided in October, dramatically expanded the tools available to address the needs of our system. We are confident we are pursuing the right strategy to stabilize the financial system and support the flow of credit to the economy.

Thank you again for having me here today, and I would be happy to take your questions.

[The prepared statement of Mr. Kashkari can be found on page 115 of the appendix.]

Mr. KANJORSKI. Thank you very much, Mr. Secretary.

Mr. Secretary, it is sometimes, in my opinion, sort of unfortunate that we don't have more of a mix of associating between Members of Congress and the Executive Branch. But when you are in a role such as mine, you get to hear very often the opinions of Members

out of the public realm and off the newspapers, but their honest opinions of what happened.

And I think one of our colleagues, yesterday at a caucus, made a great observation, Mr. Kucinich of Ohio. He posed the question, after all the turmoil of the last 10 or 12 weeks, why is it that we do not have the beginning of an industrial policy in this country so that, as we start structuring the recovery acts and various programs, we don't have a standard or a base to measure what we are doing against? I thought that was a good observation.

And now working on the auto recovery program, having worked tirelessly just 6 or 8 weeks ago on the "bailout" of Wall Street, I am beginning to think that somebody has to become a drafter of a master plan of what we are going to do, what we intend to do, what we are doing, so that we have some measure of objective judgment or understanding.

Now I, for one, have been very sympathetic to the Secretary and to the Administration. And you obviously know I am on the other side of the aisle, politically, from the Administration. Because I think that we are in such a challenge in our economic structure that we have to tell the American people the truth, and that truth is going to hurt. Some of that truth is we are going to spend billions of dollars incorrectly and wrongfully and wastefully. And they are going to have to know that, because we are like mad scientists in an economic laboratory trying to get the correct potion to resolve this problem. And I don't know that anyone has gotten that.

So that we can't be harsh judges of what the Administration is doing and hold you to such a high order when, in fact, none of us know what the true answer is. I think as you have testified and just indicated, nobody does really know.

On the other hand, it is very disconcerting to listen to the Secretary come up here 1 week, as he did in September, and tell us the sky was falling, and I can't even repeat some of the issues that were raised by him and Dr. Bernanke, in terms of they are still confidential and secret, as I understand it. But they did shake the hell out of Congress, I can tell you that.

We did react within a couple of weeks to pass the rescue program, and in my opinion, we did it inadequately. We didn't accrete the Office of the Inspector General with the powers necessary to really do the job. We didn't get the people in place on the oversight board. We didn't get the inspector general, until 2 days ago, appointed. And we really up here don't know what is totally going on.

But I keep looking at the Administration. And Mr. Paulson, when he called that reverse in the backfield, going from purchasing toxic assets to making investments, and he did it overnight without any pre-information, just did it, and now he has been making these calls, totally reversing the position of where we thought we were going and where we were informed previously in the huddle as to where we were going, it is starting to shake our confidence.

And when I say that, it is not just the confidence of the Congress. We are probably not important in that regard. But we do represent, to an extent, the confidence of the American people. And, to a large extent, we are not coming out of this economic problem until we build the confidence of the American people. I think, by that nature, we have to build a relationship between the Admin-

istration and the Congress to build our confidence, because, in some respects, we do represent the American people.

When do you see a capacity that you are going to come forward and tell us what your plan is, what we can expect, perhaps developing an industrial policy for this country, and to give everybody a little comfort that we seem to know what we are doing and we have a game plan to play the whole game?

Mr. KASHKARI. Congressman, thank you for the question. Let me answer it in two parts.

First, in terms of the remaining use of the TARP funds, right now we are executing the programs that we have announced. So we have announced the Capital Purchase Program. We are deep in execution; the execution is going quite well. We can discuss that, and I am sure members have views.

Second, we have announced, the Federal Reserve has announced a program for asset-backed securitization facility, which is going to get consumer credit going—auto lending, consumer loans, student loans, etc. That program in the process of being developed and stood up. That also will use $20 billion from the TARP.

In terms of future programs, we have a lot of policy development work going on. That policy development work, in many cases, is we are consulting with the transition team to keep them informed of what we are developing. At this point, there has been no determination made by the Secretary on whether or when to request further funds from the Congress, the $350 billion. If that determination were to be made, he would do it, consult with the transition team, also notify Congress and provide details of exactly what our plans would be for those remaining funds, number one.

Number two, in terms of a master industrial policy, candidly, Congressman, that is not something that I have spent much time thinking about. My focus, and I think the Treasury Department's focus right now, is just to ensure the stability of the financial system so that credit can flow to our communities and our consumers and our businesses.

I think that, as a Nation, my personal perspective is, once we get through the immediate crisis, we need to take a step back and thoughtfully review our regulatory system to make sure we don't get back here again in the future. Sometimes it is hard to make those judgments in the middle of a crisis.

Mr. KANJORSKI. Thank you very much. I wish we could go on, but we have others. Let uss turn to the ranking member now, Mr. Bachus.

Mr. BACHUS. Well, it might take a while.

Mr. Dodaro, the original asset purchase program, it had a pretty extensive mechanism to administer the program, you know, where we would pay fair value or fair price, etc., etc., you know, and that the goals would be realized.

Has the Treasury adopted a similar detailed mechanism to ensure that the Capital Purchase Program fulfills its goals?

Mr. DODARO. The Department has been largely relying on the regulators for the industries to help in their process for determining which institutions they will approve under the Capital Purchase Program and that the institutions are sound and financially

viable going forward. So I think relying on the regulators was a good step in that process going forward.

What our—

Mr. BACHUS. Let me ask you, when you say relying on regulators to inject capital into this, hold off on that, what about the State-chartered institutions? Is there a bias against them? Are they also consulting with—

Mr. DODARO. I think all the institutions are going through the same process.

Mr. BACHUS. All right.

Mr. DODARO. The applications come in, are screened by the regulators, and then they go forward to the Treasury Department, where Mr. Kashkari then makes the decision, you know, going forward with the process.

What our recommendations are focused on is, once the Capital Purchase Programs are approved and the money is then transferred to the institutions, that is where we see the need to have greater monitoring by the regulators, more timely reporting. The regulators get a lot of information—

Mr. BACHUS. Is that into what they are doing with the money?

Mr. DODARO. Yes, yes. That is what they are doing with the money, whether it is consistent with the purposes of the Act, and what kind of effect is it having to achieve the program's objectives.

Mr. BACHUS. I understand.

Is there leverage under the law, or under the lending regulations, to require them to lend it, as opposed to, say, they pay the amount of dividend or to make acquisitions?

I will ask Mr. Kashkari or either one of you gentlemen.

Mr. DODARO. Basically—and Mr. Kashkari can elaborate on this—my understanding is the requirements that are signed basically require the institutions to spend the funds in accordance with the purposes of the act.

Mr. BACHUS. Okay.

Mr. KASHKARI. And, Congressman, I would just add that the contracts that these banks—we have now funded 87 banks in 30 States. The contracts that we have entered into restrict their dividends; they cannot increase their dividends. They cannot do a share buy-back. So we have put—

Mr. BACHUS. Yes, I know they can't increase it, but they are using it to pay and maintain the dividend.

Mr. KASHKARI. That is correct. And, again, one of the keys here is we want to attract private capital to our banking system. To come in to healthy banks and wipe out all their dividends would drive away private capital. We want to encourage private capital.

And may I respectfully repeat that this is a program for healthy institutions of all sizes. Hundreds, potentially thousands, of banks from across the country are applying. We feel great about that.

Mr. BACHUS. In fact, you know, we had conversations that we wanted all the banks to participate. Now, I wasn't in the end game there, but let me ask you about that. The Subchapter S banks, a third of the banks are in that case. You still haven't come up with a program for them, have you?

Mr. KASHKARI. Not yet. We have professionals at Treasury working on it and consulting with outside experts. It is a very complex

legal issue. Our program intention is that every bank in America that is healthy gets to participate on equal terms. There are some real legal complexities on how to make equity investments in Subchapter S and mutuals. And if you can make the investments, how do you get it out in the end so that the taxpayers can get their money back in the future? We are looking hard at that.

Mr. BACHUS. Right. I think there are 2,500 such institutions.

Let me ask you this. You know, the switch from troubled assets to capital injection, did that imply that it was a solvency issue as well as a liquidity issue?

Mr. KASHKARI. Congressman, this has always been about capital. Buying troubled assets, the initial plan was also focused on getting more capital into the system and freeing up their balances sheets.

The Secretary made the determination to lead with capital, because, although Congress moved with lightning speed, just 2 weeks between when Secretary Paulson and Chairman Bernanke came to the Congress and the legislation was passed and signed, credit markets deteriorated rapidly. And we realized very quickly that we had to lead with capital.

The key for an asset purchase—

Mr. BACHUS. And I agree with that. As you know, I proposed that in the first meeting.

Mr. KASHKARI. The key, Congressman, for an asset purchase program to work is it must be done on a very, very large scale. And once it became clear that we had to lead with significant capital and maybe more capital, we would be left with a very much smaller asset purchase program that may not be big enough to do the trick.

Mr. BACHUS. Okay. Let me say this, and I will close with this question. You know, you have done repeated capital injections into AIG and Citigroup. I say repeated; it is over $100 billion in the case of AIG. You know, have you required any corrective action on their part, similar to what you are hearing about the auto companies today, as opposed to what you—

Mr. KASHKARI. We should segment—this is very important; I am glad you raised it—we should segment failing institutions, such as AIG, Fannie Mae, Freddie Mac, from the healthy bank program. If you look at our track record, in the case of AIG, Fannie, and Freddie, in each case we replaced the management. The taxpayers got 80 percent of the equity of those institutions. Their existing shareholders paid the ultimate price. And so, when we have a situation like that, we are very, very aggressive to protect the taxpayers.

When we have a healthy bank program and we want thousands of banks to participate, we want to make it attractive for them to volunteer to participate in the program, not to scare them off.

Mr. BACHUS. And I like that model, as opposed to having the Congress or the Administration micromanage these operations; you replace the management. I think maybe that might be a model for some, not all, but some of our automobile companies, too.

Thank you.

Mr. KASHKARI. Thank you.

Mr. KANJORSKI. Thank you very much, Mr. Bachus.

And now we will hear from Ms. Waters.

Ms. WATERS. Thank you very much.

Mr. Kashkari, you know that I and some of the others are focused on trying to save homeowners and stop these foreclosures so that American citizens can remain in their homes. You have done nothing, Treasury has done nothing, to pursue any program, except I think begrudgingly you took Ms. Sheila Bair's program and applied it to, I guess, Citigroup, when you gave them all of that money.

If it is good enough for the Citigroup program, why hasn't it been applied to all of the banks, or why didn't you go back to purchasing the toxic paper and doing loan modifications? What is your resistance to helping homeowners stay in their homes and to stopping these foreclosures?

Mr. KASHKARI. Congresswoman, thank you for asking. This is a very important topic. And, if you will permit me, I am going to give you three parts to the answer.

The first part is Secretary Paulson came to the Congress to ask for this legislation to prevent a financial collapse. And if you will permit me, imagine how many foreclosures we would have had if we had allowed the financial system to collapse, number one.

Number two, we continue to work very hard at Treasury, within the Administration, with the Federal Reserve, in consultation with the transition team, looking at various foreclosure mitigation policies—

Ms. WATERS. Taking back my time, why haven't you adopted the Sheila Bair program?

Mr. KASHKARI. These programs are more complicated than they seem on the surface.

Ms. WATERS. Why was it good enough for Citigroup?

Mr. KASHKARI. That was a request that the FDIC made as part of the negotiation. If you will permit me to complete my answer—

Ms. WATERS. No, I can't, because what you are doing is you are just going over what you have already said. And I really want to focus on why we don't have a comprehensive program to deal with the foreclosures and helping homeowners stay in their homes.

Fannie Mae and Freddie Mac adopted a program. Do you like that program?

Mr. KASHKARI. Yes, actually, thank you for raising that. That is where I was going to go.

We are trying to use the right tool for the right job. So, for example, Fannie Mae and Freddie Mac, we worked with FHFA and with Fannie and Freddie to adopt a streamlined model. Why that is so important, Congresswoman, is because most of the pooling and servicing agreements for private mortgage-backed securities, subprimes, point to the Fannie/Freddie servicing standards for how their loans need to be serviced. So, by imposing those at Fannie and Freddie, we have now adopted a new industrywide standard with a streamlined protocol. If we had spent all $700 billion buying whole loans, we could have bought 3 million to 4 million loans. As you know, there are 55 million loans in America. Versus, using Fannie and Freddie, we can now touch almost every loan in America by establishing this new standard.

Ms. WATERS. Well, let me, if I can, take back my time again. By simply working on Fannie and Freddie, you cannot—you cannot—cover all of those loans that are out there, those mortgages.

And let me just say this: You have resisted working with Sheila Bair, with what we think is a legitimate program. You have had a program presented by RLJ Companies, Mr. Bob Johnson, that talked about dealing with the services problem. You have just ignored him, and you have not responded to what looks like a legitimate way in which to deal with these foreclosures. You don't have a comprehensive plan to deal with foreclosures. Now the scam artists have taken over.

I just recently responded to a scam artist that—the name of the company is the Federal Loan Modification Program. I gave them phony criteria as a consumer about a foreclosure. They assured me that I qualified for their program, and they asked me for $3,500. And you are doing nothing about that. The scam artists are now filling the gap of a lack of assistance to American consumers and homeowners that Treasury should be dealing with.

And so you talk about or allude to the other $350 billion. Please don't come here and ask for another penny. Because, if you do, I am going to work 24 hours a day with the same people that I worked with to support you to make sure that they do not support giving you another dime.

President-elect Obama has said that he wanted to do something for the homeowners. You have not even followed up with that request, with that signal that he has sent. And you come here and tell us about how you have saved all of the economy with what you have done.

One question, have you called Bank of America? Did you get them involved in helping to extend the financing to the door company in Chicago where people have been sitting in? Did you ask them to do anything?

Mr. KASHKARI. We have not talked to Bank of America.

Ms. WATERS. Why not? You gave them, what, $15 billion?

Mr. KASHKARI. Congresswoman, I don't know the details of that instance.

Ms. WATERS. Well, you should. They have been in the media. You should be embarrassed by that.

Mr. KASHKARI. Well, Congresswoman, it is not appropriate for me, as a Treasury official, to comment on specific loans or specific banks in that regard. They have a bank regulator, the OCC, that is their primary Federal regulator, that has dozens of staff on site at Bank of America every day as part of their normal supervisory activity.

Ms. WATERS. Okay. I appreciate that you think that is not appropriate, but let me tell you what is appropriate. It is appropriate, when you come before this committee, where we have worked very hard to follow your lead on buying up all that toxic paper, it is appropriate for you to tell us why you didn't do it. You haven't done a good job of that, and you still come without a program to deal with that.

I yield back the balance of my time. And I thank you very much, Mr. Chairman.

Mr. KANJORSKI. Thank you, Ms. Waters.

And now, we will hear from Mr. Neugebauer.

Mr. NEUGEBAUER. Thank you.

Mr. Kashkari, can you tell me a little bit—87 different entities, banks that you have bought, I guess, warrants and preferred stock in. What was the criteria? I mean, I am looking at this amount. Some people got $10 billion; some people got $17 million. What was the criteria on how much money you got?

Mr. KASHKARI. Sure. Congressman, we established a standard program where banks of all sizes could apply for between 1 percent and 3 percent of their risk-weighted assets. So it is an equal deal for all banks in the country.

They submit their application to their primary regulator, who reviews the application, makes a recommendation to Treasury. We review their recommendation and make a final decision.

This is meant to be a healthy bank program so that, if a regulator deems an institution is not viable, they will likely not recommend them for the program. But in terms of the amount, the guidelines are 1 percent to 3 percent of assets. So, although, you know, some banks got as high as $25 billion, the smallest amount has been less than $2 million. That is because there are huge banks and there are little banks.

Mr. NEUGEBAUER. Sure. What about the pricing? Was everybody's pricing the same?

Mr. KASHKARI. Identical.

Mr. NEUGEBAUER. And so, does that say that every one of those entities is an equal risk of that capital that you are putting in there?

Mr. KASHKARI. That is a good question. It is very hard for us to go out and value individually the thousands and thousands of banks around the country. So we felt that the fairest way to go was to apply the same terms for everybody so they could all apply. So long as their regulator deems that they are a healthy, viable bank, then they would be able to participate on the same terms as their neighbors, big or small.

Mr. NEUGEBAUER. And when these banks applied for this money, did they present a business plan? For example, "If you put $2.2 billion in my bank, this is what we are going to do with it?"

Mr. KASHKARI. Not specifically. In some cases, banks offered some indicator. We felt that—a couple of things on this, because it is very important.

The overall purpose was to put more capital in the financial system, to increase the strength of the system and, over time, increase lending. By putting more capital in, restricting dividends and restricting share repurchases, the banks have very strong economic incentive to want to put that money to work. If they don't put it to work, their return on equity, their return on assets will go down, so their returns will suffer.

So we wanted to put the right economic incentives in there. But, at the same time, thousands of banks across the country in all of our communities—it is very hard for us to try to micromanage and say, "This is how you should run your business," because each bank, and each community, is a little bit different.

So we wanted to work with the regulators to identify the healthy banks, put capital in on the same terms, and then create the economic incentives for them to want to go make new loans.

Mr. NEUGEBAUER. When you look at the economy and markets, many would say that markets are a reflection of the economy. And when I look at the plan that Treasury and the Federal Reserve put forward, it appears to me you are trying to address the market structure, when, fundamentally, I think what a lot of people—and somebody said a while ago, we owe the American people the truth. We do owe them the truth. The truth is we have fundamental problems with the overall economy, which I think are being reflected in the markets.

And so would you say this plan tries to address markets or it tries to address the economy?

Mr. KASHKARI. That is a great question. I am glad you asked it.

This is an economic stabilization plan to prevent a financial system collapse, to stabilize the financial system. It is not an economic growth plan, an economic stimulus plan. Those are very different.

And our energy is focused on making sure the financial system is stable so that credit can flow. The economy has real challenges, as you indicated. And that is not going to be addressed. Even if we execute the TARP perfectly, that is different than stabilizing the financial system.

Mr. NEUGEBAUER. But the question is, then, were we trying to—you say this is a healthy bank program. Many of these banks said they would not have ever probably participated in this, but, you know, it is kind of like, if the candy jar was out there, I think we should go and get some of those. So we have banks probably that are very healthy, very stable, still they were making loans, participating in the market, but now we have encouraged them to participate in this program. And so I kind of wonder how that is addressing the market.

Mr. KASHKARI. Right. If we have a dollar and we give this dollar to a healthy bank or gave that same dollar to a failing bank, the healthy bank is in a much better position to turn around and make new loans. And that is exactly why we focused on healthy banks for the Capital Purchase Program, because they are the ones who are in the best position in this time of economic disruption to step up and make new loans to their businesses and their consumers in their communities. That is exactly right.

Mr. NEUGEBAUER. Last question then, as a follow-up on that. Do you have evidence that this capital injection has, in fact, led to increased lending activity? Have you monitored that?

Mr. KASHKARI. We are in the process of working with the regulators to monitor that.

As I indicated in my opening statement, there are indicators of the credit crisis softening, some confidence returning. It is going to take time. Think of it this way: Remember the economic stimulus checks that Americans got? If a homeowner or a person was nervous about their economic situation, and they got that check, they would be more likely to put it in the bank than to go out and spend it. And so we need to see confidence return to the system to really see the lending take off, and we need to get all the capital in the system. It is not going to happen as fast as any of us would like,

but it is going to happen much faster for us having taken this action than if we hadn't.

Mr. KANJORSKI. The gentlelady from New York, Mrs. Maloney?

Mrs. MALONEY. Thank you.

And I would like to welcome and thank both panelists for their government service and their testimony today.

I would like to ask Mr. Dodaro about the report that you just issued on the program and where we are going and what has happened. Along with several Members of Congress—and I would like to place in the record this letter—we sent a letter to you and to Secretary Paulson asking if you had the technological capacity to provide real-time data, transparency on transactions by the entities receiving the TARP moneys, so that we can be sure that the moneys are used for the purposes that they were intended, not only to stabilize our markets but to provide credit to Americans.

We are hearing some stories that this money is being used for overseas purchases. We want to make sure this money is not for private gain, but is consistent with the purposes of the Act.

I would like you to comment on the recommendations that your report made. And is Treasury accepting your recommendations? Are we moving toward a systemic system with regulators so that we can track if the money is used for the purpose it was intended?

Mr. DODARO. Our first recommendation in the report was to Treasury to work with the regulators. And, as Mr. Kashkari mentioned, some of the regulators are right in the institutions, and some of the larger ones on a regular basis. Others have a lot of knowledge, obviously, about the institutions that they regulate. So we think it is good.

You need a systematic process for doing that, and it has to be more timely. Right now the regulators get information on a quarterly basis, usually called data quarterly financial statements, but that could be modified for a certain amount of the information.

Now, that is, though, the one recommendation that we made that Treasury had a different interpretation on it. And I think it is important for them to reconsider collecting this information at an individual institution level. It is not micromanaging to ask people what they did with what you gave them, to the extent that it is possible. And I think it is very important, and it is the only way that we will have transparency.

Mrs. MALONEY. I agree completely and I intend to legislate that recommendation to make it clear to Treasury that we want transparency and accountability.

I would like to ask Mr. Kashkari—I am grateful that the financial system of America did not collapse and that we are moving toward stability of our financial institutions. That was a goal, and we have achieved that, and we are getting stronger every day.

But what I am hearing from my constituents is that the next step of getting credit out in the community is not happening. We have put $7.8 trillion into the financial system—10 times the $700 billion of the TARP program.

Yesterday, there were 10 car dealers in my office from New York State. They say people want to buy from them, they want to buy their cars, but they cannot get a loan from a bank. We are hearing from constituents who would like to buy houses, but they don't

know where to go to get a loan. The money is not getting out into the community. And I would venture that we should look more at what is happening to the money now, as opposed to putting it into the system.

I have received numerous phone calls in support of a proposal of Treasury of a 4.5 percent program that would allow for people to buy their first homes.

I think what is lacking here is there is not a clarify of programs to the people of where they can go for help. This, I believe, got such a groundswell of support because it was clear: You can go to Treasury, you can get a 4.5 percent, 30-year loan. And economists tell us that key to solving our challenge is helping people stay in their homes and getting the homebuilding, the home purchasing, this segment of our society moving.

I want to underscore what many members on this panel have said, that we support moneys going to help people stay in their homes for long-term loans. And if Treasury has an objection to Commissioner Sheila Bair's program, if you feel you can streamline it, you can make it more effective, then do it. But that certainly is a goal.

Numerous economists have told us we will not solve this problem —meaning the overall economy—until we stabilize the foreclosures, the 2 million to 5 million foreclosures that are predicted by some economists. But also a factor is the 4.5 percent program to get the economy moving.

And I would like to know, are you moving forward with this program? I certainly support it. What is the status of it? And any program that you have that will get lending out to the community.

Mr. KASHKARI. Thank you, Congresswoman.

Let me answer by starting with we look at the foreclosure problem as a critically important problem and issue that we are working hard on that is distinct but related to getting housing going again. And so the mortgage program that you referred to we put in the latter category. It is a housing program to help the housing market more broadly. We are looking at a variety of programs there. This is one thing we are looking at very seriously, trying to work out the details to understand exactly how to do it and implement it.

But I agree with you, reducing interest rates to get borrowers off the sidelines so they can afford to buy a home for the first time or to afford a bigger home, it is the only thing that is going to help home prices, so we think it has some merit.

On the foreclosure side, again, as I mentioned to Ms. Waters, we, again, continue to do a lot of work. We are in consultation with the transition team. Ultimately, programs that we implement, they are going to be the ones living with and executing, so we want to make sure that there is coordination there. So we are doing a lot of work on both fronts. And I agree with you in terms of the merit of both.

In terms of consumer credit more broadly and auto loans and auto dealerships, we have heard the exact same thing. If you look at the cost of an auto loan today compared to a year or 2 years ago, it is remarkable. I mean, who would pay 14 percent to go buy a car today?

That is exactly why we worked with the Federal Reserve to design this new consumer credit securitization facility. That should help bring the cost of consumer finance down right directly to our consumers—to our homeowners, to our car buyers, to our students who want to go to school, etc.

Mrs. MALONEY. My time has expired. Thank you.

Mr. KANJORSKI. I thank the gentlelady from New York. There has been a request on her part for submission.

Mrs. MALONEY. Yes.

Mr. KANJORSKI. If there is no objection, it is so ordered.

Mr. KANJORSKI. I also have two letters, one from Mr. Keating from the ACLI, and one from Mr. Racicot from the American Insurance Association. If there is no objection, we will admit the same into the record. The Chair hears none, so they are admitted.

And now, we will have Mr. Castle of Delaware.

Mr. CASTLE. Thank you, Mr. Chairman.

Mr. Dodaro, back in my opening statement, I mentioned what I would like to ask you questions about, and that is the role of the lending by the Federal Reserve and what is being done with respect to overseeing what they have actually been doing.

Their loans, actually, are at a rate much higher than anything the Treasury has done. It is close to a trillion dollars. I am looking at their balance sheet now, which is a very odd balance sheet, because assets become liabilities and vice versa. But it is approximately in that range.

And I am interested in more oversight and greater detail concerning their expenditures and what they are doing, all of which is pursuant to section 13–3 of the Act allowing these loans.

I realize when I say all this that the Federal Reserve has, by legislation and by fiat in general, certain protections with respect to the kinds of lending which they are doing to banks for reasons of security. But, to me, these kinds of loans aren't that dissimilar from what is happening in Treasury. And when we deal with these section 13–3 loans, we are dealing with something of which there should be more transparency and, I think, more knowledge with respect to what is happening.

I would just like to get your views on it, since you are the ones who are really overseeing what Treasury is doing. And I realize there is nothing you can do now because of the confidentiality aspects of the Federal Reserve, but should we be doing something as legislators to make sure that transparency is increased?

Mr. DODARO. There is no question, Congressman, that the Fed's activities, you know, in terms of volume and the amount of money, you know, it far exceeds the TARP program activities.

The Federal Reserve has certain protections to statutorily protect its independence. Part of that is that it is one of the few areas in the Federal Government where there are prohibitions against GAO oversight for activities regarding foreign currency transactions, transactions with foreign banks, with open market transactions, and also with the discount window. So there are limitations on our ability to provide this type of oversight.

There have been legislative proposals in the past to give GAO additional statutory authority to provide greater oversight over some of these activities that would be taking place. My view would be

that a carefully crafted legislative solution would be necessary for GAO to have more ability to oversee those type of transactions while also providing and safeguarding the confidentiality necessary to do that.

We have a long history of protecting information of a classified status in the national security area and others and have an unblemished record, so I think we have the ability to do this. But, in my opinion, it would require a statutory change.

Mr. CASTLE. Oh, I agree with that. I guess my question really is, is it something you would welcome? Is it something that would be helpful, in terms of the broader picture of all these loans which are being made and the return to stability that we are all concerned about?

Mr. DODARO. My philosophy on this is that we exist at the GAO to support the Congress in carrying out its constitutional responsibilities. And if the Congress believes that it is necessary, we would be happy to work with you to craft the type of legislative proposal that would provide that type of oversight and assistance to the Congress.

Mr. CASTLE. And let me just restate, of course, that I am just talking about those loans which are being made pursuant to these emergency circumstances as opposed to their normal bank lending, which I think takes on a different tone all together.

Mr. DODARO. I understand that, Congressman, and I agree with that. And that is what I was speaking about also.

Mr. CASTLE. Okay.

Mr. Kashkari, quickly, are you or the regulators who deal with—let's see, there are 87 loans, as you have indicated—following what the banks have actually done after they have gotten the money? We are all concerned about, is this getting out to Main Street in some way or another. And is that being done?

I realize the representations they made, I realize that you are worrying about securing them as far as their capital is concerned. But we are somewhat concerned about what are they actually doing. Are they doing what they represented they would do, and are they actually making sure that, pursuant to what you said here today, it is in their best interest to have these loans go out and to become economically strong again.

Is that actually being pursued to make sure that is happening as a part of these reports which we are getting and going to get?

Mr. KASHKARI. Congressman, we are working on that very issue with the regulators. We had a call just a day or so ago with the four banking regulators to look at their supervisory data that they can get to monitor on an individual basis and on an aggregate basis what is happening with the banks that have received the funds versus the banks that haven't received the funds.

So that program is being designed and put into place. It is not going to be perfect. And, as you know, you put a dollar into an institution, it is impossible to follow where that dollar goes. You know, you have to look at it in the aggregate. And so we are looking at market-wide measures, as well as working with the regulators to look at institutional measures, as well. And we are not there yet, but we are working on it.

Mr. CASTLE. Okay.

Thank you, Mr. Chairman.

Mr. KANJORSKI. Thank you, Mr. Castle.

And now we will hear from the gentleman from North Carolina, Mr. Watt.

Mr. WATT. Thank you, Mr. Chairman.

Welcome, Mr. Kashkari.

I am looking, in front of me, at a sequence of events here. On October 6th, at 12:30 p.m., the Treasury Department announced procurement authorities and procedures, in which they were talking about purchasing whole assets and whole loans and the whole process of things; they outline the procedures. At 1:45 that same day, they announced that you were being hired as the Interim Assistant Secretary for Financial Stability.

On October 13th, you gave a speech to the Institute of International Bankers, in which you were still talking about purchasing troubled assets, "mortgage-backed securities purchase program: This team is identifying which troubled assets to purchase, from whom to buy them, and which purchase mechanism will best meet our policy objectives. We are designing a detail auction protocol," so forth and so on.

On October 13th, at 2:27 p.m., it was announced that a firm, Ennis Knupp & Associates, had been hired. And in that announcement, "The investment advisor will conduct research on mortgage whole loan asset managers and on servicing organizations. Firm will identify qualified minority- and women-owned businesses to provide services for the portfolios." A contract of $2,495,190 was announced on that occasion.

My questions to you: How much has Ennis Knupp been paid, and what have they done?

Mr. KASHKARI. Thank you, Congressman. Ennis Knupp is our consultant—

Mr. WATT. I know who they are. Tell me how much they have they been paid and what they have done.

Mr. KASHKARI. I don't have the dollar value for how many dollars have gone out the door, but I can get it for you.

They are advising us right now. We have received hundreds of applications for equity asset managers for all the equity investments we have made. They are helping us screen through those applications, identifying small, minority- and women-owned equity asset managers.

And so, although we hired them to be our asset manager selection consultant, we thought we would be selecting asset managers for mortgages and mortgage-backed securities, we are using the same firm to help select the equity asset managers.

Congressman, we have hired no firm for the asset managers, mortgage-backed securities, or mortgages. We never hired anybody. And so there is no one that we have hired who is just sitting around doing nothing because we changed strategies. We made sure that didn't happen.

Mr. WATT. But when you put out the request for a proposal, it was to deal with the purchase of distressed assets. Did you put out another request for a proposal and give other applicants the opportunity to compete for that or you just decided this firm is the firm because they had some formal connection to Goldman Sachs and—

I mean, that is what the public is asking us, Mr. Kashkari. This looks like a Goldman Sachs monopoly. And when you have all of these people who have these connections to Goldman Sachs in the chain, it makes all of us look bad, including yourself, mind you. I can't tell you the number of people who have questioned your credentials, as well as they are, because of your former connections to Goldman Sachs.

Do you see what I am saying? And here are Ennis Knupp principals having connections to Goldman Sachs—people are asking me, is Goldman Sachs running this country? What are we doing? We have given $700 billion, and there is this monopoly on who is controlling it. Nobody is accounting to anybody for it. And the perception, whether the reality is correct or not, the perception is that there is something sinister going on here. So I want you to send to me, if you would, a detailed description of what has been paid to this firm and what they have done, because none of the people who have submitted applications to manage any of these assets have heard anything from Ennis Knupp. There are 100-and-some applicants out there that Representative Waters and I have been trying to get in the door to help with this process, and they can't get in the door because you all keep changing the rules about what it is they are supposed to do, and Knupp is not doing anything to process their applications.

I yield back, Mr. Chairman.

Mr. KASHKARI. Mr. Chairman, may I respond?

The CHAIRMAN. Briefly, Mr. Kashkari, yes.

Mr. KASHKARI. We have a very formal procurement process, led by career staff at the Treasury. Let me segment it in three categories. Mortgage asset managers, we put out solicitations, received applications, hired nobody. Investment manager consultant, that is Ennis Knupp. They are not making any decisions. They are just advising the career Treasury staff. And we have received hundreds of applications for equity asset managers. Our career staff is reviewing those, with advice from Ennis Knupp, has down selected, are right now in the process of negotiating conflicts of interest to make sure taxpayers are fully protected.

I am very proud of the procurement process that we have established very quickly, led by the most senior career professionals at Treasury.

Mr. WATT. Let me just say this as gently as I can: All these billions of dollars are out there doing something, and you are telling me that nobody has been hired to do any of the management of what they are doing. That is not adding up for me, Mr. Kashkari, I am sorry. And it is not adding up for the public. I mean, I am not a conspiracy theorist here, but I wouldn't come and make these accusations or even ask the questions if people were not asking me.

The gentleman who ended up being the CEO at Wachovia was from Goldman Sachs. And people on the ground in my community are saying, what is up here? Is Goldman Sachs running the country or is Congress running the country? Is this Administration running the country? It looks bad, Mr. Kashkari. That is the problem we have.

The CHAIRMAN. The gentlewoman from Illinois.

Mrs. BIGGERT. Thank you, Mr. Chairman. And thank you, Mr. Dodaro, for your, I think, very thorough report. I really appreciate it. My question is for Mr. Kashkari.

The deadline for submitting insurance proposals has passed. I think that was October 28th. Did you receive a large number of responses on the request? And can we expect to hear more from Treasury regarding the insurance program?

Mr. KASHKARI. Yes, Congresswoman, we received, I believe, close to 100 responses, which we have gone through very carefully. And actually, the recent Citigroup investment that we made, in coordinated action with the Federal Reserve and the FDIC, the Treasury provided—the TARP provided $5 billion of insurance against mortgage-related assets. That is the first exercise of our authority under Section 102 of the Troubled Asset Relief Plan.

Mrs. BIGGERT. Well, you know, I applaud the exercise of authorities other than the capital injection. But I wonder why the government didn't implement a program where it is the insurer of first resort, and not secondary.

Mr. KASHKARI. Forgive me, I don't follow you.

Mrs. BIGGERT. Well, for example, under the Aon plan the Treasury Department could implement a program allowing holders of illiquid assets to form an asset stabilization pool so that those entities are the first resort, while in the Citi, isn't it that the government is the—

Mr. KASHKARI. No, actually Congresswoman, Citigroup in that program is taking the first loss position, followed by TARP and the FDIC and then the Federal Reserve.

Mrs. BIGGERT. Yes, but for a very limited amount.

Mr. KASHKARI. I don't have the number. I believe it is close to $40 billion, $30- or $40 billion is the Citigroup's first loss position.

Mrs. BIGGERT. Could you get that to me?

Mr. KASHKARI. Absolutely. I would be happy to.

Mrs. BIGGERT. Thank you. Have you reviewed the Aon proposal to develop an insurance solution to deal with the illiquidity of mortgage-backed assets?

Mr. KASHKARI. I personally have not, but we have a team that studied all of the proposals, all close to a hundred, and I am almost certain that that proposal came in through the formal channels. And all of those were reviewed very carefully.

Mrs. BIGGERT. Well, that proposal was really the same as the language that we put into the bill. Isn't that correct?

Mr. KASHKARI. Again, Congresswoman, I am not sure. I can find out, though.

Mrs. BIGGERT. Okay. Well, what plans does the Treasury have for addressing then the undervalued mark-to-market assets, which really do drag down the balance sheets of the financial institutions?

Mr. KASHKARI. The mark-to-market is a very important issue. We are focused on stabilizing the financial system so that they can recognize their losses and also raise additional capital and get lending going in our community again. We believe that both by helping the consumers directly; for example, through our facility with the Federal Reserve that I have spoken about, and putting more capital in the banks, it puts them in a better position so that we can weather this downturn and get these assets moving again. So there

is no one tool. All of the regulators are bringing the various tools to bear in a complementary manner to try to get through the financial crisis. The TARP is very important, but it complements the other tools that we have.

Mrs. BIGGERT. Well, you said that you are monitoring, and there are indicators that include: One, that the financial system hasn't collapsed; two, that the credit default swap spread for the 8 largest U.S. banks has declined more than 200 points; and three, that the LIBOR and OIS spreads have declined 100 basis points, but when will we hear a more concrete description just about what the institutions are doing with the funds that they are receiving?

Mr. KASHKARI. Congresswoman, that is something we are working on right now with the regulators. As you know, the four banking regulators, the Fed, FDIC, OCC, and Treasury are the supervisors of these banks.

Mrs. BIGGERT. Can you give us a date?

Mr. KASHKARI. I can't give you a specific date aside from saying as we speak right now, just yesterday we spoke about it, we are working with the regulators to collect this information on a regular basis, taking very seriously the feedback provided by the GAO and the Congress.

Mrs. BIGGERT. Do we have to mandate that if you can't give us some timeline? Everybody, I think, has asked this, when are we going—

Mr. KASHKARI. Again, it will probably be weeks before we are going to start seeing the initial data. They collect this data right now I believe quarterly, the call report data. We are working with the regulators to figure out which are the right metrics that are going to get at the fundamental questions that people are asking. I don't want to overcommit here, but it is something that we are taking very, very seriously.

Mrs. BIGGERT. I yield back.

The CHAIRMAN. I recognize myself for 5 minutes. First, before my 5 minutes starts, I apologize, but I have been working on the question of the automobile industry, and I will be leaving shortly to go testify before the Rules Committee. So the chairman of the Financial Institutions Subcommittee will continue the very good job he is doing of presiding.

I also want to respond, I received a letter apparently today, if today is December 10th, from—the lead signature is the minority leader, Mr. Boehner, and some others, asking me to immediately summon CEOs from institutions that have received TARP funds before the committee. Now, we do have a week before we can have a hearing, so this is apparently a request for a hearing sometime next week. I will consider it and consult with the members. I will say this: If it is not likely to be the case that the second $350 billion is requested until January, then I think this is something we can accommodate. I will say that I know people don't always think of things instantly, the banks in question have had TARP funds for some time. Apparently someone woke up yesterday and thought it would be a good idea to have a hearing right away, today being December 10th. I think it will be hard logistically to accommodate that next week, but I agree in the substance. And I would say this, my assumption is that we will be able to have such a hearing with

some of the CEOs, obviously not all of them. There are, I don't know, several dozen I would guess who have gotten funds under the TARP are banks, but we will call in a representative sample, including different sizes, and have such a hearing. At some point, there will be a request to trigger the second $350 billion. We will have 15 days to vote on that. My intention now would be to have that hearing sometime during this period. So I will not, I think, be able to comply with the request that I do it immediately. I am not sure that the request that I do it immediately was done with any expectation that I would do it immediately. But yes, I do think it is appropriate to have such a hearing.

Mrs. BIGGERT. Will the gentleman yield?

The CHAIRMAN. Yes.

Mrs. BIGGERT. As a signatory of that letter, I appreciate you taking such a prompt look at it. And I appreciate you considering holding a hearing when it—

The CHAIRMAN. And if we did it on that timetable, does the gentlewoman think that would be compliant?

Mrs. BIGGERT. Well, "immediately" is a term that people have different ideas about, but I think that timetable would work.

The CHAIRMAN. Okay. As long as it is clear that by immediately, we don't mean immediately, then we will be able to do it.

Mr. SCOTT. Mr. Chairman, would the chairman yield for a moment?

The CHAIRMAN. To whom?

Mr. SCOTT. To me.

The CHAIRMAN. The gentleman from Georgia, yes.

Mr. SCOTT. Thank you, Mr. Chairman. Let me just encourage you to move ahead with all deliberate speed to get these CEOs before our committee. There are pertinent questions that we have to ask and get that answer as to why they are not lending.

The CHAIRMAN. That is why I said that we would do it.

Mr. SCOTT. Yes, sir.

The CHAIRMAN. Let me say that the deliberate speed I will employ will be a lot quicker than the deliberate speed which the gentleman is well aware of is not the fastest moment in our history when we segregated for much longer.

Mr. SCOTT. Amen.

Mr. LYNCH. Mr. Chairman?

The CHAIRMAN. Yes.

Mr. LYNCH. One question: I know under the original TARP bill that it is a joint resolution of disapproval that we would have to pass. So is there any fear that there might be some—

The CHAIRMAN. I have no expectation—let me say this, and I have had some business with the Secretary of the Treasury and we have discussed this. It is conceivable that we could have a request for $350 billion. I will tell you this: If it came, I know that the Speaker and the Majority Leader would reconvene our bodies, as inconvenient as that might be. I think it is likely at this point, absent a lot of work on foreclosures and other things, that such a resolution of disapproval could pass. Yes, it could be vetoed. Given the extent to which the psychology of the investor community is a large part of our problem, and I have spoken to people in the Administration, I don't think anyone thinks that releasing the second $350

billion as a result of the President vetoing a resolution of disapproval would not in fact be doing more harm than good. So I am confident there will be conversations. I think people are behaving responsibly here. There were conversations between the outgoing Administration, the incoming Administration, and the leadership. And my own advice is that I think ultimately we should have that $350 billion, but after there has been a lot of conversation about how it would be used. And I don't think it would be in anybody's interest to force that issue before there is a consensus on that. I am reasonably confident of that.

Mr. LYNCH. Okay. Great. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Secretary, I apologize for having been in and out. One of the things that, as you know, raised my concern was the GAO's recommendation that you do a better job of trying to see whether or not the banks in question were relending the money that they were lending.

Let me say my 5 minutes should just be starting now in terms of the questions. And I know we had a conversation, and I appreciated your responsiveness, and you may have touched upon this in your statement, I believe that the response you put in writing was so worded as to suggest that you weren't going to try to do that, and I was afraid that would give a signal to some of the banks that they wouldn't have to worry so much. And I understand we had that regulator's statement of November 12th, which was useful. The anecdotal evidence is still overwhelming that there are people who think they are good borrowers who can't get loans. I know there is some problem with where the loans could be.

So I guess I would ask you to clarify what is the state now of this? Are you going to be measuring in some near term whether the banks that got the money have relended? I understand that money is fungible, but total loan amounts are also countable, so that there should be some way to do that. What is the current state of your view? And the answer to that I think whether or not there is a successful request for a drawdown of the second $350 billion is dependent, in my judgment, in part on mortgage foreclosure, some of the relief going forward, including the 4.5 percent or some variant of it, and the consumer matters.

I will say to people who have been concerned about auto dealers that relief for the auto dealers is going to come ultimately from the TARP, but that also showing that there is some way of counting how we are doing that. And I ask you to comment and then Mr. Dodaro to comment on your comment, please.

Mr. KASHKARI. Thank you, Mr. Chairman. We are working very hard with the four banking agencies to look at the supervisory data they collect and to understand if that will get at an answer to the fundamental questions that you and other members are asking and that the GAO is asking. So we are working right now with the four banking agencies to look at the quarterly reports that they collect, does that shed light on this issue? If not, what other data do we need? And how frequently can we collect it? So we have heard the feedback, we got it, and we are working on it.

The CHAIRMAN. Mr. Dodaro, let me ask you to comment, but first let me take some credit of there is a credit scarcity in this country, one of money to lend, and two, for anything we do. We never get

any credit. So I want to give us some. One of the criticisms made of the bill was it didn't have adequate oversight. Now, there was a slowdown in the creation of the congressional panel. My guess is some who were complaining that there was too little oversight, now that we have that congressional panel will be heard to complain that there is too much of it. I myself welcome it. But we did write—and we still have a pending confirmation in the Senate of an Inspector General. But we knew that the GAO was there, we know—there are few institutions around here that are as respected across the ideological and political spectrum as the GAO. And we were very pleased, as you know, Mr. Dodaro, we met with you early. You reported to us that with the cooperation of Secretary Paulson and Mr. Kashkari you were on the ground as soon as this startup was there. You had people there. And the very fact that we are here talking about a report which gives them some credit and some criticism I think testifies to the adequacy at the very least of the oversight parts of the bill.

But would you now comment on Mr. Kashkari's—are you in on these discussions? Do you have some confidence about them going forward?

Mr. DODARO. We have had some preliminary conversations, the staff on the team, with Mr. Kashkari and his team. But we need to stay involved to see what they come up with in their proposal that they are going to work with the regulators on. I think they are now headed in the right direction, but you know, I would like to see the specifics about what data, how frequently they are going to do it. We will stay involved, give them our feedback to ensure that recommendation—

The CHAIRMAN. I appreciate that. Let me just say this, given the jurisdictions around here, if there is a request for the second $350 billion, whether it comes early in January as a joint proposal from the two Administrations or it comes later, I would like to be in a position to defend the $350 billion, not to oppose efforts to cut it off. My ability to give a good answer to this question that we are now talking about, are we effectively measuring relending, that will be critical to my getting the bill through. I think the extent to which I and the Speaker and a few others can get major legislation through entirely on our charm has run out. So we are going to need some very hard answers.

The gentlewoman from Florida is overreacting to that, I might say. But we will try to get some hard answers. I thank you. And the gentleman from Pennsylvania will resume the Chair.

Mr. KANJORSKI. [presiding] The gentleman from Texas, Mr. Hensarling.

Mr. HENSARLING. Thank you, Mr. Chairman. Mr. Kashkari, in your testimony you speak, I think in the first paragraph, about the critical objectives that Treasury has undertaken under the EESA statute. By my reading, it appears that Treasury has nine different factors it must take into consideration in operating the TARP program, including protecting the interests of the taxpayers, maximizing overall returns, minimizing the impact of the national debt, stabilizing our financial markets, helping families keep their homes, stabilizing communities, and ensuring that all financial institutions are eligible.

In your interpretation of the statute, did you get direction from Congress on how to weigh these various considerations? And do you consider some of them to be competing interests in the short term?

Mr. KASHKARI. Congressman, I think that all of those considerations are important. I think some of them can be competing. And it can be difficult to prioritize, especially in a time of financial crisis. As an example, we absolutely want to protect the taxpayer, but we first and foremost want to prevent the financial system from collapsing. That was our highest priority. Once we were able to do that, we want to do that in a manner that provides as much protection to the taxpayer as possible. Also keep in mind what would happen to the taxpayers if the financial system had been allowed to collapse. So these are very complex and important considerations, and I will just tell you our highest priority was to get out there and move aggressively to stabilize the financial system.

Mr. HENSARLING. Mr. Kashkari, I have a great preference for the use of voluntary capital from investors over the involuntary capital of taxpayers. I believe that one man's nimble response to the economic crisis may be another man's confused ad hoc approach. It is anecdotal, but I have heard from many investors that frankly they have been less than confident in the actions of the Treasury, that their capital is sitting on the sideline, that there are homeowners who have the ability to pay their mortgages or to work with lenders, but are unwilling to do it at this time, thinking they may get a better deal from Treasury, or a better deal from Chairman Bair of the FDIC.

My question is in bringing stability, at what point is certainty, legislative and regulatory certainty, needed in the marketplace? I mean some of what we are facing is psychological, I believe, in nature. And in fact Chairman Frank, I see he is no longer in the chair, has stated, "the psychological problem is even worse than the real problem." But at least the anecdotal evidence is very strong that by careening seemingly from one strategy to another, frankly you have done more to incite panic in the markets as opposed to calming them.

Mr. KASHKARI. Congressman, there is no question that clarity and certainty are very important for developing market confidence. We have had to move and be nimble and react to changes on the ground. I say since the beginning of the credit crisis, the one constant has been its unpredictability. And it has only intensified and deepened more rapidly than we had expected, even in the few weeks that we were working with the Congress on this legislation. So I think we have a choice of being on our back foot and seeing what happens, potentially risking a financial collapse, or being on our front foot and being aggressive to try to stabilize the system, prevent a collapse, and then let the system heal. But I agree with you that more clarity will help with confidence, and will help the system to heal faster. And we think we have the right strategy.

Mr. HENSARLING. Mr. Dodaro, not a question but a comment, I read every word of your report. It was excellent. It was very helpful to the process. In the remaining seconds I may have available, Mr. Kashkari, I am still somewhat confused about the point. I want there to be clarity. For institutions requesting funds under CPP, is

it the policy of Treasury to allow the regulator of the financial institution in question to determine viability? And is that the only criteria that Treasury is employing at this time for access to those funds?

Mr. KASHKARI. The regulator—we are looking at viability. That is our test. And the regulator offers us their assessment of the institution's viability without government assistance. Ultimately, Treasury makes the decision. So in some cases the regulator will submit an application and recommend a "yes." We may look at it and say, gee, we are not so sure. We will send the application back to the four banking regulators so they can review it, a peer review process, and come to us with a combined regulation. The point is that we don't want to put government capital into a bank that is ultimately going to fail. We don't think that is protecting the taxpayers. And so there are some unhealthy banks that are out there, and the regulators are in the best position to offer us information and their judgment on who is healthy and who is not.

Mr. KANJORSKI. Thank you. Now the gentleman from New York, Mr. Meeks.

Mr. MEEKS. Thank you, Mr. Chairman. I am still waiting to hear really some answers, especially in regards to some of the questions that Ms. Waters asked. I am concerned with reference to just the response to Mrs. Maloney when—and I agree that lowering interest rates, you know, may be a good thing in trying to get individuals back into buying homes, etc. However, the number of individuals who can get back into the market because of the lack of availability of credit and the fact that you have to have the super high scores to be eligible shows that the number of individuals who are going to buy homes is not going to be great in comparison to the number of individuals who continue to lose their homes. And thereby, you know, it seems to me to make sense if in fact we figure out how we are going to help those individuals to prevent them from losing their homes so that we can make sure that we are starting to stabilize this market.

And in the Emergency Economic Stabilization Act that we passed, we put in there specific words that the Secretary had the authority to use loan guarantees and credit enhancements to facilitate these loan modifications to prevent affordable foreclosures. But it seems that the Secretary has not moved. Whether it is the program that was put out there by Mr. Johnson or Chairwoman Bair, the Secretary has not moved to do anything, or at least it appears to us to do anything to make a difference in helping those individuals or preventing individuals from going into foreclosure.

So my first question is, is the Treasury looking to do anything with reference to what he has the authority to do to stop the rising tide of foreclosures that are imperiling the economy that we are currently suffering from?

Mr. KASHKARI. Thank you, Congressman. The answer is yes, absolutely. And I am going to give you, if you will permit me, a two-part answer. First, we continue to work very hard looking at the various proposals that we have received and that we have developed ourselves working with the Federal Reserve, also consulting with the transition team to identify the right approach that is going to help homeowners without creating a windfall to hedge

fund investors. We want to balance it so that the homeowners are getting the benefit, not the investors, number one.

Number two, we are trying to bring all of the tools in the Federal Government to bear on this problem. And so, for example, the work that we did with Fannie Mae and Freddie Mac by establishing a streamlined loan modification protocol for Fannie Mae and Freddie Mac, the advantage of that, Congressman, is that most of the agreements that govern the subprime loans out there refer back to the Fannie and Freddie underwriting—excuse me, the Fannie and Freddie servicing standards. So by using Fannie and Freddie, we have been able, with their regulator, FHFA, to establish effectively a new industry-wide standard for loan modifications. So we are looking at what we can do under the TARP, but we are also looking at what other tools we have outside the TARP. We want to bring all of the tools to bear and use the right tool for the right job.

Mr. MEEKS. Except it seems as though there is none—because we are talking about a small percentage of the TARP money that would be utilized in regards to trying to make sure that the mortgagors—that would prevent the foreclosures of these mortgages. And when you look at the number of individuals, I think it is 70 percent of subprime borrowers are not getting the help, that there are not enough servicers. And unless we start putting some money into training and having more servicers for these loans so that we can help save some more individuals from going into foreclosure, then we will never get from under this mortgage foreclosure problem, which seems to be the epicenter of all of the problems that we are having here.

And then, let me ask this question also, because I think it goes to something of the perception, continuing the perception that Mr. Watt talked about. Because I am also concerned that in recent weeks the Federal Reserve has approved expedited bank holding company applications for numerous companies, including Goldman Sachs, and I think Morgan Stanley, and the Treasury Department has already awarded TARP money under the Capital Purchase Program to Goldman Sachs and Morgan Stanley, and that these companies are also issuing billions of dollars of federally guaranteed debt under the FDIC's debt guarantee program, designed specifically for banks and bank holding companies. In light of these circumstances, what I want to find out is what safeguards is the Treasury Department establishing to ensure that taxpayer money under the TARP program and the FDIC programs and the Federal Reserve discount window is not being used to support the substantial nonbank commercial activities of any of these newly formed bank holding companies?

Mr. KASHKARI. Congressman, by becoming bank holding companies, these various entities are coming under increased regulatory supervision. So the Federal Reserve will now be their regulator, perhaps the OCC. They are going to now have Federal regulators in their offices on the ground with them supervising their activity, making sure they are not putting the taxpayers at undue risk. So the Federal regulators are in the best position to do that. They are now onsite doing that.

Mr. MEEKS. But see—just one follow up—because there are bank holding companies that also own commercial businesses such as

travel agency businesses. And what I don't see, and I am trying to find out what safeguards are in place to prevent TARP money from going to say the travel agency that happens to be owned by a diversified company? And just because it became a bank holding company? Because we had that same kind of situation when we talk about even when we are dealing with the auto industry, that they don't qualify under TARP. But I don't understand what we are doing here in that regards—

Mr. KASHKARI. It is very difficult—

Mr. MEEKS. —as far as protections are concerned.

Mr. KASHKARI. It is very difficult, Congressman, to ring fence money in an organization and say, well, this money stays here and that money stays there. If we gave money to one part of the organization, that would mean they would have to take less money from the other part of the organization in. So this is something that we are looking at, but it is very difficult to try to say this money needs to stay in this little part of the organization. I haven't heard a good idea how to do that.

Mr. KANJORSKI. Maybe a good idea would be to separate the institutions. Maybe we ought to revisit that question. Thank you, Mr. Meeks.

The gentleman from New Jersey, Mr. Garrett.

Mr. GARRETT. Thank you. Thank you for your hard work and your dedication to this issue. Let me begin with a question that I hear from my district all the time. You sort of touched on it, and I think the answer is probably an easy "no." When you said to one of the other questions how many foreclosures would have occurred had we not done this, and of course you have heard other people say before the bill came along if you don't do it the credit market will crash, and so on and so forth. We did pass the bill, obviously the market still crashed, and what have you. It seemed things didn't really begin to get a little bit of an uptick until you saw the globalization coordinated effort.

So the short question is, is there any way to measure what would have occurred had we not taken the passage of this bill?

Mr. KASHKARI. It is very difficult to measure the counterfactual, as the chairman started with.

Mr. GARRETT. Yes. Okay. That is what I thought. To the gentleman behind me, he raised the good question I thought with regard to what some of the goals are here, and is it an economic one or is it towards market driven? I appreciate your answer there. To the extent that it is not simply to get the market, the stock market up again and the market going in the right direction again, but larger global or larger economic issues and what have you, one of the questions I have is at what level? The number I read the other day was, for example, that household debt to income is down for 2 quarters straight now from a high of 139 percent down to I don't know what the current number is. Now, in one sense, that is bad for the economy when going forward. But in the other sense, if we can get back to a reasonable level on that, that may be a good thing. As the gentleman behind me always asks, what do you have against poor people in the sense that they are the ones who want to be able to buy into these houses, and what we are trying to do

with a number of these initiatives is to keep the price inflated. So in a nutshell, how do you address that question as to what level?

Mr. KASHKARI. It is a great question. Clearly, we don't want our consumers to be overlevered. And coming back to a more normal savings rate is an appropriate process. I think the challenge for policymakers and for legislators is we don't want that correction to happen too quickly, where it becomes destructive to the economy as a whole and we suffer grave economic consequences. So having a gradual, orderly transition to that new level probably makes sense. It is hard for me to opine on what the right level is.

The other comment, Congressman, I would make is we want to be careful to avoid an overcorrection, either an overcorrection in house prices or an overcorrection and excessive deleveraging of the system, because that will exacerbate our economic problems that result from that correction, even if much of the correction is necessary. And so a lot of the actions that we are looking at and that we are taking are to stabilize the system and to try to prevent an overshoot on the downside.

Mr. GARRETT. Some of the other economists or experts who speak on these things worry about we may go to that overcorrection because of some of the actions we are taking with regard to the valuation of the dollar, and although no one is talking about it today, down the road when you V-type approach as far as interest rates and inflation down the road, so you may see a spiking of the overcorrection occurring there.

One of the other comments that you made was with regard to the goal initially, or always has been I think you said with regard to TARP was to get more capital back into the system. I have to tell you that wasn't always the impression that we got as it was selling. The cap phrase always was, how do we get these toxic assets off the books? And then, of course, we were talking about the reverse mortgage aspect. A lot of us were asking how is that going to work? Because if you don't hit the numbers exactly right, you may end up with those banks having too low.

So I have to just share with you that it was not the presentation by the Administration that was the goal. It was just to get them off and to have lending occur there. And the capital aspect was a secondary issue, except for some members, as the ranking member was trying to raise those.

Mr. KASHKARI. I understand your question. From our perspective, and if we didn't articulate it clearly I apologize, it has always been about capital. As the correction has taken its course, Secretary Paulson and Chairman Bernanke were aware that there may come a time when there would be not enough capital in the system, and the private markets would be unwilling to provide that capital. There are different ways you can get at the capital problem. Purchasing illiquid assets—

Mr. GARRETT. Was one way.

Mr. KASHKARI. —was one way.

Mr. GARRETT. Yes.

Mr. KASHKARI. And then this was a faster way.

Mr. GARRETT. The last question is, can you just briefly talk about the TALF program and explain to me what actually are the assets that are actually backing them if you are talking about things like

student loans or credit cards or even cars, car loans, which obviously are a depreciating asset in normal times, and are probably depreciating even more? But what is the actual asset that we are looking back to be able to reclaim if these things go bad?

Mr. KASHKARI. The assets will be—the details are being designed right now, but it is new securitizations of new credit card receivables.

Mr. GARRETT. Yes.

Mr. KASHKARI. New auto loan securitizations, so the AAA pieces of new securitizations. The very high quality credit, low risk for the taxpayers, where right now some of the spreads have just completely blown out, and it is just completely unreasonable for someone to go buy a car today.

Mr. GARRETT. So what is the backing on a credit card, a AAA credit card situation? What do you go after? What does the taxpayer go after, in essence, if that asset goes bad?

Mr. KASHKARI. Well, ultimately, it is the credit cards, and ultimately it is the borrowers who owe on the credit cards, or on auto loans. Similarly, these are consumer credit vehicles to start with. But what the Federal Reserve and Treasury are focused on is these are historically very low credit risk. They are not being priced where they are today because of credit risk; they are being priced where they are today because of illiquidity in the system.

Mr. GARRETT. I yield back.

Mr. KANJORSKI. Thank you very much, Mr. Garrett. Now, Mr. Capuano of Massachusetts.

Mr. CAPUANO. Thank you, Mr. Chairman. Gentlemen, first of all, thank you for being here. Mr. Dodaro, my question revolves around one item in your report. I want to make sure that I read this clearly.

You have recommended that Mr. Kashkari's group monitor individual institutions in the use of their money. Is that correct?

Mr. DODARO. That is correct.

Mr. CAPUANO. And Mr. Kashkari, you have been reported as saying you oppose that position. Do you still oppose it?

Mr. KASHKARI. Congressman, we do not oppose it. We are working with the banking regulators, who are collecting various data from these institutions, to look at the best way to do it. Our hesitation has been about our effectiveness, our ability to determine is it the Capital Purchase Program having the effect? Are there other policy programs having the effect? It has not been a lack of desire, it has been concern about our ability to isolate what is the effect, what is the cause, and is it really boiling down to the policy objectives?

Mr. CAPUANO. Well, in that case, I think you better clarify both to the GAO and to the independent Congressional Oversight Board, because they both report that you oppose it. Now, if you have changed your position or it wasn't clear, so be it. But I was under the impression that was what the GAO was supposed to be about, they make a recommendation, you tell how you feel about it. They reported clearly that you oppose it. They reported that the Federal Reserve opposes it. And the Congressional Oversight Board just today reported that you oppose it. And if you don't, that is good news. But if you do, or you hesitate to review the use of these mon-

eys by individual institutions to see if they are fulfilling the requirements of the law and the intention of the Congress and the President in passing this law, I would strongly suggest that you couldn't be more wrong if your life depended on it, and you would be heading into very, very dangerous waters.

I would personally think that it is a dereliction of duty to not look at individual uses. To give any bank, any institution $45 billion and not look at how they did it? I will tell you unequivocally I don't think you will find a single Member of Congress who would suggest, and I voted for the package, I don't regret it yet, but I would like to see a little bit more oversight on the individual institutions to see whether they are using the money individually. I understand you are looking at generic metrics, and I respect that, and I am willing to wait for that time, I understand that takes some time, I get all that. But it is not that hard to tell whether individual institutions are living up to their requirements and actually using this money to actually put money on the streets. Your own words in your own report, actually very clearly, I think very well, banks in turn have an obligation, an obligation, that is your words, not mine, to their communities to continue making credit available to creditworthy borrowers and to work with struggling borrowers to avoid preventable foreclosures. I couldn't agree with that statement more. That is a wonderful statement. But if you don't look at the individual banks and you don't look at them hard, you will never be able to fulfill that requirement. And I would just encourage you to do so. And again, if it is a miscommunication, I would strongly urge you to communicate more directly to the gentleman sitting next to you and also to the people at the Congressional Oversight Board.

Mr. KASHKARI. Thank you.

Mr. CAPUANO. I yield back.

Mr. KANJORSKI. The gentlelady from Florida, Ms. Brown-Waite.

Ms. BROWN-WAITE. Thank you very much. Mr. Dodaro, I appreciate the report that you put together. It is very helpful. Did you have access to the contracts that were given when the money was given to the 87 banks in the 30 States? Did you see those contracts?

Mr. DODARO. We have looked at all the individual contracts, once the decisions have been made, not only for the agreements that the banks have made—they are all signing, my understanding is, let me just correct that—make sure I am correct, but they are all signing a standard agreement for the 87 institutions. And we have looked at that standard agreement. We have also looked at the contracts that have been let to hire the financial agent, the one that has been hired, as well as the other contractors to support Treasury's administrative operation.

Ms. BROWN-WAITE. Let me just clarify. So it is a boilerplate contract that the 87 banks, 87 financial institutions who received funds signed. Is that correct?

Mr. DODARO. That is correct.

Ms. BROWN-WAITE. And in this boilerplate contract, was there specific language that said the purpose of this money—and remember, it is taxpayer dollars—and I am just asking you, and then I am going to ask Mr. Kashkari—

Mr. DODARO. Right, right.

Ms. BROWN-WAITE. —was the purpose there specifically so that the financial institutions would be helping consumers and helping to free up money in the marketplace?

Mr. DODARO. Yes, my understanding is the language in there, in the boilerplate languages, included in what is called the recitals there in the agreement that the money was to be used for purposes of the Act which would increase the flow of credit and also be used potentially to mitigate foreclosures.

Ms. BROWN-WAITE. Did the contract at any point say, "Use this money and go forth and purchase other financial institutions?"

Mr. DODARO. No.

Ms. BROWN-WAITE. Mr. Kashkari, you have a difficult job to do. You really and truly do. But you have to realize that we have a responsibility to the taxpayers. Right now I can tell you, and I think members, whether they voted for it or voted against it, are viewing the action that was taking place with the bailout as the great taxpayer train robbery. Because while you made a statement, and I wrote it down, you said that it did not—that the public is not considering the fact that you did not allow the financial system to collapse—am I correct that was your statement?

Mr. KASHKARI. Yes, it was not about the public, it was just a statement that we did not allow the financial system to collapse.

Ms. BROWN-WAITE. But, sir, the economy is collapsing. When businesses do not—cannot have access to a line of credit that they have had with the same bank for over 20 years and become—grow from a small business to a medium-sized business and employ lots of people, the economy, sir, I don't want to quote the quote that was used during one of the presidential campaigns, but it is the economy. And if the money is stagnantly being hoarded or used for these other purposes, we are going down a rat hole, sir. That is not what people who voted for it believed that they were getting. Individuals who called me encouraging me to vote originally for it, now that they know the details, are saying they were wrong. And when constituents and business people call you up and say they were wrong to try to encourage this Member of Congress to vote for it, you have to realize what the public thinks of the Treasury and of this Congress.

Mr. KASHKARI. Congresswoman, thank you for the feedback. We take such feedback very seriously. And it is hard, the other Congressman to your right asked about the counterfactual and whether we could—Mr. Garrett—whether we could prove with evidence what would have happened had we not taken these actions. And it is very hard to demonstrate that to people. It is hard to demonstrate it—it is hard for economists to quantify it and show the effects. And so the actions that we are taking, all we can do is try to be as clear and transparent in the actions we are taking to try to communicate why we are taking the actions that we are taking, and to measure our results, and to make adjustments as we need to as we move forward.

Ms. BROWN-WAITE. And let me also point out that Treasury notes, 4-week Treasury notes are now being sold at 0 percent. So it has a total effect on the economy, small businesses, and also the Treasury.

Mr. KASHKARI. Absolutely. And if you will permit me, please, as I mentioned previously, this was a plan and is a program to stabilize the financial system so that credit can flow. It is not going to happen overnight or as fast as we would like. But that is different than an economic growth plan or an economic stimulus plan. And we do face real economic challenges.

Ms. BROWN-WAITE. I yield back.

Mr. KANJORSKI. I thank the gentlelady from Florida. The gentleman from Texas, Mr. Hinojosa.

Mr. HINOJOSA. Thank you, Mr. Chairman. My question is going to be to the honorable Secretary Kashkari. I voted in favor of this bill for many reasons. And I would like to focus on one, which was the calls that I got from the presidents of colleges and universities, chancellors and others who were saying that there was a lack of credit, and consequently banks that used to make college student loans were no longer making them. So I would like to know how Treasury's Term Asset-Backed Securities Loan Facility, which we will call TALF here, will help the not-for-profit secondary markets for student loans return to making and purchasing student loans. Treasury's plans seem to have focused solely on the for-profit sector, despite the fact that private student loan lenders have been the subject of investigation by State attorneys general. Tell me what the Treasury is going to do to help these lenders who have played a key role in the federally guaranteed student loan program, as well as have been providers for low-cost, consumer-friendly, non-Federal loans to fill the gaps between the cost of attendance and what is available through Federal financial aid?

Mr. KASHKARI. Thank you, Congressman. We too believe that the issue of making student loans available at a cost-effective rate for our students is absolutely vital for our country short term and long term. So the way the TALF is structured, and it is a Federal Reserve facility that the Treasury is investing in, it is structured, from my understanding, to help both the private and the nonprivate providers of student loan credit. It will help both. And it will provide liquidity to the markets to bring down student loan rates so that they are available on rates that students can afford just so they can go to college.

Now, we have a team at Treasury that is working with a team at the Federal Reserve to design the details and get the program up and running. They have been receiving a lot of feedback from market participants in the student loan space and the auto space and the credit card space, etc., and are incorporating that feedback as they design the details. We want this program to help as many students as possible. Right now, it is being designed as a $200 billion program with $20 billion from Treasury, but it is designed to be scalable so we could expand it from there over time to make sure we are getting help to everybody who needs it.

Mr. HINOJOSA. But you should know that this sector is huge; there was over $16 billion that was lent out in college loans. And to have banks not offering credit, not offering these student loans not only for the cars and for appliances and for many things that you have heard from my colleagues before me, these student loan programs are not working right now. And you need to know and have people report back to you on how it is not fixing the problem.

I would like to ask Comptroller General Dodaro, the TALF program's aim was to increase credit availability for credit cards, auto loans, and student loans, as I mentioned. However, private lenders of the non-Federal student loans already enjoy Federal protections that auto and credit lenders do not, making it nearly impossible for student borrowers to discharge private student loans in bankruptcy. How will TALF program take into consideration these differences in the treatment of consumer debt?

Mr. DODARO. Congressman, that is something that is under consideration by the Treasury Department, so a lot will depend on how they decide to move forward in those programs. I mean we are watching what they are doing, and as they institute programs, evaluating whether they are going to achieve the objectives or not. So it will depend on how that program will be designed going forward.

Mr. HINOJOSA. Would Comptroller General Dodaro like to address my question?

I am sorry, I meant to say Secretary Kashkari. Forgive me. I apologize.

Mr. DODARO. I am the one with the gray hair.

Mr. HINOJOSA. There you go.

Mr. KASHKARI. Congressman, the details, as I said, are being worked out right now, as the Comptroller General said. The only other comment I would make, sir, is that the program is being developed and it is going to take, you know, probably sometime in January before it is up and running. So again, none of these things can be turned on overnight. But we are getting a lot of positive market feedback from lenders of all types who are saying this is the right tool that they need to get credit flowing to our students and to our consumers.

Mr. HINOJOSA. I yield back, Mr. Chairman.

Mr. KANJORSKI. Thank you. Mr. Barrett?

Mr. BARRETT. Thank you, Mr. Chairman. Gentlemen, thank you are being here today.

I was reading the legislation. The explicit intent is to immediately restore liquidity and stability in the financial system in the United States, and I believe that. That is why I voted for it. Are we, Mr. Kashkari, have we passed the point where our banking system, our financial system is catastrophe proof? Are we past that point?

Mr. KASHKARI. Congressman, I feel confident that the financial system is stronger than it was when the Congress acted so quickly. But this crisis has been unpredictable. And there have been times in the past when market participants breathed a sigh of relief and said, okay, we are through it. I don't want to make predictions, but I do say that it is important that we all stay on our front foot, and continue to move aggressively to take action to adjust to situations on the ground until we are sure we are through it. That is about as good an answer as I can give you, Congressman.

Mr. BARRETT. Well, that is an answer. I know it is tough. There seems to be a lot of fundamental inconsistencies between the claim the financial system was at risk because of toxic assets and the claims that the TARP go to healthy banks. I heard your answer, and I understand that. But looking in my district, and looking

across America, it seems like the smaller banks are the healthier banks. They are the ones that are actually doing well right now. Is bigger better? Is giving TARP funds to these healthy banks that are in turn buying other banks and becoming mega banks, and it seems to me that that was part of the problem that some of these institutions were too big and didn't know what was going on, that seems a little counterproductive. Walk me through that.

Mr. KASHKARI. Sure. That is a great question. Bigger is not necessarily better. And you are right, some of our smallest institutions are some of our healthiest. That is exactly why we want small banks to participate and to take the capital, because in many cases they are in the best position to extend new loans. Now to the topic of mergers and acquisitions, it is absolutely not our policy objective to encourage mergers or to consolidate the banking industry. Because as you said, bigger is not necessarily better.

Mr. BARRETT. Right.

Mr. KASHKARI. But if you have a bank that is weak or failing, and that bank is acquired by a healthy bank, that community is often better off, because now credit can still be extended, and branches will still stay open in that community, versus if that bank were allowed to fail and the bank would have to be shut down and dissolved, then that community would be worse off. So prudent mergers and acquisitions can be a healthy part of the financial system. We don't want to overdo it.

Mr. BARRETT. I agree with you 100 percent. I guess the key word is "prudent." And as some of our banks have gotten larger, and I do agree, I think they are protecting some weak communities or some weak banks that in turn protect the community, how do we ensure that these bigger banks are using the prudent oversight so this doesn't manifest into the same thing on down the road?

Mr. KASHKARI. It is a very important issue. And I don't think there is a perfect brightline test that anybody can apply. But ultimately, each of these mergers and acquisitions needs to be approved by their primary Federal regulator, in many cases of both the target bank and the acquiring bank. And the regulators who are there onsite are in the best position to judge is this a prudent acquisition or is this a risky acquisition. Treasury, as you know, is not a bank regulator. But they don't have an easy job either.

Mr. BARRETT. Have we, Congress, in this legislation hamstrung you guys with specific mandates or specific directions we are telling you to go in that have decreased the program's effectiveness? I mean I know it seems like when Congress gets involved every time, you know, we try to mandate something, and too many times every time we do that we screw it up. Is that the case? If so, can you be specific?

Mr. KASHKARI. Broadly speaking, I don't believe so. I think we worked very hard and constructively with the Congress to build in a lot of flexibility. It is interesting, sitting through those midnight negotiations sometimes what seemed like an obvious good idea at the time, when you actually go to implement it, it turns out to be a lot more complicated. We found those cases, but I this we also found ways of implementing the intent and the spirit of what was in the legislation in a manner that can be executed as quickly as we need. We are not done. There are things that we still have to

do to follow up, to make sure banks are complying on a go-forward basis. So we are learning as we go, but we are making a lot of progress.

Mr. BARRETT. Thank you, gentlemen. Thank you, Mr. Chairman.

Mr. KANJORSKI. Thank you very much. We have a little bit of a problem. We are trying to accommodate Mr. Hensarling, who has a conflict meeting at 1:15, so at this time, we would ask the indulgence of Panel One to step aside, remain here of course, because we are going to recall you to continue examination. But we will ask Mr. Hensarling to make his presentation. At the table, or do you want to do it from there, Mr. Hensarling?

Mr. HENSARLING. If it would help accommodate the panel and the committee, I am happy to issue the testimony here.

Mr. KANJORSKI. We want to accommodate our friends on the other side of the aisle. Any way you wish to do it.

Mr. HENSARLING. Why don't we allow our panelists to keep their seats, Mr. Chairman?

Mr. KANJORSKI. Very good. You are recognized then to make your presentation, Mr. Hensarling.

STATEMENT OF THE HONORABLE JEB HENSARLING (TX-05), CONGRESSIONAL OVERSIGHT PANEL UNDER THE EMERGENCY ECONOMIC STABILIZATION ACT

Mr. HENSARLING. Thank you, Mr. Chairman, and I appreciate the accommodation, since earlier we were scheduled for the first panel. So Mr. Chairman, Ranking Member Bachus, and fellow members of the committee, I want to thank you for inviting me to testify in this oversight hearing on the Troubled Asset Relief Program and to address the role of the Congressional Oversight Panel, after which I look forward to reclaiming again my role as inquisitor as opposed to inquisitee.

Before I begin my testimony, I do want to recognize the work of the Congressional Oversight Panel Chairwoman, Elizabeth Warren. Faced with a number of challenges and time constraints not of her making, she was able to first, produce an initial report and, second, produce one that raises legitimate issues and questions for which Treasury must account, and about which this committee should care. Although I cannot in good conscience support the report at this time for reasons I will discuss later, I commend her nonetheless on her work.

Mr. Chairman, it is clear that many Members of Congress are only now awaking to the fact that Congress has granted unprecedented discretionary powers to the Treasury Secretary, and has simultaneously created unprecedented taxpayer exposure. I, along with many of my colleagues on both sides of the aisle, supported alternative plans, and opposed the enactment of EESA. We were not, as one of my colleagues put it earlier today, bamboozled. I believe many of the criticisms that we are hearing today of Treasury are better directed at Congress for passing the misguided law in the first place. Be that as it may, EESA is now the law of the land, and I intend to do whatever I can to help ensure its success.

In that regard, Mr. Chairman, I believe that effective oversight should have three main goals:

One, ensure the program actually works. In other words, ensure that Treasury actually exercises its broad authority commensurate with the act, and that its actions are effective.

Two, ensure the decision-making process is transparent and based on meritorious considerations of what helps the entire American economy, not an opaque political process picking winners and losers.

Last, but certainly not least, ensuring that the often forgotten taxpayer is protected in this program.

Even by Washington standards, $700 billion is a great deal of money. It translates into roughly $9,400 per American family, when they are struggling to keep their jobs, send their kids to college, and pay their mortgages. Mr. Chairman, they need the $9,400 paid back.

First, we must again ask, is TARP working? After listening to the testimony, it is: (a) probably too early to tell; and (b), certainly most challenging to tell with respect to cause and effect. One, again, can argue in the short run that Congress has given Treasury a number of competing goals without guidance on how to weigh them.

Furthermore, as we know, and as the panel's report has indicated, Treasury under EESA does not operate in a bailout vacuum. Treasury's efforts over EESA are dwarfed by the actions of the Fed. Since the inception of the financial crisis, the Fed has committed over $5 trillion through its facilities, windows, and other actions, compared to $335 billion for Treasury under TARP, a factor of roughly 15 to 1.

Mr. Chairman, we in Congress will be negligent if we only focus upon Treasury and TARP and ignore the actions of the Federal Reserve.

Second, with regard to transparency and the meritorious decision-making process, even after the testimony we have received, many questions remain: How will the activities of those participating in CPP be monitored; why AIG; why Citigroup; why are some Capital Purchase Program applicants encouraged to withdraw their applications?

Finally, is the American taxpayer truly protected? We have an unprecedented level of Federal intervention, and every Treasury action will be paid for by congressionally mandated drawdown on future generations, compromising their freedom, their opportunity, and their standards of living.

Mr. Chairman, I believe the Congressional Oversight Panel has a unique role to play in the accountability of EESA. Time will tell whether or not the panel will prove effective in that role. For a number of reasons, panelists were appointed late in the process, with a report looming large for submission today. Due to these and other exigent circumstances, the panel has operated rather informally and has held no hearings. Issues of panel rules, panel process, resource allocation, minority rights, and the panel's hearing agenda remain unresolved.

In order to be an effective advocate for the American taxpayer, I have to ensure that every panel member has the resources and rights necessary to conduct effective oversight. And I wish to ensure that the panel officially adopts a serious hearing agenda that

brings transparency and accountability to the process. I have raised these concerns, but I assume due to the urgency and exigency of the circumstances, they have yet to be addressed.

The report today, Mr. Chairman, and I will conclude briefly, has many good points and questions that I agree need to be asked of Treasury. I, however, remain concerned about language that I believe can be interpreted as a panel expectation that Treasury adopt policies that could make credit more expensive and less available and policies that could delay the recovery of our housing market at exactly the wrong time.

Mr. Chairman, I hope that soon I can conclude that taxpayers' voices are effectively represented on the panel. The panel represents a serious attempt at bipartisan oversight. Until such time as I can conclude that, I cannot and will not in good conscience approve any panel reports. Regardless of the panel's future or my future, I remain committed to bringing the highest level of accountability and transparency to the process.

With that, I appreciate the chairman's indulgence and his accommodation to my schedule. I yield back.

Mr. KANJORSKI. [presiding] Thank you very much, Mr. Hensarling. Since Mr. Hensarling is technically a member of Panel Number 2, the committee members would have a right to exercise an examination of Mr. Hensarling. But because of his other commitment, what I would suggest, unless there is some pressing question that has to be immediately answered, that any questions either side of the committee has for Mr. Hensarling be submitted in writing. I am sure he will accommodate the committee by answering the same in writing. Is there any objection to that?

The Chair, hearing none, Mr. Hensarling, thank you very much for your testimony.

Now we will resume with our Panel Number 1. The gentleman from California.

Mr. SHERMAN. Thank you, Mr. Chairman. I will have a number of questions for the record because 5 minutes is not enough to ask all the questions I have.

Let me first start with a question that affects the travel plans of all of my colleagues. Mr. Kashkari, how certain are you or confident are you that Treasury will not be asking for the final $350 billion in a formal submission to Congress this month?

Mr. KASHKARI. Congressman, I am not certain of the timing of any such submission. Ultimately, the Secretary would make the determination, likely in consultation with—

Mr. SHERMAN. I look forward to singing Christmas carols with my colleagues on the steps. But can you at least assure me that we are not going to get such a request in the next day or two?

Mr. KASHKARI. Again, Congressman, honestly, I don't want to make promises. It is the Secretary's determination.

Mr. SHERMAN. Has the Secretary clued you in that he is planning to ask for the money in the next day or two? Wouldn't he tell you? You are running the program.

Mr. KASHKARI. We talk about that topic quite often, and ultimately it is the Secretary's decision to be made.

Mr. SHERMAN. I am asking you whether he has indicated to you that he is going to ask for the money in the next day or two.

Mr. KASHKARI. He has not indicated that.

Mr. SHERMAN. Thank you.

Now, one of the most fun things, especially at this time of year, is to play Santa Claus, particularly when you can be generous and it doesn't cost you anything. One thing that the Treasury has done is to buy preferred stock in these banks and get warrants that are supposed to compensate the taxpayer for the risks we are taking. But, of course, Treasury accepted one-sixth the warrants that Warren Buffet got in a similar transaction, and took the same number of warrants from every institution, whether it was a high-risk institution or a low-risk institution, indicating that we are being generous to the shareholders and executives of the high-risk institutions.

But I want to focus first on another act of generosity. Section 111 of TARP says: "The Secretary shall require that the financial institution in which you invest meet appropriate standards for executive compensation."

The law then lists three particular items that you need to put into the stew. But the mandate is clear; not just deal with these three particulars involving like golden parachute-type contracts, but devise appropriate standards, enforce appropriate standards on executive compensation.

Now, after AIG got TARP money, they announced and are in the process of paying bonuses as high as $3 million or $4 million. Sir, have you met your responsibility to require that appropriate standards of executive compensation be imposed on AIG and the other recipients of TARP funds?

Mr. KASHKARI. Congressman, this is an important issue in which we must not lump all the institutions together.

Mr. SHERMAN. I am not. I am asking about AIG. Is a $3 million bonus an appropriate standard of executive compensation, or has the law been violated?

Mr. KASHKARI. Congressman, I don't have the details of what the bonus levels are at AIG.

Mr. SHERMAN. You are the one who is supposed to impose appropriate levels of executive compensation. Have you done that? Are they making payments of executive compensation that are not appropriate, or are you just blind to whether they are appropriate or not?

Mr. KASHKARI. Congressman, we have imposed on AIG new corporate governance standards, executive compensation standards.

Mr. SHERMAN. Do your standards prevent the payment of a $3 million bonus?

Mr. KASHKARI. I do not believe that they specifically prevent a payment of $3 million.

Mr. SHERMAN. So have you imposed appropriate standards for executive compensation? Are you here to tell this committee that appropriate standards of executive compensation would allow a $3 million bonus? How about a $30 million bonus; would that be appropriate executive compensation, or would that be prohibited by any standards that met the statutory requirement imposed on by Treasury?

Mr. KASHKARI. Congressman, in the case of AIG we were placed—please permit me to finish. This is a very important issue.

Mr. SHERMAN. Sir, I didn't ask you about corporate governance, I didn't ask you about the makeup of the executives. I asked whether a $3 million bonus or a $30 million bonus is consistent with a statutory requirement that we have appropriate standards on executive compensation.

Let me ask it specifically: As to $30 million, is that appropriate or inappropriate, or you have no opinion?

Mr. KASHKARI. I am not in a position to opine on a specific number, if it is appropriate or not.

Mr. SHERMAN. Well, when Congress tells Treasury to limit things to appropriate compensation, I would hope that you would devise such standards. And so the standards that you have written so far do allow $30 million bonuses to be paid. There is nothing that Treasury has done that would prevent a $30 million bonus, correct?

Mr. KASHKARI. Ultimately, I believe, and I need to check, the Treasury and Federal Reserve, the U.S.—

Mr. SHERMAN. Sir, you wrote the regulations. What is in them?

Mr. KASHKARI. Congress, ultimately the Treasury and the Federal Reserve, because now the taxpayers own 80 percent of AIG, are in a position to approve specific compensation standards. My point in talking about the executives—we want to get the taxpayers' money back, in the case of AIG. And so we needed to put in place a management team, hire quality managers. For me to come in here and say, well, $100,000 is the right number or $500,000; I don't know the right number.

Mr. SHERMAN. Sir, these bonuses were paid to executives that had been there for a while and a part of the team that ran the company into the ground, and your level of generosity is in stark contrast to the suffering of the people in my district.

I yield back.

Mr. KANJORSKI. Thank you very much, Mr. Chairman.

May I add something? That is the one question that I hear more of as I travel across this country, the absolute frustration of the American people in this Administration not imposing some standard or rule. I have to just make the point because we just finished the examination with the auto industry. We have a successful CEO running Toyota in the United States, getting $1 million a year as compensation, and we have a very unsuccessful CEO in the United States, running one of the major car companies called GM, getting $23 million a year. The American people are just wondering what is wrong with this Administration that they can't establish a standard of compensation.

Mr. Kashkari, are you saying you don't have the capacity to make those standards down there? Do you want us to do it? Is that what you are recommending, that we legislate that?

Mr. KASHKARI. Congressman, I am suggesting respectfully that we were implementing the letter and spirit of the law. Very specific executive compensation provisions were spelled out in the legislation. We have met every single one of those in every case we have made an investment. We took those very seriously.

Mr. KANJORSKI. So it is your opinion that the Congress, in regard to compensation, inadequately structured the law.

Mr. KASHKARI. I don't believe the Congress specified that you want to set a specific cap on what an appropriate payment level is.

Mr. SHERMAN. Mr. Chairman, if I can just quote the statute, subdivision (b) of section 111 includes the words: "The Secretary shall require the financial institution meet appropriate standards of executive compensation." It requires Treasury to decide what that means. And apparently it means $30 million is just fine, since the regulations they wrote do not prohibit a $30 million bonus, nor is Mr. Kashkari willing to say here and now that he would not allow $30 billion bonuses in the future.

I yield back.

Mr. KANJORSKI. Thank you very much. While I have you, Mr. Kashkari, I heard you defend the right of some of these entities to pay dividends. There is a difference. I served on boards of directors in my past, and there is a way of paying cash dividends and paying stock dividends. There is no reason in the world, if you want to encourage people to participate and therefore they need a dividend, give them a cash dividend. If they want to go out in the marketplace at the rate the market pays for their shares of stock, let them sell that interest. But there is no reason to be handing out millions and millions of dollars of taxpayers' money as a dividend to some existing companies and say it is perfectly justified because it encourages people to invest or make a contribution of equities. There are other ways of getting equity to people and to encourage them to participate.

I think it is just sloppy management, if you want my honest opinion. And I think I am hearing from you today that we should reinstigate some of these rules and regulations and start laying down a congressionally mandated standard. Set it out.

I think one of them we are all talking about now is, by God, if the CEO of Toyota, running one of the most successful auto manufacturing companies in the world can do it on $1 million a year, it just seems to me it is not a bad standard if the taxpayers of the United States are paying for the operation of a motor company in this country, that we accept that standard; and if somebody doesn't want to work for $1 million a year, maybe we could entice the President to give up his $400,000 salary and come to work for $1 million a year for running that company, or any Members of Congress for that case, or some of the professors at our universities and law schools. We may be able to find somebody in this country who is willing to take that.

Anyway, I have rambled on enough.

Our next participant is Mr. Roskam.

Mr. ROSKAM. Thank you, Mr. Chairman. I just would point out, my predecessor, Henry Hyde, had a way of describing this conundrum, and he observed that there is one thing worse than gridlock, and the worse thing than gridlock is the greased chute of government. It is exactly what we are dealing with today, a greased chute that created this TARP program and now, seriously, there are Members of Congress who are looking at the Administration, and the Administration is looking at Members of Congress, saying, oh, is this what you meant? It is really shocking. So here we are, several hundred billion dollars into this.

I want to shift gears a little bit and really go toward part of the conversation during the deliberation of TARP that really didn't get a lot of discussion and that was revisiting mark-to-market. As you

know, mark-to-market is a good idea sort of in theory and in a post-Enron environment where there were manipulations in the past that had to be dealt with. But my question is: There has been all this energy and capital that has been injected into the marketplace, either originally in the purchase of toxic assets or now ultimately in direct capital injection, and that is bringing capital in one way; but are we adequately making sure that there are not regulations in place that are draining the market of the very capital that we are trying to create?

Could you comment, because basically when the mark-to-market conversation came up during the TARP deliberations, there was sort of this pat you on the head, tap you on the backside, and kind of a feeling of it is really interesting, but off with you, be lively, we are not really interested in that, because the orthodoxy that had developed was we are going to pump capital in, and that is the way we are going to do it.

Now that we can be a little bit more reflective, is there an interest or is there a recognition that mark-to-market and some of the changes need to be in play and need to be more than sort of the dalliance that we have seen from the Securities and Exchange Commission so far, but there has to be a real safe harbor here?

Mr. KASHKARI. Congressman, I remember the discussions that you reference from the negotiations. Mark-to-market is a very important issue. You are right to raise it. A lot of people have raised it. First, as you know, I believe the legislation called for the FCC to undertake a thorough study of mark-to-market, and I believe they are well underway and their report is due, I believe, on January 2nd. So they are consulting both internally with government experts and with outside experts to look at mark-to-market. There is no question that mark-to-market is procyclical and it is exacerbating the swings.

At the same time, we have not seen a better alternative. There are cases in history where countries have pretended that their assets were worth a lot more than they ultimately were worth, and they prolonged their economic downturn and their economic crisis. So we clearly need to find the right balance.

What we have right now where there is no bid in the market also does not appear to be optimal, clearly; but just also pretending these loans are worth more than they are does not also seem to be a good solution. So I will respectfully defer to the FCC and their ongoing work to study this issue. It clearly needs to be studied very carefully.

Mr. ROSKAM. We are not going to settle this in the couple of minutes that we have this afternoon, but it seems to me that the urgency with which the original TARP deliberation took place, we would have been well-served had that same urgency and that same clarity been brought about to require or to provoke—use any verb you want to—but to get a fundamental change in mark-to-market. It would seem to me there were things that were on the table that would have been substantive and very helpful, and we may have been in a very different situation right now.

Let me just turn quickly, Mr. Dodaro, could you comment on that element of things? In other words, as the GAO evaluates TARP, can—or is part of your deliberation and your evaluation, regulatory

burdens that may be in place, impediments to progress that Congress itself can remove, or the Securities and Exchange Commission or FASB or others? Is that part of your portfolio, so to speak?

Mr. DODARO. It is not part of the specific requirements under TARP for us to take a look at it. It is more program implementation, whether it is meeting the performance and expectation of goals of the legislation. But we do have other authorities and other work that we have underway to look at the regulatory structure which we think needs to be reexamined in light of current events, and we will have a report to the Congress with some criteria and characteristics that we think should be guiding principles in reexamining the regulatory structure.

We also have an effort underway to look at, similarly, criteria that could be considered in making a determination as to the ultimate character of the entities for Fannie Mae and Freddie Mac once they emerge from conservatorship. We are also following the mark-to-market situation closely at the SEC, and we will be in a position to comment on that as well.

Mr. ROSKAM. Thank you. I yield back.

Mr. KANJORSKI. The gentleman from Missouri, Mr. Clay.

Mr. CLAY. Thank you, Mr. Chairman, and I thank the witnesses for their amazing testimony today. We have witnessed an amazing set of events since we originally passed TARP—I guess while we passed TARP. The Administration was able to influence a majority of the members of this legislature to go along with the plan that they said they were sure would rescue the U.S. economy. Several weeks later, you dumped the entire plan and said, oh, that probably won't work. I didn't think it would work then, and I don't think you all know what you are doing now.

Let me ask you, Mr. Secretary, we own 80 percent of AIG. What benefits do the taxpayers of this country—what have we derived in benefits from owning 80 percent of AIG, lending them a total of $125 billion? Did we buy the assets or were the assets sold? If so, to whom? And how is AIG managing those assets now if they didn't sell them?

Mr. KASHKARI. Congressman, let me start by saying we didn't want to own 80 percent of AIG. We didn't want to intervene in AIG. AIG was on the verge of collapse, which jeopardized the financial system as a whole. So we had to take this action.

Mr. CLAY. Jeopardized what?

Mr. KASHKARI. The financial system as a whole.

Mr. CLAY. Look, I am from Missouri. We speak plainly. People of Missouri want to know. What if they had failed? So what? What if they had failed? What would have happened?

Mr. KASHKARI. It is hard to know for sure. It is conceivable that the financial and banking system would not function. Imagine if you went to your ATM and couldn't get money out of your checking account, or your money just wasn't available, or your 401(k) was worth half as much as it was the day before. It is hard to know.

Mr. CLAY. Based on AIG failing.

Mr. KASHKARI. AIG is a trillion-dollar institution with transactions and counterparties around the United States. We took this action to make sure that a collapse did not happen because the consequences were grave. And now, because we had to step in to sta-

bilize them, we have tried to provide as much protection for the taxpayers as possible. So now the taxpayers own 80 percent of the company. The new management's job is to do an orderly disposition of some of the businesses, to generate cash to pay back the taxpayers so that we are made whole.

Mr. CLAY. Today, Mr. Secretary, what is the company worth?

Mr. KASHKARI. I don't know the answer to that. I will try to find out. I don't know the answer to that.

Mr. CLAY. Thank you. Let me ask you about GAO's recommendations. There are nine recommendations. One of them, my friend from California brought up. What measures have CPP taken to ensure that institutions comply with executive compensation, dividend payments, and repurchase of stock; and have you all taken the recommendations of GAO and instituted them?

Mr. KASHKARI. Yes, Congressman. We agree with GAO's recommendations and we are already instituting them. That is why we felt good about the report, because it verified the directions that we felt we were already going. These are not going to happen overnight. We are instituting the programs now.

Now, most importantly, executive compensation, dividend restrictions, these are contractual agreements between the United States Government and these institutions. If they violate our contracts, we have many legal recourses to go after them, including going to the Justice Department and going after them. So I think banks will be very hesitant to sign a contract with the U.S. Government and then not fulfill their obligations. We are going to go after them. The regulators are already supervising, and we are looking at other measures to make sure that they continue to comply.

Mr. CLAY. Thank you for that response. We understand the TARP program continues for credit card, auto loan and student loans. However, private lenders for non-Federal student loans enjoy Federal protections that auto and credit lenders do not; namely, private student loans are exempted from bankruptcy, except under extreme circumstances.

How will the TARP program take into consideration these differences in consumer debt?

Mr. KASHKARI. Congressman, I don't know the answer to that. I would have to talk to my colleagues at Treasury who are implementing it with the Federal Reserve. It will help all classes of the consumer credit, but I don't know how it will take into account the bankruptcy difference.

Mr. CLAY. Mr. Secretary, would you please get back to us on what AIG is worth on this day?

Mr. KASHKARI. Yes, sir.

Mr. CLAY. Thank you.

Mr. KANJORSKI. Thank you, Mr. Clay.

We will now hear from Mr. McCotter.

Mr. MCCOTTER. Thank you. Mr. Kashkari, you have a very difficult job. I know you work under Mr. Paulson, who works under the President, and sometimes things roll downhill. Yet they roll inevitably anyway.

With that said, I heard your testimony, read through it, and it gave me great insight for the next time I take a weekend trip with my wife. I am generally loath to ask for directions or assistance,

which greatly annoys my wife, but the next time that she claims we are lost, I am simply going to say, "We are taking many steps to adapt to events on the ground. And we have made remarkable progress in only 68 days, Dear. We cannot be lost, because I am sure that I know what I am doing."

So in that spirit of disconcertion, I would like to ask you a couple of questions. The first thing that I found very interesting as this began was the concept of stigma—the stigma of having to receive taxpayer assistance for a problem that you may have caused. Now we have seen individuals, average working people who are down on their luck and have had to go through things such as drug testing to receive Federal assistance or State assistance, because the stigma that attaches to seeking government benefits is a protection of the taxpayer because it prevents other people from coming forward and seeking assistance when they do not really need it. And yet, in the instance of the bailout, we have heard that we cannot stigmatize financial institutions that come forward for taxpayer money; that would be wrong. And we hear reports of healthy financial institutions being asked to take taxpayer money they don't necessarily want so that the stigma does not attach to the people who have helped cause this problem, unlike individuals.

So I would like to ask the logic behind that, because it seems to me that if you hand out taxpayer money to avoid a stigma, that you will then stigmatize those who do not unnecessarily take taxpayer money. It seems counterintuitive to me.

Secondly, we have heard discussion from the gentleman from California, Mr. Sherman, that there is a prospect that the second round of billions of dollars will be asked for because, as you know, we have only appropriated directly $350 billion—"only" $350 billion. And yet as I read through the testimony, the GAO has identified several instances where, shall we say, oversight has to continue to occur. And this—if I am wrong, correct me—but we have already spent $200 billion. I think with AIG at $40 billion, we are over $200 billion.

Mr. KASHKARI. I think that is approximately correct.

Mr. MCCOTTER. Let me see what we haven't done. We have already spent $200 billion and these things have not been done completely yet. We have not developed a comprehensive system of internal controls, we have not issued final regulations on conflicts of interest, we have not instituted a system to manage and monitor the mitigation of conflicts of interest. And I could go into the other six items. This is after $200 billion of taxpayer money has been spent in a program that has had more twists and turns than an Agatha Christie plot.

So my question is: How can there be consideration of asking for another $350 billion in taxpayer money for this program when these controls are not in place for accountability and oversight and $200 billion has already been spent?

Mr. KASHKARI. Well, Congressman, again, as indicated in my testimony, it has been 68 days since the President signed the law. We have teams of people working around the clock to build the operation, design the programs, and implement them all at the same time. We would love it if the financial markets just healed them-

selves and we could go at a much slower pace and just implement this thing as a normal government program would be implemented.

We haven't had that luxury. We have had to move quickly, we have had to adapt to events on the ground, and we are going to continue to move aggressively as long as we are here.

Mr. MCCOTTER. As I remember, when we met with Mr. Bernanke, some of the House Republican leadership, and—I think it was Bear Stearns—there was an indication that the entire financial system could melt down because of the interconnectivity due to the credit market and the stakes that have been made. I also remember reports that potential scenarios for legislation such as this and a program such as this had been prepared by potentially Treasury and the Federal Reserve for just such a potentiality occurring.

So I am aware of the 68 days because I was voting against it. And I have been counting the days until we actually have someone from the CEOs come in, and I thank Chairman Frank for that. But this isn't as if you are telling me that the Republican Administration of President Bush was sitting there and Secretary Paulson and his predecessor were sitting there with absolutely no indication whatsoever that this could be potentially a problem down the road that might need some type of foresight and forethought put into a potential plan.

You make it sound as if it was an economic Pearl Harbor that came without warning. I think the facts preceding the 68 days tend to disprove that. But that is my opinion.

Mr. KASHKARI. Well, Congressman, over the course of the the winter and the spring—I think I mentioned earlier—we thought there may come a time when the government would have to step in to provide capital because the private sector was unwilling to, and began planning for such a contingency. It is very different to lay out the broad strokes of a plan and to work through the very detailed internal control procedures. We hired PWC, who is working with us. You can't do that in advance.

Mr. MCCOTTER. If I can, because my time is up, I welcome your response in writing. Let's just be clear: The broad stroke that you outlined was a TARP program of toxic assets, and that proved to be wrong.

Mr. KASHKARI. It proved that the credit crisis intensified deeply in the 2 weeks between when Secretary Paulson first came to the Congress and the Congress acted. I can show you lots of data that substantiates that. And I would be happy to, Congressman.

Mr. KANJORSKI. I thank the gentleman.

The gentleman from Massachusetts, Mr. Lynch.

Mr. LYNCH. Thank you, Mr. Chairman. Let me pick up right where Mr. McCotter left off. And I appreciate both witnesses hanging in, and your help with the committee's work today.

One of the central factors within this current crisis has been the lack of reliable information in the credit markets with respect to counterparty risk. That has been a huge part of this. I think what Mr. McCotter—part of what he was saying, not to put words in his mouth—was some of the things that Treasury has done in this whole process has really hurt confidence. Getting us all in line here for this toxic asset purchase program and getting enough votes and

then, a few days later, just completely changing, without any explanation or any real debate here, changing the whole program here so now the Troubled Asset Relief Program doesn't purchase any troubled assets. That all goes away. That itself is very upsetting to the markets when you say you are going in one direction and all of a sudden you go in the other.

A couple of other things: The dramatic infusions of cash into a lot of these banks. And we heard the reports about how several of them actually said they didn't want the money, they didn't need the money. That doesn't instill a lot of confidence in folks either, especially when there are so many people in other industries begging for help. I don't think that really pumping up the capitalization 1 or 3 percent in these banks is going to address the underlying fear of a lot of banks that they are not sure that their counterparty or other lenders, other banks, are not going to go belly-up at some point because of some CDOs that they hold, or that there may be something that would lead them to be unable to repay their loans.

So for me, really a lot of what needs to be done here deals with transparency. Again, this TARP program, when you think about it, is really operated in the dark, with the exception of the work that Mr. Dodaro has been trying to do. The bill called for a Special Inspector General. And I am not blaming you, Mr. Kashkari, but under the bill, the new Inspector General is supposed to inform Congress within 60 days of his swearing-in over at the Senate. He is never going to file a report. He is going to be gone. By the time he is required to report to us, he will have been gone. There will be a new guy in his place with the new President, I suspect. It is reasonable to assume.

The new guy won't have to report until the 3rd week of March. So we are going to have, very likely, $700 billion out the door without having had anyone, other than the good work of Mr. Dodaro, telling us where the money is, what it has been used for.

With these new plans that have been going out there, now we are going to start to, as I understand, purchase some asset-backed securities; but there will be no information for Congress or the people whom I represent, who keep asking me, "What are we buying, who is getting the money, where is it going?" There is a disconnect here. Believe it or not, at some point I will stop talking.

What are we doing? What are we doing to address that piece of it, the lack of transparency? We have to get this thing going again. As long as people don't trust each other, as long as there is no transparency here, folks are going to be afraid to lend. And I am afraid that some of those flaws, some of those frailties, are reflected in your own organization, this TARP program, because there is a lack of transparency there. We can't understand what is going on and we don't have a regular flow of information back and forth. How do you help that situation?

Mr. KASHKARI. Thank you, Congressman. It is something I am personally very focused on. I give a lot of updates to the country in the form of speeches and hearings such as this so that people can see in granular detail what we are doing.

But let me also comment on reporting. The legislation calls for many levels of reporting: Transaction reports within 2 days of

every investment; traunch reports every time we obligate $50 billion; and a report to Congress within the first 6 days of our first commitment, and then monthly thereafter.

We have met every single one of our reporting requirements, every single one, on time. All of this information—there is a wealth of information on the Treasury Web site, and I am having a heck of a time getting people to go there and look at it. People say, "We don't have the data." And I say, "Well, have you looked at the Treasury Web site? It's all there." They say, "No, I hadn't looked there."

So we need help getting the message out because we are putting so much data out there, I am afraid we are overwhelming people with too much information and too much data.

Mr. LYNCH. Mr. Dodaro, what do you think Mr. Kashkari can do to help that transparency issue, in addition to what he has just commented on?

Mr. DODARO. First of all, our first couple of recommendations, particularly the one that focuses on tracking what the individual institutions are doing with the money and providing reporting back as to what is happening at that level, I think would do wonders for transparency. I do agree with Mr. Kashkari, they are posting a lot of information. But the bottom line is, what are people doing with the money? That is what people want to know.

Mr. LYNCH. I agree. Thank you for your forebearance, Mr. Chairman. I yield back.

Mr. KANJORSKI. Thank you, Mr. Lynch. Now, Mr. Heller.

Mr. HELLER. Thank you very much, Mr. Chairman. I appreciate the patience of those at the desk today. By the time you get to me, you have had to have been very patient, so I do appreciate spending a few minutes.

Mr. Chairman, thanks for the hearing and the opportunity to ask a few questions. The specific question I have is if you are a nonsystemically significant institution, i.e., a State-chartered bank, an independent community bank, or perhaps a credit union, is it a waste of your time to apply for TARP funds?

Mr. KASHKARI. Congressman, we want all of our healthy banks across the country to apply and participate in the program. We put out term sheets, as I am sure you are aware, for public banks as well as for private C Corp banks. There are other categories of banks such as the mutuals, subchapter S, which we are working to come up with term sheets so they can access the funds on the same terms as everybody else. There are some real legal complexities with doing that, and we are working to make this as broad a program as possible, because we want the healthy banks around the country to participate.

Mr. HELLER. I am looking at the list of 87 banks that are currently participating in this program. I see in here one bank from South Carolina, the First Community Corporation. I don't know how large that is. There is one bank in Nevada that is a regional bank, so it is in Nevada, Arizona, and California. They may very well be State-chartered banks or independent community banks.

Mr. KASHKARI. I don't know. I can find out. In each case, the bank must have a primary Federal regulator. So if there is no Federal regulator, it would not be in the program because we are rely-

ing on the primary Federal regulators to do the initial screen to the applications and then make recommendations to us. It has been essential for us. Because we want to use taxpayer resources efficiently and protect the taxpayers, we don't want to invest in banks that are nonviable or unhealthy banks in the Capital Purchase Program so we are relying on the Federal regulators to make an initial screen. And if there is a bank that does not have Federal regulation, then they would not be in the program.

Mr. HELLER. I guess the definition of nonviable or a healthy bank would be very helpful in this process because we have numerous bankers, as I mentioned in my opening statement, that have called me and asked me, "What are the criteria? We go to your Web site, we take a look at the Web site, we fill out the application, and we wait."

Is there something out there that can determine the viability of a financial institution, some of the criteria that you just mentioned that I can share or spread with these other bankers so that they are aware of what the criteria is to become a healthy bank or unhealthy bank, a viable bank or nonviable bank?

Mr. KASHKARI. Let me just start with, if you will permit me, there are many applications in the system. So the applications go through the regulators. There are literally hundreds and hundreds of applications that the regulators are processing, and then they are submitted to Treasury for review and approval.

The Treasury process is actually very efficient. When it comes to funding these deals, oftentimes it is the banks who need more time than Treasury. So my first response is, I would recommend, respectfully, that you go back to your banks and say, "It's probably being looked at by the regulator right now on its way to Treasury." So don't interpret the fact that it is taking some time to be reviewed as the fact that they are not going to be eligible for the program, number one.

Number two, the viability judgment. There is no one measurement you can look at. The regulators and Treasury look at capital positions, look at exposure to real estate, look at how many nonperforming loans, look at different ratings that the regulators look at. Because each bank is unique, we can't point to one measurement and say, this is the one test. The regulators look at a wealth of information in coming up with an overall assessment that we then review and make the decision on.

Mr. HELLER. You can understand the frustration where I am coming from with these independent bankers calling me and saying, "Hey, we have done what we have been asked to do. In fact, we have invested in GSEs as we were asked to do, either by this Congress or through the Administration, and yet we have these applications out there and we are getting no feedback. We continue to ask, we continue to write letters, and there is just no information coming back as to whether or not we are considered a healthy bank, whether we are considered a viable bank."

And what they want to know is, is there any way—and I understand it is a clouded question because it is very difficult to pinpoint specific viability or not—but there has to be some criteria out there that they can use in order to determine whether or not they can actually apply or should be applying for these TARP dollars.

Mr. KASHKARI. It is a very good question. Most banks that apply, the vast majority are ultimately going to be approved, just having gone through the investment committee so many times now, watching the process. There are some banks that in the regulators' judgment are not viable, in which case they will go to the bank and say, maybe you shouldn't apply, or you should withdraw your application.

If that hasn't happened, they should feel pretty good. But ultimately, it needs to work through Treasury to make the final decision.

Mr. HELLER. Thank you. I yield back. Thank you, Mr. Chairman.

Mr. KANJORSKI. Thank you very much, Mr. Heller.

Mr. Miller.

Mr. MILLER OF NORTH CAROLINA. I agree with those members who have said that we have to get a handle on the foreclosure problem. Credit Suisse, I think just this week, said we are probably going to experience 8.1 million foreclosures or perhaps 10.2 million foreclosures, which is almost one mortgage in five, in the next 4 years. If we don't get control of that, nothing else we do is going to work.

But my questions are about due diligence. You have said that you are trying—you are working carefully to make sure we are putting money in viable institutions and we are relying principally on the principal regulators to assess viability for that determination.

There was a sentence in the Congressional Oversight Panel's report that was striking: "The Citigroup experience, the AIG experience, raise questions about assessment of institutional health and need by Treasury and by bank regulators." No kidding.

AIG, I understand, got into trouble not because of anything the subsidiaries are doing, which are very closely regulated by State insurance commissioners, but by the parent, the holding company, which is, as I understand it, almost entirely unregulated, and because of the business derivatives and credit defaults were almost entirely unregulated. What regulator did you depend upon to assess the viability of AIG?

Mr. KASHKARI. Congressman, when we talk about the regulators assessing viability, I am speaking about the Capital Purchase Program. It is $250 billion for a healthy bank. AIG was a separate program. That is the systemically significant failing institution program, where the regulators were not assessing viability, the regulators were assessing what would happen if we had allowed them to collapse.

Mr. MILLER OF NORTH CAROLINA. That was my impression as well, that it had nothing to do with viability. And that was the gist of your answers to Mr. Clay's questions a couple of minutes ago.

There was a story in The New York Times on November 11th that talked about the systemic risk and about making good on derivative contracts by AIG. The usual rule in the economy is when you do business with somebody and you can't perform the contracts, you lose. But those who were in derivative contracts with AIG aren't losing; that the money that we put into AIG is being used to pay them in full.

Lynn Turner was quoted as saying, "We are funding someone on the other side." And the article said that neither AIG nor the

Treasury was identifying who the significant counterparties were for AIG. Did The New York Times just not look on your Web site? Have you identified who those counterparties are? And if you have not, why have you not?

Mr. KASHKARI. We have not—to my knowledge, we do not have a list of all of AIG's counterparties. We now have examiners, especially with the Federal Reserve, onsite at AIG, going through all of their books and records to try to understand their businesses and sell off assets over time in an orderly manner to pay back the taxpayers. So we have examiners onsite now and can look into that. But the reporting requirements that I spoke about were all of the requirements under the law for all the investments we make.

Mr. MILLER OF NORTH CAROLINA. Are you going to tell us, ever, who got the money that we paid under AIG's derivatives contracts? And if not, why not?

Mr. KASHKARI. It is hard to know—Congressman, it is a tough question because it is hard to know with a dollar in a company, did this dollar of the taxpayers go to this use, did it go to paying expenses?

Mr. MILLER OF NORTH CAROLINA. That is really not a credible response.

Who were we paying off? Who are all of the counterparties in AIG's derivative contracts?

Now, with respect to other people who are getting money from us, we are getting something. We are getting warrants, we are getting preferred stock, we are getting senior debt. But with respect to AIG, the money we are paying to their counterparties, in the words of Rob Blagojevich, "We are not getting anything except appreciation."

Mr. KASHKARI. Congressman, look at another example. When we put in money in Fannie Mae and Freddie Mac—when you put money into a business, that goes to sustaining the business. So all of the customers, all of the contractors, all of the counterparties benefit from having put the money in to stabilize that business. I am just trying to understand how you isolate the derivative counterparties versus all of the customers of AIG who have benefited from the action as well.

Mr. MILLER OF NORTH CAROLINA. The subsidiaries, the folks who had boring old commercial lines and personal lines, they are getting paid. Those subsidiaries are fine. State regulators make sure they are solvent. The entity that is not is the parent, is the holding company. My understanding, and maybe I need to go on your Web site, my understanding was that those were always almost exclusively because of derivatives, credit default swaps, etc.

Mr. KASHKARI. Forgive me. If we didn't put in the money to stabilize AIG, would all of those insurance customers still be getting paid?

Mr. MILLER OF NORTH CAROLINA. My understanding is that the subsidiaries were closely regulated. They are all solvent, fine. The problems with AIG are all the parent, the holding company, which is completely unregulated. Is that wrong?

Mr. KASHKARI. I believe a lot of the problems were at the parent. Again, even if the parent ran into trouble, that doesn't mean the subs would necessarily be fine. Again, when we try to stabilize it,

we are trying to stabilize the entity as a whole and ultimately allow them to sell off the subsidiaries so we can pay back the taxpayers. It is very hard to isolate one business and say the money went for this, and not that. That is what I am struggling with.

Mr. MILLER OF NORTH CAROLINA. With respect to Citigroup, was there anything about the panicked additional $25 billion in guaranteeing $306 billion in troubled assets without really saying much about what the assets were or why they were troubled, was there anything about that that undermined your faith in the principal regulator for Citigroup?

Mr. KASHKARI. I think these are very large, very complex institutions, and the actions that we took for Citigroup were to strengthen the institution and improve confidence in the system as a whole. These institutions are not just there in isolation. A lot of times the market looks at these institutions in combination or in the aggregate. So we had to make sure confidence was there for the system as a whole.

Mr. KANJORSKI. Thank you, Mr. Miller.

Mr. Feeney.

Mr. FEENEY. Thank you, Mr. Chairman. Mr. Kashkari, you have an economics background, I understand.

Mr. KASHKARI. I have a finance background, sir.

Mr. FEENEY. A finance background. The severity of the credit crisis today is reminiscent, certainly not as severe, as what happened after the October 29th stock market crash in America. At the time, it was a contraction in the monetary supply by some 33 percent over 4 years. Today, the Fed is easing significantly. Interest rates are next to zero, we have TARP trying to pour money into financial institutions, and yet there is more than anecdotal evidence that there is a credit seizure. Even banks often refusing to lend to banks, let alone small business borrowers, etc.

If you are not an economist by background, you are familiar with the term "paradox of thrift." If each of us or any particular institution saves, that is probably a good thing at a micro level; but if everybody decides to save and not lend. Yet, that is exactly what is happening as banks and financial institutions put this money in their balance sheets to firm up their own creditworthiness. But they are, for a variety of reasons, not lending to others, including a crackdown by Federal Reserve regulations on existing loans to businesses and others. There is a severe credit contraction that continues today regardless of what you are trying to do with interest rates or with TARP.

Are you familiar with what Mr. Isaac at the FDIC did during the 1980's savings and loan crisis to save the credit crunch in the United States?

Mr. KASHKARI. I know several actions were taken, and we have studied many of them.

Mr. FEENEY. Well, it was successful. By the way, what they essentially did was take notes from banks over a 5- or 6-year window, and the Treasury gave, effectively, a note back. They were called network certificates. The importance of that trade was that for every million dollars, number one, the taxpayers got virtually all their money back. It was beautiful.

Number two, it created $10 million worth of lending capability for every $1 million trade. Why we haven't used that as a model to save homeowners, to save small businesses and individuals, is beyond me. By the way, it is beyond Mr. Isaac, who actually saved us from severe credit problems at the time. I suggest that model to you.

Since we sold this most recent bailout—by the way, I have been against all the bailouts. I believe this is not your fault or the Treasury Secretary's. I believe that you have been in charge of a fool's errand. Trying to micromanage something as complicated and centrally plan something as complicated as the American economy can never work, in my view. It never has worked. Are you familiar with the Nobel Prize winning economist, Mr. Hayek?

Mr. KASHKARI. With the name, but not his research.

Mr. FEENEY. Well, he wrote a book, and the title should be sufficient. He said that centralized planning, no matter how well intended, led to what he called—and this is the name of the book in quotes—"The Road to Serfdom." And bit by bit, that seems to be, in my view, where we are going.

So I don't blame you. I think you have been instructed to lead a fool's errand. I do not think it is good for America, but I don't think it is because of anything particularly that you have done.

I will say trying to micromanage the American economy with tinkering and bailing out individual institutions, and now going we are going on to the auto industry, apparently this afternoon, is a little bit like trying to manage the circus from the middle of the monkey cage. It may be fun, it is enjoyable to watch, but it is just not going to work, and I don't think it has ever worked for any economy on the planet in history. It never creates prosperity. And yet, we seem to be committed.

We were told by the same people, both in the Administration and the leaders in Congress, that if we passed the stimulus package of $600 per taxpayer, including many nontaxpayers, that would fix the problem with the American economy. That was 8 months ago. We bailed out Bear Stearns and AIG. We were told that bailing out Fannie and Freddie this summer would do the trick.

By the way, Mr. Dodaro, the GAO at the time estimated that the likely cost of the bailout of Fannie and Freddie would be $20 billion. Do you know what the current likely estimate is?

Mr. DODARO. No, but I can do some research and provide that for the record.

Mr. FEENEY. I bet it is many multiples of the $20 billion. So, again, this is not GAO's fault. I think Congress and the Administration have led Americans in a direction that may be very difficult long term to recover from.

There are things that we can do like managing a monetary supply not to create bubbles. There are things that we simply cannot do. Micromanaging the decisions of 300 million Americans and businesses and institutions is not something that Washington will ever do successfully, in my view. God bless you on your mission. I don't think it will work. I hope it does. It never has in history.

With that, I yield back.

Mr. KANJORSKI. Thank you very much, Mr. Feeney.

Mr. Scott.

Mr. SCOTT. Thank you very much, Mr. Chairman. Mr. Kashkari, first of all, the great concern we have is—the fundamental need right now are two things for us to get out of this doldrum that we have in our economy. One is we have to lend the money—the banks have to lend the money. We have to get consumers to spend the money.

As you well know from finance—and you are a man of finance—the banking system is sort of like the heart of our economy. Like our own heart and our own bodies, the primary function is to pump the blood to get throughout the body. That is what the banks are there for. But they are not pumping the blood, the money, out to the system. It is not getting out to the fingers, and out to the toes. It is not getting out there. It is not getting out to the homeowners who are hanging on by their fingernails, and not getting out to those people who need to keep their jobs. That is what we have to break through with.

I want to deal with a couple of specific points, and I think that we can give you an example, and I want to get your answers as to how you might be able to help us to do this. For example, here is one example. In Atlanta, Georgia, we have the Hartsfield International Airport which, I am sure, if you have been around, everybody has gone through. It is the world's busiest airport. We have a great need now. We are building a second terminal, the Maynard H. Jackson International Terminal. However, without access to the short-term credit market, construction will stop. We need that access.

The question is: Can Treasury make sure that the reserves and money and resources that are going to the banks be directed to unfreeze the market for State and local debt so that projects like this can go forward? That is nearly over 3,000 jobs that will stop. Now, can we do that?

Mr. KASHKARI. Congressman, we are very aware of the challenges of State and local finance in the municipal bond market and we are designing programs and plans. Right now, some of my colleagues are trying to directly address that so we can get credit flowing to State and local governments for the exact same reason that you are saying.

So we have ideas on how to go about that and we are designing our plans and getting feedback from experts in the market and in the industry to make sure that they will work.

Mr. SCOTT. But can we not use the banking system to do that, for example? And you are saying, yes, we can.

Mr. KASHKARI. Well, I think that the banks have an important role to play. But I think that the non-bank financial sector is also really important, and we need to try to get both working.

Mr. SCOTT. Let me give you an example. Right now, today, a bank, the major bank in Atlanta, Georgia, where the airport is, SunTrust Bank, is coming and asking you for an additional $1.4 billion. Cannot you use that direction to put that marriage together, and cannot we use that as a pattern, that, as we go about getting moneys into these banks, that we systematically have an identification plan of which we can assist these banks, say, "Okay, you want this money?"—these are taxpayers' dollars. They are not the bank's dollars. These are the taxpayers' dollars. We are the

stewards of the taxpayers' dollars. The taxpayers want this money to get out into the system so they can stay in their homes, they can keep their car dealerships, they can keep their jobs, and we can build the expansion for the Maynard Jackson terminal airport.

Or, for example, another example, at the same time in my district, in Clayton County, for example, we are on the verge of losing a hospital, because the hospital is $40 billion in debt to their creditors. Well, it seems to me that we ought to be able to—if the bank is down there—that is what I am saying. They are hoarding this. The communities around them are suffering. It is not just the homeowners who are not getting money; the businesses are not either.

Can we do this?

Mr. KASHKARI. I think we can continue to encourage banks to increase credit. And that is what we are working on with the regulators, to measure that now, so we have the data to know what is really happening.

But I will say I am very cautious about getting into the business where the Treasury Department is telling an individual bank, "You should make this individual loan." I think that is a bridge too far. I don't think the Treasury Department or Washington is the best place to make those individual decisions. But we think the system as a whole should get the credit out to the people who need it.

Mr. SCOTT. Right.

Let me go to you, Mr. Dodaro—we have pumped $290 billion into these banks. Do we know how they are spending it? Do we have a record of where this money has gone?

Because we have another $350 billion that we are going to put some halt on. I am going to do everything, I am here to stop any more, not another dime, going out to these banks until we get an accounting for how they have spent this $290 billion that is there. And hopefully, we can maintain a hold on this remaining $60 billion, since we are not using it. Or, hopefully, we can use it to get to Ms. Bair to help with the home foreclosure program.

But could you answer that for me?

Mr. DODARO. Right now, there is not a systematic reporting process in place to report back how this money is being used by the individual institutions. This was our recommendation.

Mr. SCOTT. And let me ask you, your primary need to do this, is it not that you want to use your bank regulators to facilitate this?

Mr. DODARO. We believe that structure is already in place. It is something to build off of. In this case, you know, you have a new program, you don't want to create a whole new mechanism. You can build off the existing structure with the regulators who are already involved.

Remember, they are the ones reviewing the applications in the first place from the bank and making the decision as to whether or not the institution is financially viable and sound. So they have knowledge about these institutions. They collect information on a quarterly basis. And what we are suggesting is they modify their normal collection process to get more information back, in a more timely manner than quarterly, but they get the information, and it

gets fed in, and there is a systematic roll-up of this information, as best it could be determined.

Mr. SCOTT. Are you concerned that there may be too cozy a relationship that exists right now that should be re-examined between the bank regulators who are right there in the bank and the bank? Is that too close?

Mr. DODARO. You know, I am focused on getting the data, and I think that is what people want to be focused on, is getting the data. We trust the regulators to provide proper oversight of the system, and I am not questioning that.

Mr. SCOTT. All right.

Mr. DODARO. But I do think they need to be part of the solution here to get better feedback on how this money is being used. I mean, that is what everybody wants to know. They can help in accomplishing that.

Mr. SCOTT. Thank you, Mr. Chairman.

Mr. KANJORSKI. Thank you very much, Mr. Scott.

Mrs. Bachmann?

Mrs. BACHMANN. Mr. Chairman, thank you.

And thank you gentlemen for being here for this long period of time. I appreciate it.

I, too, voted against the bailout, and I must say that, in the time that we were away from this body after that vote, every day I was happier and happier that I had made that vote against the bailout. I can tell you most assuredly that my constituents are not happy with the bailout.

And you are not responsible for all of them, but if you go back to January of 2008 and begin with the initial stimulus package, that was expected to be about $150 billion; it ended up being $168 billion. And then if you go forward from there and you go through the litany of all—the $29 billion for Bear Stearns, and then you go to the hundreds of billions for the Federal Home Loan Association, hundreds of billions of dollars for Freddie and Fannie. Each one of these initiatives, this is just the spring. We were told each one of these initiatives would help to bring about the turnaround in the economy.

And it seemed what happened is, with each intervention, whether it was through the Federal Reserve or whether it was through Treasury or whether it was through the Federal Home Loan Association, each one of those measures seemed to only roil the stock market. So we would see increasing nosedives on Wall Street just as the American taxpayer was being asked to continually open up his or her wallet yet one more time and put more greenbacks on the table for troubled industries.

After a while, as Members of Congress—and this, I think, is a bipartisan feel—we felt as though we were not being given the entire story. And that is what I think this GAO report said to me. When the GAO report came forward this month, I thought that the title said it all, "Additional Actions Needed to Better Ensure Integrity, Accountability and Transparency." Literally what we saw in this report, then, was a litany of the shortcomings related to Treasury's lack of oversight of the TARP program.

And that is something that I think that people in the United States right now are feeling: a real lack of security about what

Treasury is doing. They feel there has been a lack of communication with this Congress. That has been itemized in this report that came out, that not only does the report feel that you have failed to communicate with this body, with the Members of Congress, but, in turn, with the American people. So they really don't know who to believe anymore.

And that is the beauty of our country. The beauty of our system of government is that we govern by the consent of the people. I don't really believe that we have the consent of the people right now. And it seems to me that part of that responsibility must lie with Treasury, in that you have failed to adequately assure the public that the work that you are doing on the TARP program is work that is getting our country on the right side of the economy.

And I don't say that in any personal way, but just that I believe that this report also gives backing to what I am hearing from my constituents. As a matter of fact, it refers to this as "information gaps and surprises." And this communication, I think, is more than just irksome. I think that it has actually led to real market instability, where literally we can go 700 points up and then we can go 600 points down, then 200 up, then 800 down. People don't know what to do, and they are very frightened. And you see that even in the retail market for this important Christmas season.

I, too, had members of the automobile dealers in my office yesterday. And they are telling me that people can't get loans unless they are at a 15 percent interest rate. That is keeping people out of their showrooms, and they are not being able to make these purchases.

Now, I know that you are attempting, through your work, to try to bring those interest rates down. You are attempting to unthaw the credit freeze. But what it appears like to many of us is that what we are seeing over and over by government intervention is moving further and further away way from a free-market economy, not only in financial markets but also now in the auto industry. And there is a very real concern that we will not find an answer that comes with a free-market answer.

I am wondering, will we get to that point when we return to a free-market economy? Or will we stay with a deep philosophy of government intervention at every turn?

And so, finally, here is my question, and if we don't have enough time, I would ask that you respond in writing. How will you determine whether the capital that the government has injected into a specific institution is being used for lending purposes?

This was one of the very concerns that I had with the fundamental principles behind TARP and the Capital Purchase Program. On one hand, government should not micromanage, and I believe that, the entire private banking industry. But on the other hand, how will you ensure that your plan achieves its goals so that we can actually unthaw this credit freeze?

Mr. KASHKARI. Congresswoman, thank you for the comment. I will say three things.

First, remember, when we started in this hearing, the overall objective of our actions has been to stabilize the financial system and to prevent a collapse, number one.

Number two, we are working with the regulators to design the right measurements to look at loan levels, to see if increasing in lending is taking place relative to those who did not take the capital over time, to judge the merits of the Capital Purchase Program by themselves.

And third, Mr. Chairman, if you will indulge me for just 30 seconds, to get some sense of the severity of this crisis, think about this: Bear Stearns; Washington Mutual; IndyMac; Fannie Mae; Freddie Mac; AIG; Wachovia; Lehman Brothers—all major U.S. financial institutions that have collapsed in the last 9 or 10 months. This is not a joke.

Mr. KANJORSKI. Thank you very much.

Mrs. BACHMANN. Mr. Chairman, thank you.

And if I could just respond, my remarks were not that this is a joke. I think we all understand and take this very seriously, as do the American people.

My remarks are that the American people no longer have confidence over how the program is being run. And the question again is, how will we have adequate oversight, as GAO has suggested Treasury needs to have, to make sure there is adequate communication with this body?

Thank you.

And, Mr. Chairman, thank you for your indulgence.

Mr. KANJORSKI. Thank you, Mrs. Bachmann.

Now, we will hear from Mr. Green.

Mr. GREEN. Thank you, Mr. Chairman.

And I thank the witnesses for being so patient. I know it has been a long day for at least one of you.

Mr. Kashkari, you just indicated that the overriding aim—and I am paraphrasing—of the program was to stabilize financial systems or financial institutions. I think that may be a part of departure with reference to your position or the position of the Treasury juxtaposed to the position of the Congress. Because, in Congress, we passed the Emergency Economic Stabilization Act of 2008. And when we passed it, we included therein the opportunity for the Secretary of the Treasury to establish TARP, the Troubled Asset Relief Program. It appears to us that the CPP, which is what you established, the Capital Purchase Program, is a little bit antithetical, not that it is of no good, serves no purpose, but it is a little bit antithetical to where we thought we were going to go from our perch. Our perch gave us one vista, and yours apparently accorded another vista.

The question becomes this, given that we have these two different propositions before us. Focusing on the concern with reference to toxic mortgage-backed securities, I believe you concur and agree that they are a part of the problem that we are trying to confront. True?

Mr. KASHKARI. Yes.

Mr. GREEN. Okay. If they are—and we have at least one chairwoman, Chairwoman Bair, who has suggested that her plan will deal with, not in toto, but will deal with to a great extent toxic mortgage-backed securities. Do you concur that her plan does that, that it deals with toxic mortgage-backed securities?

Mr. KASHKARI. It certainly attempts to deal with and reduce foreclosures, which would help toxic mortgage-backed securities.

Mr. GREEN. Exactly. So my question to you, and this is, to a limited extent, a follow-up on what Chairwoman Waters introduced to us earlier, and I think she was quite eloquent, but I do want to follow up. The question is, what are the deficiencies in the Bair program?

And I ask this because, clearly, you have moved $20 billion from the TARP over to the Fed for the Fed to use with TALF. So you can move the money. There is no question about whether it can be moved, in my opinion, because you have demonstrated you can do it. It is a $200 billion program, but you are using $20 billion just as a sort of a backstop for some of the losses.

So the question becomes, what is the problem with the Bair program, if there is a problem?

Mr. KASHKARI. Sure. Thank you, Congressman.

One of the other Members of Congress talked about competing interest and tensions. We have an interest to avoid preventable foreclosures. We also have an interest to protect the taxpayers.

And one of the concerns that we have to look at very carefully are redefaults and what happens if borrowers redefault. If a borrower redefaults, that borrower is out of luck, because they are going to be out on the street, so that borrower has not been helped. If the borrower redefaults and then, at the same time, the costs to the taxpayer go through the roof, what have we accomplished?

Comptroller Dugan, the head of the OCC, on Monday released data showing very high redefault rates for some types of loan modifications. And so one of the things we have to look very carefully at is, how do we make sure that the loan modifications are sustainable, that they are not going to lead to a lot of redefaults? And if there are redefaults, we don't want to reward the banks because the borrowers have lost a house. So we have to construct the right incentives so that the borrowers who need help are helped without creating the wrong incentives and rewarding the banks if the borrower redefaults.

So there are some—Congressman, this is an issue that I have studied for 18 months, and it is probably the most difficult policy issue I have come across, is how do you find a program that helps the borrowers who need help without rewarding everybody who doesn't?

You know, the legislation that this body, this committee championed, the HOPE for Homeowners legislation, was a very thoughtful attempt at this problem. By putting in place the taxpayer protections, not as many borrowers as we would like are getting the help that they need.

And so, there are real tensions here that we are trying to work through to try to find the right solution.

Mr. GREEN. Permit me to ask this. The Bair program contemplates, I believe, 31 percent of income as the markdown in terms of monthly payments, trying to get persons at that point, because it is perceived that if you are at that point, you can afford the property. So it is a restructuring program.

That formula apparently has attracted the attention of a number of economists who think that it can work. What do you see as a problem with that formula?

Mr. KASHKARI. Well, it is not whether it is a 38 debt-to-income or 34 or 31; different people have different views. We have adopted a similar approach with Fannie and Freddie, where they are moving people down.

The key is, if you are putting insurance on an asset, that is a payout if the borrower redefaults. Think about that. The bank only gets a payout if the borrower redefaults. Does that create an incentive for the bank to encourage a default and foreclosure?

So we just have to look very carefully at these incentives to make sure that they are aligned so that the taxpayer dollars are really going to help the homeowners. That is our objective.

Mr. GREEN. Thank you.

Mr. KANJORSKI. Thank you, Mr. Green.

Mr. Manzullo?

Mr. MANZULLO. Thank you, Mr. Chairman.

Mr. Kashkari, you were asked the question about whether or not you thought a $3 million bonus to an executive at AIG was excessive. And from my understanding of the answer that you gave to Mr. Sherman, your answer was no. Is that correct?

Mr. KASHKARI. Congressman, my answer was I don't have a number in my head that says, this is an appropriate bonus level, and that is—

Mr. MANZULLO. Well, does anybody have a number in their head when we spend $125 billion of the taxpayers' money on AIG? Is a $3 million bonus too much to give to a person who was there and responsible when that company went under? Yes or no?

Mr. KASHKARI. Congressman, our track record is clear—

Mr. MANZULLO. Your track record is clear here. I want a yes or no.

Mr. KASHKARI. Congressman—

Mr. MANZULLO. I represent—no, let me tell you something. I represent a city—the largest city in my district has 11.3 percent unemployment, $41,000 a year median income. In 1980, Rockford, Illinois, led the Nation in unemployment, at 25 percent.

I am asking you right now, and I want an answer, and there is a reason for it: Is a $3 million a year bonus excessive to a company owned 80 percent by the United States Government and into which over $125 billion of taxpayers' money has been invested?

Mr. KASHKARI. It is excessive for a failing institution, yes.

Mr. MANZULLO. All right. So are you going to ask for the money back, yes or no?

Mr. KASHKARI. Forgive me, Congressman. Which money back?

Mr. MANZULLO. The $3 million bonus that just went to the AIG executive. Are you going to ask for it back?

Mr. KASHKARI. Again, Congressman, I don't know the details of the bonus that—

Mr. MANZULLO. That is the bonus. If he got a bonus of $3 million, are you going to ask for it back?

Mr. KASHKARI. Again, Congressman, I don't know the detail of the bonuses.

Mr. MANZULLO. Mr. Kashkari.

Mr. KASHKARI. Yes, sir.

Mr. MANZULLO. An executive at AIG just got a bonus of $3 million. The three executives from the Big Three said they would work for a dollar a year. I am asking you, if that is the case, is TARP going to ask for the money back, if they got the $3 million bonus?

Mr. KASHKARI. Again, Congressman, I am going have to look into it and get back to you.

Mr. MANZULLO. Mr. Kashkari, I want to suggest something here. And it is not because of—maybe it is because of the people I represent. We can't relate to you in your world. I don't know where you come from or the people with whom you deal on a day-to-day basis, but when you sit there and cannot take a position as to whether or not a $3 million bonus to a failed company and into which the taxpayers have put $125 billion in assets, perhaps you are not the right person for the job. Perhaps you don't understand the situation at all. Perhaps we should put somebody in your position who is one of my community bankers, who understands people.

What would you think if you earned $41,000 a year and the city in which you live has 11.3 percent unemployment, yes, and five of the last governors in the State of Illinois have been indicted, and you sit here in charge of all this money, and you can't tell them whether or not a $3 million bonus to an executive at that failed institution is excessive?

Mr. KASHKARI. May I answer?

Mr. MANZULLO. Of course.

Mr. KASHKARI. There have been some press reports—and, again, I don't know the details of the specific case you are referring to—there have been some press reports about AIG that have referred to bonus schemes. When I have looked into it and had our people look into it, there have been some cases where they had deferred compensation that was already earned by people, not the CEOs—

Mr. MANZULLO. Well, deferred compensation of $3 million?

Mr. KASHKARI. Remember, Congressman, we got rid of the management team of AIG.

Mr. MANZULLO. Well, who are these new clowns getting that money? Why can't you just give a simple answer so the people I represent can have confidence in you? We don't have confidence in your answer; how can we have confidence in your decisions?

Mr. KASHKARI. Because I am trying to be precise in my answer, Congressman.

Mr. MANZULLO. Your answer is imprecise. I don't think you understand. I don't think you understand at all the pain and the hurting that is going on in this country, of the people who are on the verge of losing their jobs. And you can sit there and not come to a decision as to whether or not a $3 million bonus is too much?

If you even have to ask that question, whether it is too much, Mr. Kashkari, you are not the man for the job. We need somebody else in that position. We need somebody with the long-term experience, somebody who has dealt with loans of ordinary, common people, somebody who understands the hurt that this country is going through, somebody that can feel their pain and the anxiety which they express to me on a daily basis. On the basis of your answer, sir, I think you should step aside.

Mr. KANJORSKI. Thank you, Mr. Manzullo.

The gentleman from Missouri, Mr. Cleaver.

Mr. CLEAVER. Thank you, Mr. Chairman.

Mr. Kashkari, I actually feel sorry for you. And the reason is that it is Mr. Paulson who needs to be in that chair.

Do you have staff members with you?

Mr. KASHKARI. A few.

Mr. CLEAVER. Because I have been watching—I left for 20 minutes to meet with someone. By my count, there were four members who asked for information to be sent back to them. And I watched to see if anybody on the front row was writing down their names and what they asked for, and I didn't see it. If I overlooked, if you have it, if you could raise your hands?

You wrote it down? Okay, I just looked at the front row, so I didn't see you back there on the second row.

The reason I went there is because my concern is that—and maybe you can answer the question—do you know why we were not asked to come back as a committee to hear Secretary Paulson's reason for diverting the money to banks? I mean, the name of the program is "Toxic Assets," and nothing went there. So I have been curious as to why we weren't called. You know, there was an emergency need for us to gather. Do you know?

Mr. KASHKARI. Congressman, in the negotiations as we worked with the Congress to design the legislation, we worked very heard to build in flexibility because we knew the credit crisis is unpredictable. And so, as the crisis deteriorated in just the 2 weeks before when we first came to the Congress and when the Congress acted and then the 2 weeks that followed, we made rapid adjustments as facts changed on the ground. And the legislation provided us the flexibility that we needed to be nimble and adjust our strategy.

Mr. CLEAVER. Yes, sir. I was here. I try to—I have never missed any of our committee hearings, and I try to get here on time—I do get here on time.

You are absolutely right. But understanding that this was a dramatic turn from what Congress approved—I was listening to Lou Dobbs, which is self-prosecutorial, but I am listening to it, and he is starting the news off by saying, "The government has switched."

Now, I went to a town hall meeting in Belton, Missouri, just outside of Kansas City. There were about 125 people there, and they were furious because they think that I voted to switch. And I would dare say that the overwhelming majority of the people in this country believe that we voted to switch from what we initially said.

And so, given the delicate nature of this, don't you think that we should have publicly said, "This is the direction we need to go?" I don't disagree with the direction you went. I mean, this is the European model.

But can't you see—I mean, some of my colleagues, we have nothing in common except life, but I find myself agreeing with them because of the fact that we are the ones being politically bludgeoned. And it would have taken a call to Barney Frank. The Treasury did call Barney Frank. I had dinner with him the night that they did, the evening of the notification. But he didn't ask for any meeting; he told him what he was going to do.

Mr. KASHKARI. Congressman, I appreciate the feedback. And, clearly, we have heard the message, and we understand the concerns that have been raised by us adjusting our strategy as we move forward.

At the same time, we have had to move very quickly, as I have said, and market conditions have changed so quickly. I feel good about the actions that we have taken, that they were the right actions to take to try to stabilize the system.

Mr. CLEAVER. But don't you know that we would have gotten on airplanes and come right back to Washington?

Mr. KASHKARI. I believe that, Congressman. And the actions that the Congress took in passing the legislation in just 2 weeks is truly remarkable. The crisis was intensifying at such a rate that even 2 weeks may not have been fast enough.

Mr. CLEAVER. It wouldn't have been 2 weeks to get on a plane to come back. I don't want to argue with you about plane travel.

But I would like to switch now—I have to say this because I am hoping the people in my district will get a chance to understand that we had nothing to do with this, that this was not a bait-and-switch on the part of Congress.

And I want—and maybe I am wanting too much—I just want some understanding of why people are angry up here. And the reason I ask about the notes is because I didn't want it to appear as if we don't matter, we just do things.

And I didn't even get into the fact that we need a de-icer with credit. And if we are not giving money to Chrysler financing and GMAC, it doesn't matter how much money we put into the automakers, people won't be able to buy cars, because right now, the credit score required to get a car is between 700 and 725. There are people in this room who don't have that kind of credit score, and there is no money going into the entities that finance automobiles.

I think I have run over, Mr. Chairman. I thank you for indulging me.

Mr. KANJORSKI. Thank you, Mr. Cleaver.

Mr. Perlmutter?

Mr. PERLMUTTER. I have a number of things, but first—and I didn't expect to be an apologist for the Treasury Department, but I do want to say that things have been moving at a clip that nobody could imagine. And I have been attending all of our hearings and hearing from different economists, from the left and the right and the center, who do appreciate the fact that the Congress acted quickly and that the Treasury is acting quickly to deal with some unprecedented twists and turns in an economy. So I do want to thank you for that.

Now, I am going to chew you out. And the reason is—and I think part of Mr. Manzullo's criticisms, Mr. McCotter's criticisms, and Mr. Sherman's criticisms are that you have a massive undertaking here. You have 48 people that you have hired. That isn't enough. The Department of Defense, for $700 billion, has hundreds of people monitoring how that money is being used.

And so the GAO, in its report, really had, in my opinion, two very serious critiques. One was you don't have the staff, and you are having to deal with this stuff on the run. We need more people

to be able to monitor properly how it is happening. And, two, there does need to be a reporting system back to you from the banks as to where this money is going, if they are just recapitalizing themselves or they are purchasing another bank or whatever.

So I sent you a letter last week signed by many of the members of this committee. How do you respond to the staffing question and getting the banks to report to you how they are using the money?

Mr. KASHKARI. Right, both very important issues.

On the staffing front, let me just offer a minor correction. When we talk about 48 or 50 people, those are full-time TARP staff. We have well over 100 when you combine the Treasury personnel who are spending almost all of their time working on it, as well. And, as we are ramping up, we are hiring actively so we can replace the Treasury staff with more and more full-time TARP staff.

So I don't want to leave the impression that we have half the staff that we need. That is just not correct. We have the staff. We want more and more of the full-time. And this is one of our highest priorities. The people who report directly to me are sick of me bringing up hiring, hiring, hiring. It is just so important, and so I am spending a lot of my time on that, number one.

Number two, on the data, in terms of what the banks are doing, again, this is the very point that we are working on with the regulators, to be able to collect the data and monitor what is happening at the system level and at the individual institution level, so that we can see, are our programs having their desired results?

Mr. PERLMUTTER. I disagree with a number of my colleagues who said that you were only authorized—and Secretary Paulson turned quickly—you were only authorized to buy the troubled assets. I think you were authorized under our legislation to do three things: One, buy troubled assets, these big portfolios. You were going down that path; you chose not to do it. Two, to recapitalize the banks. That seems to be about the thing that has been focused on. And then the third, which is a much broader kind of authority within the bill, was to use some of the other agencies of the government—the Small Business Administration, the Federal Home Loan Bank boards, the Farm Credit Administration—to get money down to Main Street.

You have used the middle one, the recapitalizing, but not the other two. So a lot of our questions and a lot of the complaints that I hear in Colorado are, you know, homeowners—one of the things you have talked about is maybe using Fannie Mae, Freddie Mac, or some other agency to help with purchases at a 4 or 4.5 percent rate. What is happening with that?

Mr. KASHKARI. Congressman, that is a program that we are looking at very carefully, talking to Fannie and Freddie about to understand how we would do it. No decision has been made yet, but we understand the merits of such a program to get people buying homes again.

And if you will permit me—I am in no rush, I am happy to stay here as long as you would like—if you will permit me to just give a thorough answer, that leads to a broader point: We want to use the right tool for the right job. And the TARP is the only tool in the Federal Government, the only tool—Federal Reserve, Treasury, others—that can purchase equity. And so we want to use the TARP

now, given the severity of the crisis, for what it is uniquely capable of doing and complement that with other tools. Fannie and Freddie are a great example—outside of the TARP, but potentially some powerful tools that we can bring to bear on this problem.

Mr. PERLMUTTER. Okay.

Next question, the Treasury and the Federal Reserve turned Goldman Sachs and Morgan Stanley into banks over a weekend. We have heard now in this committee that GMAC, Chrysler Credit—I don't know about Ford Credit, but at least GMAC and Chrysler Credit have sought bank holding status so that they could receive TARP funds.

Where are you on that?

Mr. KASHKARI. First, the Treasury does not make determinations about who becomes a bank holding company and who does not. It is the Federal Reserve who does; just a minor clarification.

Second, I have heard similar things, that some of these entities are converting to bank holding companies to try to get access to the TARP. They would have to go through that process, get confirmed by the Federal Reserve, and still meet the application deadlines and be recommended by their regulator.

So I can't speak to the individual applications that you spoke of. I am aware of the issue. We have a process and procedures in place to deal with it. But, ultimately, the regulators are making many of the decisions about who can become a bank holding company and who can't, and I just don't know where they stand in terms of those individual applications.

Mr. PERLMUTTER. Thank you, Madam Chairwoman.

Mrs. MALONEY. [presiding] Thank you.

The Chair recognizes Mr. Price for 5 minutes.

Mr. PRICE. Thank you, Madam Chairwoman. I appreciate that.

I want to apologize for being out of the room for a period of time. I had another conflict. I know that you all are getting tired. I appreciate your forbearance in sticking around.

I want to echo the comments of my colleague from Georgia, Mr. Scott, who talked about Hartsfield-Jackson International Airport having difficulty gaining access to credit and an expansion of terminal facilities that have been on the books for a long time. Everything was rolling along well until recently, and many of the institutions that they are attempting to get resources through are ones that have gotten funds through the TARP. So it is a huge question that we have about who is getting this money, where is this money going.

To that end, anecdotally, a constituent of mine owns a company that sells water utility software to governments and municipalities to help them comply with EPA regulations. This company has created 10 new jobs in the last year; it is growing about 50 percent each year. Recently told me about, in their next move to expand, he has gone to eight different banks to attempt to obtain credit. Three of these have received in excess of $30 billion through the TARP. At every turn, he has been told no.

Where is this money going?

Mr. KASHKARI. Congressman, it is not surprising to see that, with confidence still low, both fears of the credit crisis and the economic downturn, that banks are cautious about extending credit.

And I hear the same anecdotes you do. Many people call us, saying, "We need credit, we need help." And so the best we can do is to work with the regulators to make sure the banks are making prudent lending decisions.

It is a delicate balance, because we don't want to go to a bank and say, "You must make more loans even if you don't think those are good loans." We don't want to return to the bad lending practices that got us here in the first place. And so, how do we strike the right balance of encouraging the banks and pushing them to make prudent loans without taking on undue risk? And the regulators are looking at this. They put out a joint statement of how they are going to be supervising all banks.

You know, all banks in America have benefited from the actions that we have taken, not just those that we have invested in. And they all have an obligation to extend credit in their communities.

We are very focused on this, but I don't think it is going to happen as fast as you or I would like. But it is going to happen faster than had we not taken this action.

Mr. PRICE. I am not certain of that. But do you have a list, of the money that has been let, of the credit that has been provided?

Mr. KASHKARI. Of the investments that we have made, we have.

Mr. PRICE. Not of the investments you have made; of the next step. That money is going out to whom?

Mr. KASHKARI. Not yet. That is part of what we are working on with the regulators for the data that they collect, to try to aggregate, you know, the banks that are receiving the capital, are they loaning versus the ones that aren't. I don't know if we are ever going to get to the point of, you know, "These 10 loans were made to these parties." That may be one layer too deep.

Mr. PRICE. Has any credit been extended out of the TARP funds?

Mr. KASHKARI. You mean have any of the banks that have received TARP capital made loans? Sure.

Mr. PRICE. How do you know?

Mr. KASHKARI. I hear from firms who are getting new loans. I hear from banks that are making credit. It is not that banks aren't making any loans; they are just not making as many loans as they used to make.

Mr. PRICE. Is that information that you are able to provide for us?

This fellow has a perfect credit score; his partners have a perfect credit score. Six months ago, he would have signed for a loan with his own signature. Now he has gone to eight banks and can't get any money. How is he supposed to expand his business? How are we supposed to move the economy?

Mr. KASHKARI. Congressman, that is exactly why we are working as hard as we are, to try to get credit flowing again. We agree with what you are saying and why this is so vitally important to get credit out to the businesses and the consumers around the country that need it.

Mr. PRICE. Let me respectfully suggest that this whole process, frankly, is absolutely predictable. To put $350 billion on the table and have the Federal Government be in charge of keeping track of that $350 billion, which it has a difficult time doing, which continues to extend the time when private capital gets into the mix,

because they are not certain how much more Federal capital is coming, that respectfully I would suggest that we are deepening the hole and lengthening the time before recovery.

This fellow's example is all across this Nation, of private individuals who had no difficulty getting capital before. And, because of the, at least in some instances, the infusion of the rules and regulation morass that has gone on, he now cannot obtain any money at all.

Mr. KASHKARI. But forgive me, Congressman. We may just have a different view on this. Do you believe that, absent the actions that we have taken, he would have been able to get a loan?

Mr. PRICE. I think that, with the control of the Federal Government at the pursestrings of this process, that we have deepened the hole and lengthened the process to recovery. I have no doubt about that. I think that has been demonstrated in previous actions, and I think it has been demonstrated in other countries.

Mrs. MALONEY. The gentleman's time has expired. But, Mr. Kashkari, if you would like to respond, it would be appropriate.

Mr. KASHKARI. I am okay. Thank you.

Mrs. MALONEY. Okay.

Congressman Donnelly?

Mr. DONNELLY. Thank you, Madam Chairwoman.

And thank you, Mr. Kashkari.

Thank you so much, Mr. Dodaro.

We had sitting in those seats a week ago the CEOs of the auto companies, just as was being mentioned. And they said to us, "Our financial companies have applied for TARP funds; we cannot get an answer." And, as you well know, we have a crisis in this country with these companies.

And I was with dealers last week who said, "I can't get these auto financial companies to provide us with funds for loans." And so, they can't get an answer, and it appears that we don't know where their application is in the process.

Now, I would suggest that this is a matter of utmost urgency, that we try to make a decision on this. And so, who would know where their applications are in the process?

Mr. KASHKARI. Congressman, as the gentleman behind you raised, I think in these cases it is a two-step process. One is becoming a bank holding company—

Mr. DONNELLY. Right. And I am trying to find out who would know, in the two steps, which step they are at today.

Mr. KASHKARI. That would be the Federal Reserve would be making determinations for firms who are becoming bank holding companies, number one. And then, second, the Federal Reserve would then receive their application for the Capital Purchase Program and submit it to Treasury. And so, you know, we can call the Federal Reserve—

Mr. DONNELLY. So are you saying it is still at the Federal Reserve level right now?

Mr. KASHKARI. To the best of my knowledge, Congressman, but I can go back to our shop and—

Mr. DONNELLY. Is there someone in your shop who could get that information to us by tomorrow at this time? Because this truly is a matter of national urgency.

Mr. KASHKARI. Yes. We agree with you. And that is why something we spoke about earlier, the TALF program, is targeted specifically at consumer credit, such as auto loans, to bring rates down for borrowers.

Mr. DONNELLY. And that is a great number-two hitter. Now, the number-three hitter is getting these approvals done for TARP funds. And so, we are thrilled to have that coming along; we want to have that done. Now we have to get this done. And it seems to me what we have to do, more than anything, is find out where in the process it is. So somebody knows, and—

Mr. KASHKARI. Sure. We will find out and get back to you tomorrow.

Mr. DONNELLY. If you could call me back tomorrow to let me know.

Mr. KASHKARI. I will.

Mr. DONNELLY. So we can give those three folks who were sitting here an answer, and all the car dealers around this country an answer, so we can find out when will these applications be approved. And the sooner, the better, because we are in a crisis situation on that.

I also have the privilege of representing a number of recreational vehicle companies, who came to me in the last few weeks and said, "Our funding has completely dried up." The people who were providing them credit for floor planning and other purposes called and said, "We just don't have the funds anymore. There is no credit that is going to be available." And they said, "Without that, how do we operate a business?"

So the next set of funds that comes along, the $350 billion, can it be put into anybody you give those funds to that they have to sign to agree to put, for every dollar they receive, at least $1 out in lending? Can that be made part of your program?

Mr. KASHKARI. We have looked at rules such as that. And, in fact, by going with capital, if you will permit me for just a moment, many of these banks are leveraged, you know, say, 10 to one. So you put in a dollar of capital, you could get many more than a dollar of loans out the door.

Mr. DONNELLY. Absolutely, but we can't even get the first dollar.

Mr. KASHKARI. Well, I think it is too soon to say that, Congressman, again, because we have an economic downturn at the same time. And so it is hard to judge how many loans would be made today had we not taken these actions.

Mr. DONNELLY. I understand that.

Mr. KASHKARI. So, going forward, we are going to continue to look at the best way to get credit flowing in our economy.

You know, if you will just indulge me for a second, my phone rings off the hook. People around the country are calling me, businesses, municipalities, saying, we need help, we need help. If we took the $700 billion and went out to everybody individually, every business and every family who needs help, it wouldn't go very far. We are focusing the $700 billion on the financial system as a whole, so, by stabilizing the system, we can then get credit flowing out to everybody who needs it.

Mr. DONNELLY. But with $350 billion sitting there, isn't there something that can be done where we say, "If you want these

funds, you have to show us that at least an equal or more significant amount due to leverage has been loaned out?"

Mr. KASHKARI. I think that is something that we can look very hard at. I don't want to overcommit, just because we haven't seen the details. But I think it is something that we can and are looking very hard at.

Mr. DONNELLY. Well, thank you.

And thank you both for your time and for hanging in there with us today.

Mrs. MALONEY. Congressman Foster?

Mr. FOSTER. Thank you again for your time. I really appreciate it.

Let's see. I would also like to say that I think some of these claims that there is some sort of bait-and-switch or bamboozling going on on your part, I think, are really unwarranted. You know, the option of recapitalizing institutions was explicitly discussed during the debate. I know in my testimony in front of this committee, in my debate on the Floor before the thing was voted on, you know, this was an explicitly discussed option. And the Members who have said that somehow you have sprung this on them I think were either not paying attention to the debate or maybe not reading what was actually passed. So that is just a comment.

One related thing, though, is that we made the decision in the legislation to specify preferred shares rather than real equity with voting rights. And I was wondering, in retrospect, given the problems that have arisen in trying to get the banks to directly loan out the money that we have injected into them, whether in retrospect we would have been better off following more exactly the Sweden model that this is, basically, and taking real equity stakes.

Mr. KASHKARI. It is a tough question. I don't think—in my judgement, there is not a clear answer. There are some advantages of common stock versus preferred shares, clearly. At the same time, as I spoke about earlier in the hearing, you know, we want healthy banks to volunteer for this. And if the price tag of volunteering to take more capital was more control from Washington, it is unclear that we would have thousands of banks across the country volunteering to take the capital. So there is a tension.

Mr. FOSTER. Okay.

And the second thing, I guess for both of you, you had mentioned two metrics, the TED spread and the LIBOR–OIS spread, as ways to tell that you have really unlocked at least the interbank lending part of this thing. And there are problems with both of these as metrics. You know, the Treasury rate is being depressed by this flight to safety and so on.

And I was wondering, is there really some combination of metrics that will give us a better feeling than these sort of simple things that we are talking about now?

Mr. DODARO. Yes, Congressman. I mean, actually, what we are developing is sort of a set of metrics where you can look at a number of them to draw some overall conclusions. And in addition to the ones that you mentioned, we are looking at foreclosure rates, for example, mortgage origination rates to see if there is new lending in the mortgage area. So we are going to be continuing to de-

velop those sets of indicators. In our future 60-day reports, we expect to flesh those out more.

Mr. FOSTER. Okay.

And then my final question is about the municipal bond market. One of the most painful aspects of the shutdown is that this is $2.7 trillion of the whole size of the market, and hundreds of billions of dollars of what would be called stimulus projects—you know, these are things that municipalities want to spend money on—are being held up by the lock-up in the municipal bond market.

And I was wondering if you have any specific ideas in mind about how you might go about helping to unlock this market?

Mr. KASHKARI. We have a team of folks who are looking at that market specifically, everything from looking at the insurance companies that provide reinsurance on these or insurance for these—

Mr. FOSTER. Have you considered recapitalizing them, for example, or allowing them to sell insurance that has a government backing of some kind?

Mr. KASHKARI. There are proposals out there that we looked at in terms of recapitalizing them, proposals in terms of setting up new firms that don't have all of the tainted legacy business. There are some proposals out there on government guarantees.

You know, the guarantee portion of the Troubled Asset Relief Program is we have an insurance program now. I am not sure that that would be the right vehicle to solve this problem. I think that there are a few ways you could go at it, and we do have people looking at it, because we hear the same thing you hear. It is a very important issue.

Mr. FOSTER. Well, it strikes me as a very high-leverage application of your funds, because these things—you know, the frustrating thing is these things have a near-zero historical default rate, and there is no reason for these not to be trading. And it is very frustrating, and it seems like there is some hope that a very limited application of recapitalization might have a huge effect.

Mr. KASHKARI. It is a fair point. I think we share some of those views and are just trying to look at the details, and also in light of the available TARP capacity and the other projects that we are working on. We are putting together a suite of options. But we have people who are on it.

Mr. FOSTER. Okay.

And I just thought I would say I am tremendously impressed by both of your organizations. It is a heck of a situation we are in. And best of luck to you.

Mr. KASHKARI. Thank you.

Mrs. MALONEY. The gentleman's time has expired.

I would like to be associated with the remarks of my colleague that underscores that, from the beginning, many members of this committee and in the Joint Economic Committee called upon Treasury to recapitalize the financial system, to protect the equity of taxpayers' funds with preferred stock, and that this was an alternative or the goal of many European countries during this crisis.

The number-one question that I am asked—and I would like to conclude the hearing with this. I voted for the bailout because the Secretary of the Treasury and the Chairman of the Federal Reserve said that, if we did not vote for this bailout, or this rescue plan,

that we would not stabilize our markets, that we confronted a possible failure of our financial institutions, and, really, the alternative was unacceptable, and the pain and suffering of taxpayers, our constituents, and the American public would be far greater.

Yet the questions that are raised at this hearing today, that are continually raised by the press, or some of the press, and by the general public is that the rescue plan was not needed.

Given the advantage of your position and what you continue to do and the startling fact that one weekend we had four investment banks, at the end of the weekend there were none remaining, and the fact that some of our major and most respected banks have failed or been forced into merger, I would like to ask the most often asked question I receive, whether it is in the grocery store, on the street, or from major media.

What would have happened to our great country if this Congress had not supported the President of the United States and the Secretary of the Treasury, who called upon us to react with assistance to our financial institutions?

I would like both of you to respond, starting with you, Mr. Kashkari.

Mr. KASHKARI. Congresswoman, it is a great question and very hard to answer. The best I can do is to try to give examples of what might have happened, examples I mentioned earlier.

Imagine if your constituents couldn't get access to their 401(k) plans, or they couldn't get money out of their checking accounts. It is possible, if their banks were failing. Their life savings could go way down, and just a complete freezing of the basic money flow in our economy. It could grind to a halt.

I mean, the downside was enormous. It is easy to make hard decisions when the consequences of inaction are so great. And I don't know what else to say other than that.

Mrs. MALONEY. Mr. Dodaro?

Mr. DODARO. The focus of our efforts has been on how the TARP program has been implemented. We haven't looked at, as I mentioned earlier, the Federal Reserve's activities, because we are really not statutorily allowed to provide that oversight. So I am really not in a position to offer an informed view in that regard.

Clearly, there were risks. Clearly, there were actions taken. Clearly, there were unanticipated events. And it is just not possible for me, at this point, to analytically provide an informed view.

Mrs. MALONEY. Well, I want to thank both of you for your testimony today and for your public service. I am deeply grateful, and I believe the American public is. So thank you very much.

And, certainly, confronting the economic challenges of our country is a bipartisan—really the most critical issue that we confront in our country. I am proud of my colleagues on both sides of the aisle that supported President Bush, Secretary Paulson, the Chairman of the Federal Reserve, Mr. Bernanke, and many others who said, if we did not support this infusion of taxpayers' money, the consequences would have been unimaginable.

Thank you for your service. Thank you for your testimony today.

Our next panel consists of Elizabeth Warren, who is the Gottlieb Professor of Law, Harvard University, and Chair of the Congressional Oversight Panel under the Emergency Economic Stabiliza-

tion Act. We welcome you today, and I have been told you were voted Chair of that oversight board. We look forward to your testimony.

STATEMENT OF ELIZABETH WARREN, LEO GOTTLIEB PROFESSOR OF LAW, HARVARD UNIVERSITY, AND CHAIR, CONGRESSIONAL OVERSIGHT PANEL UNDER THE EMERGENCY ECONOMIC STABILIZATION ACT

Ms. WARREN. Thank you, Congresswoman. Chairwoman Maloney, Members of Congress, my name is Elizabeth Warren. In my real life, I am the Leo Gottlieb Professor of Law at Harvard. Two weeks ago, I became the Chair of the Congressional Oversight Panel. Mr. Damon Silvers from the panel was here earlier, but he was called away on panel business. Mr. Neiman, who is State banking regulator for the State of New York, couldn't be with us because he is off regulating banks. And Congressman Hensarling you have heard from, and I believe he has been called away. So I am your panel for now.

You know the statutory history of this panel. It is yours. The panel was given power to hold hearings, to review official data, to write reports, to review the TARP program, and to provide regulations for regulatory reform. I just want to make clear as we start, we had our first meeting literally 2 weeks ago today. So we are a committee that is now 14 days old. I don't know if that is a special anniversary, but I at least want to make sure we are clear where we are on this timeline. At this moment, we are struggling even to get temporary office space and computers, phones, and fax machines up and running. But we have met with the representatives of the Treasury Department, the Treasury Inspector General, the Federal Reserve Bank, and the GAO. We have read documents, we have requested information, and we now have two things. We have our first report to Congress, trying to meet our statutory obligations to you, and we have a Web site. We have a Web site so that we can give American people a chance to participate in our investigation and our oversight activities.

In the report, which all of you now have copies of, we ask a series of questions about the TARP program. These questions are not abstract. They are not complex. They are questions much like the questions you have been asking today. We asked them publicly. We lay them out there. We publish them. They are tough questions. The questions are our best effort to capture the very real concerns and skepticisms of the American people. I will tell you just the highlights. We have 10 questions. What is Treasury's overall strategy? Is the strategy working? How are taxpayer dollars being used? Are the banks actually lending or are they holding onto this money or buying things with it? Is the public receiving a fair deal? What is the Treasury Department doing to help the American family and small businesses, thinking about the connection between, as you described it, the real economy and what is happening with banks? Is Treasury imposing reforms on financial institutions that are taking taxpayer dollars? How is Treasury deciding which institutions get these dollars? What is the scope of Treasury's statutory authority? A lawyer's question.

And the final one, is Treasury looking ahead, making any effort to prepare for the next economic difficulties over the timeline of days, weeks, or months? These questions drive our first report, and they also drive our work on behalf of families, workers, small businesses, and, most importantly, taxpayers. To that end, our first priority, along with issuing this report and trying to give another frame to the questions you have been so carefully asking, is this opening a line of communication for all Americans.

Today is the day our Web site goes live. It is COP, which is C–O–P for the Congressional Oversight Panel, COP.Senate.gov. It is a rudimentary site. We haven't had time to put all the bells and whistles on it. So I ask people to bear with us. But it be will a place where we can post our reports and the data that we are able to collect. More importantly, it will be a place where people can talk back. They can explain how they are experiencing the current economy, what experiences they have when they are trying to borrow money. They can discuss the questions that we pose in the report. And they can pose their own questions, telling us what answers we should seek when we ask questions in their name. We expect our oversight to be stronger and more meaningful because of the input of people across the country.

As we gather more information, we will issue two more reports in January. On January 9th, the oversight panel will release its next report on the administration of the TARP program. On January 20th, the oversight panel will release a report providing recommendations for reforms to the financial regulatory structure. In other words, we will be running very hard over the next 40 days, but this is your will under the statute.

As you know, recent headlines show a grim economic picture. The recession has now visited every household in this country. The unemployment rate is the highest it has been in 14 years. One in 10 homeowners is now in default or foreclosure. Retail sales continue to fall. Credit card defaults are rising. And the savings rate is hovering near zero for individual families. More than 100,000 families last month headed into the bankruptcy courts.

Over the past 2 months, Congress and the Administration have proposed and enacted a series of measures in an ongoing attempt to turn the tide in this crisis. Americans are watching Washington's every move with a mixture of great hope and great concern. We hope in this time of great crisis that your Congressional Oversight Panel can be helpful. I will take your questions in any way I can.

Mrs. MALONEY. First of all, I want to thank you for your testimony and your hard work, and for assuming this critically important oversight position. As you could tell, and I noticed you were here for the entire hearing—

Ms. WARREN. Yes, ma'am.

Mrs. MALONEY. —many of my colleagues, including myself, were very concerned about getting credit out into the community. We appear to have stabilized our financial markets. I would like your comments on whether or not you agree that we have accomplished that goal. And could you comment on programs or ways we can get credit out into Main Street? We have helped Wall Street. What are we doing to help people buy cars, and purchase homes? I like the

proposal from Treasury that they are studying of a 4.5 percent interest rate over 30 years to start moving our housing program. I would like to hear your comments on that and any other ideas about getting credit into Main Street. They testified, and we need to work on really an accounting system so that we can understand where the money is going. We have put out $7.8 trillion, and still people say that interest rates for cars are at 14 percent, which is unaffordable for most Americans, and many people cannot get mortgages for their homes with a 30-year mortgage.

Could you comment on steps we need to take now?

Ms. WARREN. It would be premature for me to make specific recommendations, but I would turn to page 19 of our report. We actually had a little bit to say about this. The reminder that our friends in Great Britain faced a similar problem, and they were quite explicit up front. The money was given to financial institutions in return for the financial institutions to lend to small- and medium-sized enterprises. It was an explicit quid pro quo from the beginning. There have been measurements of what was your lending a year ago at this point and what is your lending now. Recapitalized banks, as part of their obligation in receiving funds, have to turn around and put those funds back into the economy.

I mention this by way of saying that is not an entirely novel idea. It is one that has been tested somewhere else and seems to be working at least with some success. So there are ways to measure this. It is not impossible to measure what is happening to lending volume and to put metrics in to compare lending volume now with lending volume by the same bank or per dollar capitalized in the past. And this may be something that it will be appropriate to at least continue to question Treasury vigorously about.

Mrs. MALONEY. Thank you. Debated before this committee was the wisdom of buying toxic assets. Many people believe that following the model in Great Britain of saving our financial institutions and recapitalizing was a better way to go, with preferred stock to protect taxpayers. One of the problems with buying the toxic assets is no one knows the value of them. And if no one wants to buy them, why in the world should the American taxpayer buy them? It appears to me that it would be wiser with this money to try to infuse lending and help the economy with lower car loan rates, with lower interest rates to refinance homes and to purchase homes. In other words, getting the money into the community, as opposed to buying toxic assets, that was by all accounts a mismanagement, in some cases abusive, scandalous practice that some of our financial institutions engaged in, creating and selling these assets.

So could you comment on the policy of buying toxic assets? Are any of our European allies buying toxic assets during this global economic crisis?

Ms. WARREN. No, Congresswoman, but I want to actually seize on a central point that you make there. It is not possible to save banks if families and small businesses fail. The banks don't exist independently. There is no such creature. And so the idea that we focus exclusively on banks, without making this part of a more comprehensive plan to look at what is happening in the mortgage market, obviously, with foreclosures and how foreclosures are drag-

ging down the whole economy, and what is happening in all other forms of the economic health of the American family.

I recognize that Treasury has a limited portfolio. It has a limited number of dollars it can spend in targeted areas where it is authorized to spend it. Nonetheless, that is not a reason not to think through a more comprehensive way of thinking about the question of how we will make sure not just that credit flows to the American family and to small businesses, but that they are healthy, that they actually have an opportunity to borrow at reasonable rates, but that they also have manageable economic lives. If they do not, we cannot save banks without saving these families and businesses.

I really want to emphasize that tie-in. I heard that in your question.

Mrs. MALONEY. Well, thank you very much. My time has expired.

Congressman Mel Watt.

Mr. WATT. Thank you, Madam Chairwoman. Thank you for being here, Professor Warren. Let me just ask a couple of technical questions first. I noticed that Representative Hensarling is on this oversight committee. I assume he is not going to be working at this full-time. Are any of the members of this oversight committee planning to do this full-time or is this a part-time job?

Ms. WARREN. Congressman Watt, I was told explicitly that this is a part-time job. And I believe that was the case for the other members of the committee.

Mr. WATT. Then that raises the second question I have, is the extent to which this can be really taken seriously. So let me ask the question this way. We didn't seem to get many concrete responses to our inquiries as Members of Congress today. Have you all discussed what I anticipate will be a problem, what you will do if you don't get concrete answers to the questions that you have posed about this program?

Ms. WARREN. Well, Congressman, as I see it, this panel is—we work for you, and if we don't get the answers we need—

Mr. WATT. Statutorily, what authority do you have to insist on being taken seriously and on getting the kinds of answers to the questions that you have raised?

Ms. WARREN. Statutorily we can hold hearings and we can make requests. Otherwise, we can only come and talk to you.

Mr. WATT. Subpoena power?

Ms. WARREN. I don't believe so.

Mr. WATT. Okay. All right. On page 35 of your report you talk about some things, future oversight activities, and the final one of those is public participation and comment process. Let me ask whether you open the possibility there of this being simply a popularity contest, a public opinion poll, or, again in the context of being taken seriously as a serious oversight body, I hope we are not setting up a structure where basically people have the opportunity to vent about their pet peeves about the program as opposed to making a concrete effort to make the program work. What did you have in mind when you proposed this public participation and comment process?

Ms. WARREN. It is my understanding that Treasury said the one thing we need is more confidence. We need confidence so that the American people can believe we are back on the right track, that

money is being spent in a responsible way, and that we can all get out there and do our jobs and borrow and buy and pay debt off and try to stabilize ourselves financially.

Mr. WATT. That is all very good, but if the bulk of the oversight board's responsibility is to take and assess public comments, I can tell you I love public comments, I have an open phone policy in my office, so I probably get more of them than most people do, but it is very time-consuming and not always as substantive as—you know, people like to vent, and they will use this as an opportunity. So I want to make sure that the bulk of the oversight board's time is not being spent doing public relations as opposed to serious evaluation and analysis of what the Treasury and this Administration and the next Administration are doing with these funds as opposed to, you know, just kind of making people feel good, which serves an important purpose, but I would like—I think Congress viewed this as more a substantive role than a public opinion outreach process.

So I will just leave you with that. That is not a criticism. I am just giving you a real concern that I have. And it probably doesn't even require a comment, but my time has expired and I will yield back.

Mrs. MALONEY. The Chair recognizes Congressman Miller from North Carolina.

Mr. MILLER OF NORTH CAROLINA. Thank you. Professor Warren, I earlier asked Mr. Kashkari about AIG, and to a lesser extent about Citigroup, but my questions have to go more broadly to transparency and accountability, the whole program, whether the American people really know how their money is being spent and whether it is being spent for a proper purpose. Mr. Kashkari said several times in his testimony that he believed that AIG would return—was viable, would return to profitability or solvency at least, and that we would get all of our money back. But when I asked about what kind of due diligence there had been, what we knew about the financial condition of the parent, the holding company, which seems to be where all the problems were, there wasn't a regulator to provide us any information at all. And he said there were two reasons for the companies that got the TARP funds. One was that they were viable, that they were healthy, that they could use the money to lend and encourage other economic activity; and then second is systemic risk. And it appears that AIG is all about systemic risk. That if they disappeared as a counterparty in derivative contracts and credit default swaps, which is a derivative contract, that there were lots of other financial institutions that would be out a lot. And it was really about helping them, not maintaining AIG as a viable business, that we intervened in AIG. I asked him about the financial institutions that were the counterparties. And he said essentially that we didn't know exactly who they were. Is that credible? Do you know who they were? And do you think we should know?

Ms. WARREN. I do think we should know. AIG must have records on to whom this money was paid, who the counterparties were. Now, I want to be fair, sometimes they are held in street names. It is not always entirely, entirely clear, but one can certainly make an inquiry in the initial transaction.

Mr. MILLER OF NORTH CAROLINA. Can you make that inquiry? Have you made that inquiry?

Ms. WARREN. Yes, sir.

Mr. MILLER OF NORTH CAROLINA. Will you make that inquiry?

Ms. WARREN. We will make that inquiry.

Mr. MILLER OF NORTH CAROLINA. Okay. The money that we have distributed, the capital infusion we have gotten something from. We were told, Congress was told, and we told the American people this was not a giveaway, this was a reluctant loan, it was an investment, and we meant to get our money back. If AIG is not realistically viable, if they are never going to return to solvency, if the real reason we are doing it is to pay off these credit default swaps, these derivatives, that feels like a giveaway. Should we be getting something from the businesses that are getting paid on derivative contracts?

Ms. WARREN. They certainly are profiting from our money, and I think it is an appropriate inquiry.

Mr. MILLER OF NORTH CAROLINA. As to Citigroup, I know that there was a regulator that we could rely upon for Citigroup, but the regulator initially urged $25 billion, and then 2 weeks after Secretary Paulson said that all the major financial institutions were now okay, there would be no others that would collapse, we had another one of those fevered weekends where we tried to strike a deal before the Asian markets opened and put another $20 billion into Citigroup and guaranteed $306 billion in troubled assets. Do you know what the assets were and why were they troubled?

Ms. WARREN. No, I do not. We will be asking.

Mr. MILLER OF NORTH CAROLINA. Okay. I yield back the balance of my time.

Ms. WARREN. Thank you.

Mrs. MALONEY. I thank the gentleman, and would like to note as to his question at the last hearing Chairman Bernanke said he would submit to this committee the counterparties for the AIG money. He also testified that in the swaps there are two types, one with assets, one that is basically just gambling, and that we should not in any way be, in my opinion, rewarding gambling. But he said there was no way for a distinction between those two—yes.

Mr. MILLER OF NORTH CAROLINA. Actually, I do have one more question. I know that I yielded back, but I would unyield. Do we know if AIG has stopped the business of writing derivative contracts or credit default swaps where no party to the transaction has an interest in the underlying asset?

Ms. WARREN. No, Congressman, we don't know that.

Mr. MILLER OF NORTH CAROLINA. There is no readily apparent social utility for that practice, at least to me. One of the tasks of your oversight panel is to look at reforming business. Do you see any value in their writing credit default swaps or other derivative contracts on—

Mrs. MALONEY. The gentleman's time has expired, but please respond, Professor Warren.

Ms. WARREN. I have a great deal of difficulty understanding the social utility of a credit default swap when there is no underlying transaction for which either party has any connection, any finan-

cial connection. I want to be educated in this area, but I confess to deep skepticism.

Mr. MILLER OF NORTH CAROLINA. Okay. Can you find out if they are still doing it?

Ms. WARREN. We certainly will. I will put it on the list.

Mr. MILLER OF NORTH CAROLINA. Thank you.

Ms. WARREN. Thank you, Congressman.

Mrs. MALONEY. And a further follow up is should taxpayers' money be spent for basically gambling on something that has no underlying asset?

The Chair recognizes Mr. Cleaver for 5 minutes.

Mr. CLEAVER. Thank you, Madam Chairwoman. Thank you, Professor, for being here. And it has been a long day for you.

Ms. WARREN. It has.

Mr. CLEAVER. When we designed the Emergency Economic Stabilization Act, we expanded the scope of the definition for financial institutions, and it was my interpretation of that expansion that we went beyond traditional banks, beyond credit unions. And I believed at the time that the bill had been drafted to include the automobile financing arms. In my district, I have two automobile manufacturing plants. It makes no difference if they have capital to continue to operate if no one is buying the cars. I know in your role, and I am thankful, as I hope all Americans are, for your service and your willingness to serve in this capacity at a time like this, but I am somewhat disappointed, and hopefully as you look at this through the Oversight Committee that you would seek to determine whether or not, in providing oversight, that attention is being given to what I think is rather explicit in the language of the legislation. Is it your understanding about the expansion of the definition, the scope of the definition?

Ms. WARREN. I have to say at this moment, Congressman, that this is one of the questions we have addressed. I think members of the panel may have very different views on this. But it is certainly a question we will be exploring. And that is the best I can do at this moment. We have only been here 14 days.

Mr. CLEAVER. No, I understand. I appreciate it.

Ms. WARREN. But I very much hear your point.

Mr. CLEAVER. Yes.

Ms. WARREN. I want you to know I am hearing.

Mr. CLEAVER. Thank you. I don't want to overstate it.

Ms. WARREN. No.

Mr. CLEAVER. I am just very, very concerned about what is going on with regard to the financing arms.

Ms. WARREN. I understand.

Mr. CLEAVER. If they don't finance the purchase of a car, we are in trouble. And most people right now can't get it. I have a friend who sells cars. He has been told, don't even submit an application of a score under 700.

Ms. WARREN. Wow. That is a very high number.

Mr. CLEAVER. And GMAC admitted to me that is exactly where they are.

Ms. WARREN. Yes, Congressman. I certainly hear the point.

Mr. CLEAVER. Thank you.

Ms. WARREN. Thank you.

Mr. CLEAVER. Thank you, Madam Chairwoman.

Mrs. MALONEY. Thank you. We have been called for a vote. So the last question will be Congressman Foster.

Mr. FOSTER. Thank you for hanging around for this. And I would like to say these are spectacular questions. You know, if the quality of the questions coming from this committee were a fifth the quality of these, I would be proud to be a Congressman. And let's see, one question, is the staffing situation and the support you are getting adequate for your job?

Ms. WARREN. Wonderful. We have received terrific support from the people here in Congress. It is literally just a problem of we were trying to write the report at the same time we were trying to buy the fax machine. You know, I feel like I am flying an airplane and trying to screw the wings on at the same moment.

Mr. FOSTER. No complaints there. And you anticipate sunsetting this when the actual—when everything gets done, right? And so this will be the same time scale of the savings and loan bailout, it will be a decade if we are lucky?

Ms. WARREN. No, Congressman, I have not committed to a decade of this. As I understand it, by statute we expire, our panel expires in June of 2010. So we have about a year-and-a-half with you.

Mr. FOSTER. Okay. And are you going to get into the business of unwinding the securitization of the mortgage-backed securities? Because I see you have a lot of volunteer labor from Harvard law students. And if there was ever a need for bright new ideas, it seems like that is an issue that, you know, ideas would be appreciated in. And I guess that is just a comment.

And then finally, your last question was the future and are they actually looking forward. I understand that they are still putting out fires right now. But you know, one of the things that occurs to me is that there is a significant downside risk that people don't like to talk about. You know, it is quite possible that real estate values are going to fall another factor of two. That is not inconsistent with historical values. And so I understand why Treasury would not be talking about this publicly, but I would be interested in some assurance that you can give us, either privately or publicly, that Treasury is actually looking at and planning for scenarios of how they might look at a significant downturn if really things, you know, things like the bottom drops out of the real estate market or other things. That at least—I would feel good to know that there are smart people thinking about that, even if they are not talking about it publicly. In the same sense you would like to see, you know, defense against terrorists thought about in great detail by smart people. And so that is one of the things I would appreciate your looking into.

Ms. WARREN. Yes, Congressman, we will be.

Mr. FOSTER. I yield back.

Mrs. MALONEY. In line with the gentleman's question, would you comment on the proposal that Treasury is considering of 30-year long-term loans at 4.5 percent interest rate for first-time home buyers to shore up the housing market, housing values as a response to the concerns that the gentleman raised?

Ms. WARREN. Congresswoman, I just want to make this point about it. This looks like a very promising idea. But we cannot keep

taking slices of approaches here. This, for example, will do nothing to help people who are losing their homes in foreclosure. And so you cannot refinance a house that is now at 130 percent of loan-to-value ratio. You just can't do it. And so—

Mrs. MALONEY. Reclaiming my time—

Ms. WARREN. Of course.

Mrs. MALONEY. —as you heard in the hearing, a number of us are legislating that TARP money be used to support activities such as Sheila Bair, who is the Commissioner of the FDIC. She successfully saved many homeowners in the IndyMac situation. Citibank also is adopting her policies. So in conjunction, obviously, you heard we are going to legislate, requiring them to move with TARP money to help renegotiate these loans into long-term lower interest loans, as proposed by FDIC Chairwoman Sheila Bair.

Ms. WARREN. Yes. I should add, I understand that there is also at least on the table the possibility of amending the bankruptcy laws to provide for strip-down of these mortgages that are badly underwater. It is going to take a comprehensive solution and that no one—it is not even appropriate, in my view, to think about this as a one-piece. We have to think about the housing market together. Foreclosures and accelerating foreclosures are obviously, in my view, the huge driving problem right now. Then we have to think about the housing market in the context of the declining economic health of the American family. And until we think in a more comprehensive way we can't create solutions that will really make a difference. We end up pushing a little here, and then it squeezes out over there or it creates a different kind of problem.

So I don't mean to be resistant on the news about supporting 4.5 percent mortgages, but I think we have to be very careful about thinking about where we want to spend our money and who will be the primary beneficiaries of being able to refinance their current mortgages or to buy new houses at 4.5 percent versus the resources we may need to spend to deal with foreclosures. So it is only to make the point of the importance of a comprehensive solution.

Mrs. MALONEY. Well, I agree completely. Sheila Bair has asked for $25 billion. Many of us have supported her request. She believes she can keep 1.5 million people in their homes. But then there are many more that we must address.

We are called to a vote. We have 5 minutes to vote. So I will be thanking you very much for your testimony today, and I would like to note that some members may have additional questions for the panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to Professor Warren and to place her responses in the record.

The hearing is adjourned.

[Whereupon, at 3:32 p.m., the hearing was adjourned.]

A P P E N D I X

December 10, 2008

Congressman Joe Baca
Statement for Financial Services Committee Hearing of TARP
December 10, 2008

Mr. Chairman, I thank you for convening this hearing.

I am really disappointed that the Treasury Department has ignored Congressional intent and has run its own course with the TARP program.

First, it is not helping homeowners as the program was intended!

About 9,000 homeowners are foreclosing each day! We can't stabilize this economy until we address this foreclosure problem.

Many members of the Congressional Hispanic Caucus and Black Caucus came to support Treasury Bailout because it gave Treasury the distinct authority to purchase and modify whole loans and securities to help struggling homeowners.

We are very disappointed that the Treasury has not acted in good faith.

Second, I am troubled that the Treasury department has refused to purchase the troubled assets held by local governments even though the Economic Stabilization Act gives clear authority to do so.

Nineteen California counties and cities, including the city of Fontana in my district, recently wrote to Treasury asking for TARP Funds.

The catastrophic losses of these localities will result in massive job losses, termination of ongoing construction projects, and elimination or reduction in critical services.

We cannot afford to let this happen in our communities!

I am also concerned that the Treasury Department has decided to invest directly into banks but has excluded credit unions even though Congress specifically included Credit unions to be among the institutions eligible to receive capital infusions.

This type of selective assistance has to stop.

I look forward to learning more about Treasury's management of TARP money during this hearing.

Thank you, Mr. Chairman. I yield back the balance of my time.

ANDRÉ CARSON
7TH DISTRICT, INDIANA

COMMITTEE ON FINANCIAL SERVICES
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OFFICE OF CONGRESSMAN CARSON

Opening Statement for the Financial Services Committee Hearing on "Oversight Concerns Regarding Treasury Department Conduct of the Troubled Assets Relief Program"

Thank you, Mr. Chairman for your leadership through this ongoing financial crisis and to the witnesses for joining us today. Like many members of this Committee, I was deeply troubled by what the Government Accountability Office reported to Congress, but I was not surprised.

For weeks, I have heard the reports on how Treasury offered assistance to Wall Street firms that later used the capital for acquisitions or questionable investments. For weeks, I have waited to hear a comprehensive plan that uses TARP funds to help middle income families avoid foreclosure and have heard nothing.

Constituents in my district look at the executive retreats taken by AIG right after Treasury invested $40 billion to help the company and know that some of these TARP funds have been misused.

They look at CapitalOne which received $3.5 billion in TARP funds and almost immediately after, announced its purchase of Chevy Chase Bank and know that some of these TARP funds have been misused.

So surely, Mr. Kashkari, you can understand the frustration my constituents feel as Treasury refuses to demand that these companies account for their use of this taxpayer assistance.

Surely you can understand the frustration of the 147,000 auto industry employees in my home state of Indiana who see these abuses on Wall Street and yet their companies are not offered TARP assistance by Treasury.

Surely you can understand the frustration of the 16,000 families in the city I represent that are in foreclosure and know that Treasury could have acted sooner to help them.

So now, I want to know exactly how you plan to make sure the taxpayer funds my constituents contribute are spent exactly as the bill this body approved intended it to be spent.

PRINTED ON RECYCLED PAPER

Now, I want to know what exactly you plan to do on foreclosures. If your answer is that Treasury still has reservations about using TARP funds to implement promising foreclosure mitigation plans and will continue to examine possibilities, then your answer is not good enough. If avoiding preventable foreclosures is truly one of your critical objectives at Treasury as your testimony states, then act on it.

United States Government Accountability Office

GAO

Testimony
Before the Committee on Financial Services, House of Representatives

For Release on Delivery
Expected at 10:00 a.m. EST
Wednesday, December 10, 2008

TROUBLED ASSET RELIEF PROGRAM

Additional Actions Needed to Better Ensure Integrity, Accountability, and Transparency

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

GAO-09-266T

Mr. Chairman, Ranking Member Bachus, and members of the committee:

I am pleased to be here today to discuss our first report on the newly created Troubled Asset Relief Program (TARP), which gave the Department of Treasury the authority to purchase and insure up to $700 billion in troubled assets held by financial institutions through the Office of Financial Stability (OFS).[1] Treasury was granted this authority in response to the recent financial crisis that has threatened the stability of the U.S. banking system and the solvency of numerous financial institutions. Among other things, the Emergency Economic Stabilization Act (the act) that authorized TARP on October 3, 2008, requires GAO to report at least every 60 days on findings resulting from our oversight of the status of actions taken under the program.[2] My statement today is based on our December 2, 2008, report. This report is the first under the act's mandate and covers the actions taken as part of TARP through November 25, 2008.[3] Our oversight work under the act is ongoing, and our next report will be issued by January 31, 2009.

Like the report, this statement focuses on (1) the nature and purpose of activities that were initiated under TARP as of November 25, 2008; (2) the structure of OFS, its use of contractors, and its system of internal controls; and (3) preliminary indicators of TARP performance.

To do this work, we reviewed documents related to TARP, including contracts, agreements, guidance, and rules. We also met with OFS, contractors, federal agencies, and officials from the eight large institutions that had received disbursements. Going forward, we plan to continue to monitor the issues highlighted in the report, as well as future and ongoing capital purchases, other more recent transactions undertaken as part of

[1]GAO, *Troubled Asset Relief Program: Additional Actions Needed to Better Ensure Integrity, Accountability, and Transparency*, GAO-09-161 (Washington D.C.: Dec. 2, 2008).

[2]The Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343(Oct. 3, 2008). The act requires the U.S. Comptroller General to report at least every 60 days, as appropriate, on findings resulting from oversight of TARP's performance in meeting the act's purposes; the financial condition and internal controls of TARP, its representatives, and agents; the characteristics of asset purchases and the disposition of acquired assets, including any related commitments entered into; TARP's efficiency in using the funds appropriated for its operations; its compliance with applicable laws and regulations; and its efforts to prevent, identify, and minimize conflicts of interest among those involved in its operations.

[3]Selected transaction information in this statement has been updated through December 5, 2008.

TARP (e.g., capital purchases in Citigroup and American International Group), and the status of other aspects of TARP. We conducted this performance audit in October 2008 and November 2008 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Summary

Treasury has taken a number of steps to try to stabilize the U.S. financial markets and banking system, including injecting billions of dollars into financial institutions. Although Treasury initially planned to buy mortgages and mortgage-related assets through TARP, Treasury shifted its focus to a preferred stock and warrant purchase program, known as the Capital Purchase Program (CPP). Treasury has provided more than $155 billion in capital to 87 institutions through CPP as of December 5, 2008. It has also established a Systemically Significant Failing Institution (SSFI) program, through which Treasury may invest in any financial instrument, including debt, equity, or warrants determined to be a troubled asset, and continues to explore other programs, including those focused on insurance, foreclosure mitigation, and consumer lending.[4] As of December 5, 2008, Treasury had allocated a total of $335 billion of TARP funds and disbursed $195 billion to institutions under the various programs.[5] While we recognize that TARP has existed for a short time and that a new program of such magnitude faces many challenges, especially in this current uncertain economic climate, we found that Treasury has yet to address a number of critical issues. These include determining how it will ensure that CPP is achieving its intended goals and monitoring compliance with limitations on executive compensation, dividend payments, and stock repurchases. Moreover, it has yet to formalize transition planning efforts

[4]The Secretary of the Treasury is to make the determination that the asset is a troubled asset, after consultation with the Chairman of the Board of Governors of the Federal Reserve System and notice to Congress.

[5]As of December 5, 2008, Treasury had allocated $335 billion to various programs, including $250 billion to CPP, $40 billion to American International Group (AIG) under SSFI, $20 billion to Citigroup, and $20 billion to a Federal Reserve lending facility. To date, it had disbursed a total of $195 million of the $335 billion including $155 billion under CPP (excludes $10 billion committed to Merrill Lynch & Co., which has yet to be disbursed) and $40 billion to AIG.

given the upcoming shift to a new administration or to establish an effective management structure and an essential system of internal controls. In our report, we recommended that Treasury take nine actions to help ensure the program's integrity, accountability, and transparency. These would require that Treasury

- work with the bank regulators to establish a systematic means of determining and reporting in a timely manner whether financial institutions' activities are generally consistent with the purposes of CPP and help ensure an appropriate level of accountability and transparency;
- develop a means to ensure that institutions participating in CPP comply with key program requirements (for example, executive compensation, dividend payments, and the repurchase of stock);
- formalize the existing communication strategy to ensure that external stakeholders, including Congress, are informed about the program's current strategy and activities and understand the rationale for changes in this strategy to avoid information gaps and surprises;
- facilitate a smooth transition to the new administration by building on and formalizing ongoing activities, including ensuring that key OFS leadership positions are filled during and after the transition;
- expedite OFS's hiring efforts to ensure that Treasury has the personnel needed to carry out and oversee TARP;
- ensure that sufficient personnel are assigned and properly trained to oversee the performance of all contractors, especially for contracts priced on a time-and-materials basis, and move toward fixed-price arrangements whenever possible;
- continue to develop a comprehensive system of internal control over TARP, including policies, procedures, and guidance that are robust enough to protect taxpayers' interests and ensure that the program objectives are being met;
- issue final regulations on conflicts of interest quickly and review and renegotiate mitigation plans to enhance specificity and compliance; and
- institute a system to effectively manage and monitor the mitigation of conflicts of interest.

In the short period covered by our report, Treasury has taken a number of important steps to set up TARP and to address the unfolding financial crisis. While immediate action is important, this urgency must be balanced against the need for strong management and oversight. Because Treasury is establishing oversight policies and procedures at the same time that it is setting up the program, we found some lag in its administrative efforts, which we have highlighted in this statement and discussed in detail in our report. Until these issues are resolved, there is heightened risk that the interests of the government and taxpayers may not be adequately protected and that OFS may not achieve its mission in an effective and efficient manner. We are continuing to follow up on these issues and to oversee new developments in the program, such as the foreclosure mitigation and insurance programs, SSFI, and minority contracting issues, as we prepare for our next report.

We also have started to evaluate indicators that, when reviewed collectively, should provide information about the state of financial markets and credit flow. However, it is too soon to determine whether the program is having the intended effect on credit and financial markets. Further, isolating TARP's impact will be difficult because of the number of actions that have been taken by U.S. regulators and foreign governments to stabilize the markets and because we cannot say what would have happened in the absence of TARP and these other efforts. We will continue to monitor and report on these preliminary indicators, including trends in interest rate spreads, mortgage rates, mortgage originations, and foreclosures, and to identify additional indicators as the program evolves.

Treasury Has Moved Quickly to Establish CPP, but Plans for Other Approaches to Strengthening Financial Markets Are Ongoing

Treasury allocated $250 billion to CPP and purchased $115 billion in senior preferred shares of eight national financial institutions on October 28, 2008, and about $40 billion in senior preferred shares of 79 additional financial institutions on November 14, 21 and December 5, 2008.[6] Treasury and the regulators have publicly stated that they expect these institutions to use the funds in a manner consistent with the goals of the program, which include both the expansion of the flow of credit and the modification of the terms of residential mortgages. But it is unclear how OFS and the banking regulators will monitor how participating institutions are using the capital investments and whether these goals are being met. The standard agreement between Treasury and the participating

[6]One additional purchase of $10 billion is pending until a merger is complete.

institutions does not require that these institutions track or report how they use or plan to use their capital investments. Although Treasury has said that it expects the institutions to increase the flow of credit, Treasury has not yet determined whether it will impose reporting requirements on the participating financial institutions or whether it will leverage existing reporting requirements to the banking regulators to reduce the regulatory burden. While we understand that money is fungible, such monitoring and reporting requirements are critical to ensuring the transparency and accountability of CPP and would help Treasury to monitor how the infusions were being used in the aggregate across the participating institutions. We recommended that Treasury work with the bank regulators to establish a systematic means of determining and reporting in a timely manner whether financial institutions' activities are generally consistent with the purposes of CPP. Treasury had a different perspective on what should be done to evaluate how institutions were using funds received under CPP, and is opting for development of general metrics for evaluating the overall success of CPP rather than working with bank regulators to establish a systematic means for determining whether financial institutions' uses of CPP funds were consistent with the purposes of the program, as we recommended. While we agree that it will be important to develop a range of metrics to evaluate the overall success of CPP and we welcome continued discussions with Treasury and the bank regulators on general metrics to achieve this purpose, given the magnitude of funds provided to this program, these types of metrics alone will not provide the necessary transparency and accountability needed to ensure that participating institutions are using the funds in a manner that is consistent with the purposes of the act. Moreover, institution-level information aggregated across the participants would also provide an alternative basis to assess the effect of TARP in restoring liquidity and stability to the financial system.

The standard terms of the securities purchase agreements also include certain requirements regarding executive compensation—for example, certain senior executives must repay any incentive or bonus compensation

that was based on materially inaccurate financial statements.[7] However, Treasury has not yet determined how it will monitor compliance with this or other requirements, such as limitations on dividend payments and stock repurchases. Without a strong oversight and monitoring function, Treasury's ability to ensure an appropriate level of accountability and transparency will be limited. Our related recommendation in this area is intended to bolster the program's accountability and transparency.

The creation of CPP was a shift in the direction of TARP. Treasury's rationale for the shift was that purchasing troubled assets would not provide the immediate results that were needed, given the deepening crisis in financial markets. Treasury believed that purchasing preferred stocks and warrants from financial institutions would be the fastest way to stabilize the markets, encourage interbank lending, and increase confidence of lenders and investors.[8] While Treasury has provided information on its Web page about its activities, this shift in the direction of the program heightened the need for Treasury to provide sufficient information to external stakeholders, such as Congress and the public, about not only the change in strategy but also the rationale for the new focus. Consequently, we urged Treasury to strengthen its communication strategy about plans for the program in order to avoid information gaps as market conditions and TARP evolve.

It is unclear what other approaches Treasury will pursue to meet the purposes of the act, including purchasing and insuring mortgage-related assets. Treasury has established the SSFI program under TARP. According to Treasury, institutions will be considered for participation in SSFI on a case-by-case basis, and there is no deadline for participation in this program. For example, in early November, Treasury announced that it would purchase $40 billion in senior preferred stock from AIG as part of a comprehensive plan to restructure federal assistance to this company,

[7]Under CPP, a qualified financial institution can receive a minimum investment of 1 percent of its risk-weighted assets, up to the lesser of $25 billion or 3 percent of those risk-weighted assets. In exchange, Treasury receives shares of nonvoting senior preferred stock that pay dividends of 5 percent annually for 5 years and then 9 percent annually, redeemable after 3 years and earlier under certain conditions. Treasury will also receive warrants to purchase a number of shares of common stock at market-based prices. Among other things, the number of shares of common stock underlying a warrant can be reduced by half if a financial institution receives proceeds from one or more "qualified equity offerings" that equal the amount of the preferred shares by December 31, 2009.

[8]See Section 3(9)(B) of the act. Treasury transmitted its determination to the appropriate committees of Congress on October 13, 2008.

which Treasury views as systemically significant. In addition, Treasury has taken initial steps to gather comments on ways of using its authority to insure troubled assets and is exploring approaches to supporting loan modification efforts. For example, Treasury solicited comments on how to structure the program, identify institutions and assets for inclusion, and calculate premiums in the *Federal Register*.[9] Moreover, having decided against large purchases of troubled mortgage-related assets under TARP, Treasury stated that the agency was considering other ways to meet Congress's expectation that Treasury would work with lenders "to achieve aggressive loan modification standards" to mitigate foreclosures but has not yet developed a program to maintain homeownership, an area we continue to closely monitor.[10]

Efforts to Establish the Office of Financial Stability Are Ongoing

Treasury quickly established an overall organizational structure for OFS, filled key leadership roles on an interim basis, and contracted for support services. Currently, it is working to hire the full complement of staff (perhaps as many as 200 full-time-equivalent positions depending on the ultimate design of the program), and OFS officials said that about 48 employees were assigned to TARP as of November 21, 2008, including those from other Treasury offices, federal agencies, and organizations who were providing assistance on a temporary basis and 5 permanent hires. Identifying and hiring the numbers and types of staff needed to successfully operate TARP will be challenging because of the evolving nature of the program and the upcoming transition to a new administration. While Treasury has filled key positions on an interim basis, these same issues may limit its ability to ensure that key leadership positions at OFS remain filled both during and after the transition, potentially creating uncertainty about the direction of the program and impeding efforts to effectively implement and oversee TARP. Therefore, we made several recommendations aimed at facilitating a smooth transition to the new administration and ensuring effective oversight of the program.

In addition to using permanent staff, OFS plans to rely on contractors and financial agents in several key areas. Treasury used expedited solicitation

[9]73 Fed. Reg. 61452 (Oct. 16, 2008), Department of the Treasury: Development of a Guarantee Program for Troubled Assets (Notice and Request for Comments).

[10]GAO, *Troubled Asset Relief Program: Status of Efforts to Address Defaults and Foreclosures on Home Mortgages*, GAO-09-231T (Washington, D.C.: Dec. 4, 2008).

procedures and structured the agreements and contracts to allow for flexibility in obtaining the required services. Most of the contracts awarded thus far have been priced on a time-and-materials basis, which provides for payments based on a set hourly rate plus the cost of any materials. As we have noted in past work, this type of pricing arrangement requires enhanced oversight.[11] Treasury has also taken steps to help promote the use of small businesses in carrying out TARP. In addition, Treasury has issued interim guidelines to address potential and actual conflicts of interest. As required by Treasury, the financial agent and contractors selected have identified a variety of potential and actual conflicts of interest and proposed a variety of solutions to mitigate identified conflicts. However, the agent and contractors have provided few written details on how they intend to implement mitigation plans or communicate related issues to OFS, and OFS has not yet developed a process for monitoring conflicts of interest. As a result, Treasury must continue to take steps to formalize its oversight of conflicts of interest and monitoring time-and-materials contracts.

Recognizing the importance of internal controls, Treasury awarded one of the first contracts to PricewaterhouseCoopers to assist OFS in developing and implementing a comprehensive system of internal control over TARP activities, including a risk-assessment framework. However, the rapid pace of implementation and the evolving nature of the program have hampered efforts to put a comprehensive system of internal control in place. Instead, OFS has focused on specific transaction controls as programs such as CPP are implemented. While OFS and PricewaterhouseCoopers are working to implement a comprehensive system of internal controls, until such a system is fully developed and implemented there is heightened risk that the interests of the government and taxpayers may not be adequately protected and that the program objectives may not be achieved in an efficient and effective manner.

[11]GAO, *Defense Contracting: Improved Insight and Controls Needed over DOD's Time-and-Materials Contracts*, GAO-07-273 (Washington, D.C.: June 29, 2007).

Measuring the Impact of TARP on Credit Markets and the Economy Will Be Challenging

TARP's activities could improve market confidence in institutions that choose to participate and have beneficial effects on credit markets, but several factors will complicate efforts to measure any impact. If TARP is having its intended effect, a number of developments might be observed in credit and other markets over time, such as reduced risk spreads, declining borrowing costs, and increased lending. However, several factors will make isolating and measuring the impact of TARP challenging, including simultaneous changes in economic conditions, changes in monetary and fiscal policy, and other programs introduced by Treasury, the Federal Reserve, Federal Deposit Insurance Corporation, and Federal Housing Finance Agency to support banks, credit markets, and other struggling institutions. As a result, any improvement in capital markets cannot be attributed solely to TARP, nor will a slow recovery necessarily reflect its failure, because of the effects of market forces and economic conditions outside of the control of TARP. Moreover, little time has passed since the initial infusion of capital into the institutions, and a variety of other programs and efforts directed at bolstering the economy and helping homeowners are still being considered. Nevertheless, we have preliminarily identified some indicators to facilitate our assessment of TARP's activities. We believe that these preliminary indicators, when viewed collectively, should signal whether TARP and other programs are functioning as intended. Among these preliminary indicators are interest rate spreads, mortgage rates, and mortgage originations. We also have identified other indicators that may prove useful as TARP evolves. Together, these indicators should provide additional information to policymakers and others on the overall stability of our financial markets.[12]

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

Contact

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[12]GAO-09-161, see pp. 49-57.

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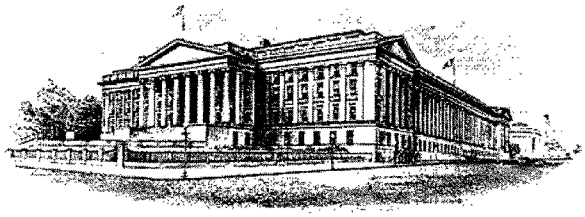

U.S. TREASURY DEPARTMENT OFFICE OF PUBLIC AFFAIRS

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INTERIM ASSISTANT SECRETARY FOR FINANCIAL STABILITY NEEL KASHKARI TESTIMONY BEFORE THE U.S. HOUSE OF REPRESENTATIVES FINANCIAL SERVICES COMMITTEE

Washington - Good morning. Mr. Chairman, Ranking Member Bachus, and Members of the Committee, thank you for asking me to testify before you today regarding oversight of the Troubled Asset Relief Program.

We are in an unprecedented period and market events are moving rapidly and unpredictably. We at Treasury have responded quickly to adapt to events on the ground. Throughout the crisis, we have always acted with the following critical objectives in mind: one, to stabilize financial markets and reduce systemic risk; two, to support the housing market by avoiding preventable foreclosures and supporting mortgage finance; and three, to protect taxpayers. The authorities and flexibility granted to us by Congress have been essential to developing the programs necessary to meet these objectives.

Today, I will focus my remarks on compliance and oversight of the TARP and on measuring the results of this program, which are two very critical issues to the Treasury Department (Treasury). The American people provided Treasury with broad authorities to stabilize the financial system and it is essential we communicate our actions in an open and transparent manner to maintain their trust. I will describe the many steps we are taking to ensure compliance with both the letter and spirit of the law and what measurements we look at to gauge the success of our programs. A program as large and complex as the TARP would normally take many months or years to establish. But, we don't have the luxury of first building the operation, then designing our programs and then executing them. Given the severity of the financial crisis, we must build the Office of Financial Stability, design our programs, and execute them - all at the same time. We have made remarkable progress since the President signed the law only 68 days ago.

Oversight

The first topic I will address is oversight of the TARP. In addition to the normal oversight provided by Congressional committees of jurisdiction, the Congress established four important avenues of oversight: one, the Financial Stability Oversight Board; two, the Special Inspector General; three, the Government Accountability Office; and four, the Congressional Oversight Panel. I will review Treasury's interaction with each body in detail.

First, we moved immediately to establish the Financial Stability Oversight Board, which, by law, includes: the Secretary of the Treasury, the Chairman of the Federal Reserve Board, the Chairman of the Securities and Exchange Commission, the Secretary of Housing and Urban Development, and the Director of the Federal Housing Finance Agency.

The law required the first board meeting to take place within fourteen days. We moved very quickly, and the Oversight Board met within four days. At that initial meeting, the members of the Board selected Chairman Bernanke to be Chairman of the Oversight Board. The law requires the Board to meet once a month, but it has already met five times in the just two months since the law was signed, with numerous staff calls between meetings, and expects to meet again this week. We have also posted the bylaws and minutes of the Board meetings on Treasury's website. In addition, the Oversight Board has interacted with other oversight bodies, such as the GAO and the Congressional Oversight Panel.

Second, the law also requires appointment of a Senate-confirmed Special Inspector General to oversee the program. We welcome the Senate's confirmation on Monday December 8 of Neil M. Barofsky as the Special Inspector General. I spoke with him on Tuesday December 9 and we look forward to working closely with his office. In the interim, we have been coordinating closely with Treasury's Inspector General. We held our first meeting with Treasury's IG on Monday, October 6, and have had numerous meetings since then to keep Treasury's Inspector General apprised of all TARP activity. We look forward to continuing our active dialogue with both the Treasury IG and with the Special IG as he builds up his office.

Third, the law calls for the Government Accountability Office to establish a physical presence at Treasury to monitor the program. Treasury provided workspace for our auditors within days of the President signing the law and Secretary Paulson had his first call with the Acting Comptroller General, Gene Dodaro, on Tuesday, October 7. The Acting Comptroller General and his team met with our team for the first time on Thursday, October 9. Since then, I have participated in multiple briefings with the GAO and our respective staffs are meeting almost daily for program updates and also to review contracts.

The GAO published its first report on TARP to Congress on December 2, which the law required within 60 days of enactment. The GAO met with our team on Saturday, November 22, before their report was finalized. They provided a thorough review of the TARP programs and progress – essentially a snapshot at the 60 day mark of a large, complex project that continues to be a successful work in progress. As I noted above, given the intensity of the financial crisis, we must build our operation, design our programs and execute them all at the same time. The GAO report identified nine "areas that warrant Treasury's ongoing attention." We are pleased with our auditors' recommendations because the GAO had identified topics that we already had focused on. The report was quite helpful because it provided us with thoughtful, independent verification

that Treasury is, indeed, focused on the right topics and Treasury agrees with the GAO on the importance of these issues.

Given the importance of the GAO's feedback, I want to spend a few minutes going through the nine areas that GAO identified and describe what we are doing in each case:

1. **Monitoring and reporting of financial institutions activities**
   - As the report indicated, given the number and variety of financial stability actions being put in place by multiple entities, it will be challenging to view the impact of the Capital Purchase Program in isolation and at the institutional level. Moreover, each individual financial institution's circumstances are different, making comparisons challenging at best, and it is difficult to track where individual dollars flow through an organization. Nonetheless, we are working with the banking regulators to develop appropriate measurements and we are focused on determining the extent to which the CPP is having its desired effect.

2. **Compliance of CPP participants with program requirements**
   - The key first step to effective compliance was developing effective program agreements and we have already accomplished that for publicly traded institutions and most private institutions. The CPP agreements are designed to require that the participants comply fully with the executive compensation restrictions set out by Congress in the legislation. We are now developing procedures to ensure that compliance with these restrictions is maintained.

3. **Formalize existing communication strategies to keep people informed about our strategy**
   - Treasury recognizes the importance of a more comprehensive communication strategy and we are looking at ways to enhance our communications, while recognizing that the TARP program is just one piece of a comprehensive response to the financial market crisis. Very detailed updates, such as this testimony, are part of that strategy.

4. **Develop a definitive transition plan**
   - Our team has been meeting regularly with the transition team and discussing our ongoing activities to ensure a smooth transition. We intend to have a fully functioning TARP organization in place as the new Administration takes office.

5. **Expedite hiring efforts to ensure the Office of Financial Stability has the needed personnel**
   - From day one, hiring has been a key focus area for the entire TARP team and we are making concrete progress every day as we staff up our team. Our Chief Operating Officer is coordinating an intense effort with our human resources office to identify and fill critical staff needs both for the immediate and long terms.

6. **Ensure sufficient personnel are assigned to oversee performance of contractors**

- Working with the Treasury procurement staff, we are implementing a comprehensive process for monitoring contractors. We view staffing in this area as a high priority and are bringing staff on board now to make sure it is done right.

7. **Continue to develop a comprehensive system of internal controls**
   - Here, we appreciate the acknowledgement by GAO of the work we are doing in this area. Internal controls were one of the first areas that we addressed. For example, we contracted Price Waterhouse Coopers to help us develop a system of internal controls, and we contracted Ernst and Young to advise us on accounting procedures. While we have more to do, we are making excellent progress.

8. **Issue final regulations on conflicts of interest**
   - Treasury has drafted conflict of interest regulations and expects to publish them soon. We will then work diligently with our existing service providers to make any necessary adjustments to bring their mitigation plans into conformance with these regulations. In the meantime, Treasury is confident that our conflict of interest requirements are some of the toughest out there.

9. **Institute a system to manage and monitor the mitigation of conflicts of interest**
   - Treasury is requiring firms to provide detailed information about their compliance programs, potential conflicts, and their mitigation plans *before* any contracts are signed, and we are using this information to select the best vendors. In addition, we will soon have regulations in place with rigorous monitoring and certification requirements and we are considering third party reviews and audits as well.

The GAO report is just one example of our compliance with the tough oversight Congress has appropriately established over the TARP. Treasury will continue to have an open dialogue with the GAO through regular briefings to keep them informed of our progress and welcome their additional feedback as we move forward.

Finally, the law called for the establishment of a Congressional Oversight Panel to review the TARP. That Oversight Panel was recently formed and we had our first meeting with its initial members on Friday, November 21. We look forward to future discussions with the Panel.

Reporting and Transparency

Next, I would like to discuss reporting requirements and transparency. Reporting results to the Congress and the American people is a critical responsibility of the TARP. People need to see what we are doing, understand why we are doing it, and know the effects of our actions. The law defined numerous reporting requirements for the TARP, which I will review here in detail. Treasury has met all of our reporting requirements on time, and we will continue to do so. All of our reports are posted on the Treasury website.

First, the law requires Treasury to publish a Transaction Report within two business days of completing each transaction. Many of our transactions are executed on the same day and so we have published four transaction reports on October 29, November 17, 25 and 26 for the 54

transactions we have completed so far. We will issue another transaction report tomorrow for the investments completed last Friday.

Second, the law requires Treasury to publish a Tranche Report to Congress within 7 days of each $50 billion commitment that is made. The comprehensive report must provide details on the following topics: the transactions made to date, the impact on the financial system, the challenges that remain, and additional actions that may be necessary to address those challenges. To date, Treasury has published three Tranche Reports on November 3 and 21 and December 2.

Finally, the law requires Treasury to provide a detailed report on the overall program within 60 days of the first exercise of the TARP purchase authority. We sent that report to Congress last Friday, December 5, and it is available on our website.

Measuring Results

People often ask: how do we know our program is working? First, we did not allow the financial system to collapse. That is the most direct, important information. Second, the system is fundamentally more stable than it was when Congress passed the legislation. While it is difficult to isolate one program's effects given policymakers' numerous actions, one indicator that points to reduced risk of default among financial institutions is the average credit default swap spread for the eight largest U.S. banks, which has declined more than 200 basis points since before Congress passed the EESA. Another key indicator of perceived risk is the spread between LIBOR and OIS: 1 month and 3-month LIBOR-OIS spreads have each declined about 100 basis points since the law was signed and about 180 basis points from their peak levels before the CPP was announced.

People also ask: when we will see banks making new loans? First, we must remember that just over half the money allocated to the Capital Purchase Program has been received by the banks. Although we are executing at record speed, it will take a few months to process all the remaining applications. The money needs to get into the system before it can have the desired effect. Second, we are still at a point of low confidence – both due to the financial crisis and the economic downturn. As long as confidence remains low, banks will remain cautious about extending credit, and consumers and businesses will remain cautious about taking on new loans. As confidence returns, we expect to see more credit extended.

The increased lending that is vital to our economy will not materialize as fast as any of us would like, but it will happen much faster as a result of having used the TARP to stabilize the system and increase capital in our banks.

We firmly believe that healthy banks of all sizes should use this program to continue making credit available in their communities. Treasury expects banks to continue their lending in a safe and sound manner as a result of these investments and we firmly support the statement issued by bank regulators on November 12 to that effect. The statement emphasized that the extraordinary government actions taken to strengthen the banking system are not one-sided; all banks – not just those participating in the CPP – have benefited from the government's actions. Banks, in turn, have obligations to their communities to continue making credit available to creditworthy

borrowers and to work with struggling borrowers to avoid preventable foreclosures. At the same time, Treasury believes institutions must not repeat the poor lending practices that were a root cause of today's problems.

In addition, we are actively engaged with regulators to determine the best way to monitor CPP investments and bank lending. We may utilize a variety of supervisory information for insured depositories, including existing Home Mortgage Disclosure Act (HMDA) data, Community Reinvestment Act (CRA) data, call report data, examination information contained in the CRA Public Evaluations, as well as broader financial conditions.

Conclusion

Treasury is committed to an open and transparent program with appropriate oversight. We look forward to continuing to work with the Financial Stability Oversight Board, the Special Inspector General, the Comptroller General, and the Congressional Oversight Panel as we execute this important program. Transparency will not only give the American people comfort in our stewardship of these funds, it will give the markets confidence that we are stabilizing and strengthening the financial system.

While we have made significant progress, we recognize challenges lie ahead. As Secretary Paulson has said, there is no single action the federal government can take to end the financial market turmoil and the economic downturn, but the new authorities that you and your colleagues provided in October dramatically expanded the tools available to address the needs of our system. We are confident that we are pursuing the right strategy to stabilize the financial system and support the flow of credit to our economy. Thank you and I would be happy to take your questions.

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December 9, 2008

The Honorable Barney Frank
Chairman
Financial Services Committee
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Frank:

I appreciate your ongoing efforts to provide the necessary oversight of Treasury Department implementation of the Troubled Asset Relief Program (TARP). The hearing tomorrow, "Oversight Concerns Regarding Treasury Department Conduct of the Troubled Asset Relief Program" is a continuation of our efforts in this regard. However, I am concerned about the almost $1 trillion of emergency loans and private asset purchases recently made by the Federal Reserve and the absence of oversight we are dedicating to these expenditures. I would welcome a hearing by this Committee and consideration of Government Accountability Office review of the expenditures made by the Federal Reserve.

Section 129 of the Emergency Economic Stabilization Act (EESA) requires oversight of decisions made by the Federal Reserve Board when acting pursuant to Section 13 (3) of the Federal Reserve Act. However, I believe these EESA requirements could go farther. The details of these emergency acts by the Fed are not subject to the same rigorous scrutiny the Congress required of Treasury actions made under the TARP. While I respect the long established history of the Fed to keep intervention of institutions confidential under other sections of the Federal Reserve Act, these emergency actions have been widely reported in the press and subject to very limited review.

Thank you for your cooperation and attention to these concerns.

Sincerely,

Mike Castle

Michael N. Castle
Member of Congress

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United States Government Accountability Office

GAO

Report to Congressional Committees

December 2008

TROUBLED ASSET RELIEF PROGRAM

Additional Actions Needed to Better Ensure Integrity, Accountability, and Transparency

GAO

Accountability * Integrity * Reliability

GAO-09-161

December 2008

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Highlights

Highlights of GAO-09-161, a report to congressional committees

TROUBLED ASSET RELIEF PROGRAM

Additional Actions Needed to Better Ensure Integrity, Accountability, and Transparency

Why GAO Did This Study

On October 3, 2008, the Emergency Economic Stabilization Act was signed into law. The act established the Office of Financial Stability (OFS) within the Department of the Treasury (Treasury) and authorized the Troubled Asset Relief Program (TARP). Every 60 days, the U.S. Comptroller General is required to report on a variety of areas associated with oversight of TARP. This report reviews (1) the activities that have been undertaken through TARP as of November 25, 2008; (2) the structure of OFS, its use of contractors, and its system of internal controls; and (3) preliminary indicators of TARP's performance. GAO reviewed documents related to TARP, including contracts, agreements, guidance, and rules. GAO also met with OFS, contractors, federal agencies, and officials from some participating institutions. GAO plans to continue to monitor these and other issues including future and ongoing capital purchases, other transactions undertaken as part of TARP (e.g., capital purchases in Citigroup and American International Group), and the status of other aspects of TARP.

What GAO Recommends

Treasury generally agreed with GAO's recommendations, but had a different perspective on the need to monitor how participating institutions are spending CPP funds. GAO believes that monitoring aggregate information across the participants would help ensure an appropriate level of transparency and accountability.

To view the full product, including the scope and methodology, click on GAO-09-161. For more information, contact Thomas McCool (202)512-2642.

What GAO Found

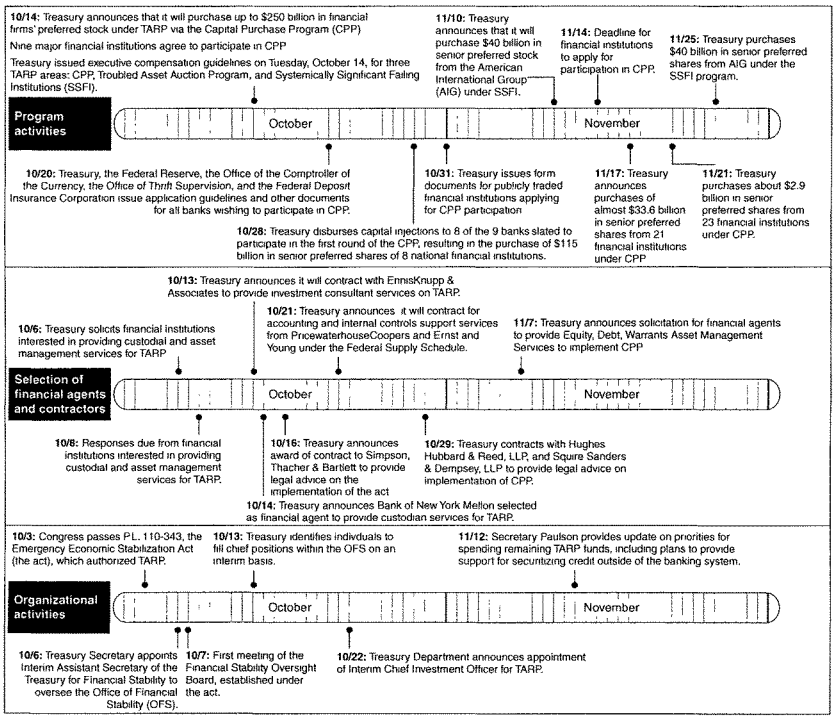
Treasury has taken a number of steps to stabilize U.S. financial markets and the banking system, including injecting billions of dollars in financial institutions. Through the capital purchase program (CPP)—a preferred stock and warrant purchase program—Treasury provided more than $150 billion in capital to 52 institutions as of November 25, 2008. GAO recognizes that TARP has existed for less than 60 days and that a new program of such magnitude faces many challenges, especially in this current uncertain economic climate. However, Treasury has yet to address a number of critical issues, including determining how it will ensure that CPP is achieving its intended goals and monitoring compliance with limitations on executive compensation and dividend payments. Moreover, further actions are needed to formalize transition planning efforts and establish an effective management structure and an essential system of internal control. To help ensure the program's integrity, accountability, and transparency, GAO recommends that Treasury

- work with the bank regulators to establish a systematic means of determining and reporting in a timely manner whether financial institutions' activities are generally consistent with the purposes of CPP and help ensure an appropriate level of accountability and transparency;
- develop a means to ensure that institutions participating in CPP comply with key program requirements (e.g., executive compensation, dividend payments, and the repurchase of stock);
- formalize the existing communication strategy to ensure that external stakeholders, including Congress, are informed about the program's current strategy and activities and understand the rationale for changes in this strategy to avoid information gaps and surprises;
- facilitate a smooth transition to the new administration by building on and formalizing ongoing activities, including ensuring that key OFS leadership positions are filled during and after the transition;
- expedite OFS's hiring efforts to ensure that Treasury has the personnel needed to carry out and oversee TARP;
- ensure that sufficient personnel are assigned and properly trained to oversee the performance of all contractors, especially for Contracts priced on a time and materials basis, and move toward fixed-price arrangements whenever possible;
- continue to develop a comprehensive system of internal control over TARP, including policies, procedures, and guidance that are robust enough to protect taxpayers interests and ensure that the program objectives are being met;
- issue final regulations on conflicts of interest quickly and review and renegotiate mitigation plans to enhance specificity and compliance; and
- institute a system to effectively manage and monitor the mitigation of conflicts of interest.

It is too soon to determine whether the program is having the intended effect on credit and financial markets. Moreover, given that U.S. regulators as well as foreign governments are continuing to take a variety of actions aimed at stabilizing markets and the economy, separately evaluating the impact of Treasury's efforts under TARP will be difficult. Nevertheless, GAO has identified a number of preliminary indicators that when viewed collectively should signal whether TARP as well as other related programs may be functioning as intended. Among these preliminary indicators are trends in interest rate spreads, mortgage rates, mortgage originations, and foreclosures.

Treasury has operated on parallel tracks in implementing the act. The following timeline highlights key actions associated with program implementation to date.

Timeline of Key Treasury Activities (Program Activities, Selection of Financial Agents and Contractors, and Organizational Activities), as of November 25, 2008



Source GAO.

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Abbreviations

ABS	asset-backed security
AIG	American International Group
CBO	Congressional Budget Office
CBOE	Chicago Board of Options Exchange
CDFI	Community Development Financial Institutions Fund
CFO	chief financial officer
COO	chief operating officer
COSO	Committee of Sponsoring Organizations of the Treadway Commission
CPP	Capital Purchase Program
FAR	Federal Acquisition Regulation
FDIC	Federal Deposit Insurance Corporation
FHA	Federal Housing Administration
FHFA	Federal Housing Finance Agency
GSA	General Services Administration
HUD	Department of Housing and Urban Development
IMF	International Monetary Fund
LIBOR	London Interbank Offered Rate
MBS	mortgage-backed security
OCC	Office of the Comptroller of Currency
OFS	Office of Financial Stability
OTS	Office of Thrift Supervision
QFI	qualified financial institution
SAS	Statement of Accounting Standards
SEC	Securities and Exchange Commission
SSFI	Systemically Significant Failing Institution
TALF	Term Asset-backed Securities Loan Facility
TARP	Troubled Asset Relief Program

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United States Government Accountability Office
Washington, DC 20548

December 2, 2008

Congressional Committees:

The current financial crisis has threatened the stability of the U.S. banking system and the solvency of numerous financial institutions at home and abroad. On October 3, 2008, Congress passed and the President signed the Emergency Economic Stabilization Act of 2008 (the act), which established the Office of Financial Stability (OFS) within the Department of the Treasury (Treasury) and authorized the Troubled Asset Relief Program (TARP). Among other things, the act provides Treasury with broad, flexible authorities to buy up to $700 billion in "troubled assets" and allows Treasury to purchase and insure mortgages and securities based on mortgages and, in consultation with the Chairman of the Board of Governors of the Federal Reserve System (Federal Reserve), purchase any other financial instrument (e.g., equities) deemed necessary to stabilize financial markets.[1]

Before the bill was passed, TARP's primary focus was expected to be the purchase of mortgage-backed securities (MBS) and whole loans. Within 2 weeks of enactment, however, following similar action by several foreign governments and central banks, Treasury announced that it would make $250 billion of the $700 billion available to U.S. financial institutions through purchases of preferred stock. The Federal Reserve and the Federal Deposit Insurance Corporation (FDIC) also announced concurrent coordinated actions that were intended to increase confidence in the U.S. financial system. FDIC announced that it would temporarily guarantee certain senior debt of all FDIC-insured institutions and certain holding companies, as well as deposits in noninterest bearing deposit transaction

[1]Pub. L. No. 110-343, sec. 3(9)(Oct. 3, 2008). The act requires that the appropriate committees of Congress be notified in writing that the Secretary of the Treasury, after consultation with the Federal Reserve Chairman, has determined that purchase of other financial instruments is necessary to promote financial market stability.

accounts at insured depository institutions.[2] The Federal Reserve announced the details of its Commercial Paper Funding Facility program, which provides a broad backstop to the commercial paper market by funding purchases of 3-month commercial paper from high-quality issuers.[3] The Federal Reserve and FDIC, among others, have also announced a variety of other initiatives aimed at addressing the current crisis, including the Federal Reserve's creation of a funding facility to support a private-sector initiative designed to provide liquidity to U.S. money market investors and the temporary increase in FDIC deposit insurance coverage.[4]

The act requires the U.S. Comptroller General to report at least every 60 days, as appropriate, on findings resulting from oversight of TARP's performance in meeting the purposes of the act; the financial condition and internal controls of TARP, its representatives, and agents; the characteristics of both asset purchases and the disposition of assets acquired, including any related commitments that are entered into; TARP's efficiency in using the funds appropriated for the program's operation; TARP's compliance with applicable laws and regulations; and TARP's

[2]The FDIC established the two guarantee programs after a determination of systemic risk by the Secretary of the Treasury. FDIC may bypass the least cost method of resolving banks in extraordinary circumstances if the least cost method would have "serious adverse effects on economic conditions and financial stability" and if bypassing the least cost method would "avoid or mitigate such adverse effects." The systemic risk exception requires the approval of the FDIC Board of Directors, the Federal Reserve Board and the Secretary of the Treasury in consultation with the President. 12 U.S.C. §1823(c)(4)(G). FDIC believes that the guarantee programs promote financial stability by preserving confidence in the banking system and encourage liquidity in order to ease lending to creditworthy businesses and consumers. GAO is required to review the systemic risk determination and report to Congress on (1) the basis for the determination; (2) the purpose for the action; and (3) the likely effect of the determination and the action on the incentives and conduct of insured depository institutions and uninsured depositors. GAO's work on this mandate is ongoing.

[3]Commercial paper is an unsecured, short-term debt instrument issued by a corporation, typically for the financing of accounts receivable, inventories, and meeting short-term liabilities. Maturities on commercial paper rarely range any longer than 270 days.

[4]The Federal Reserve Bank of New York will provide senior secured funding to a series of special purpose vehicles to facilitate an industry-supported private sector initiative to finance the purchase of eligible assets from eligible investors. Eligible assets are to include U.S. dollar-denominated certificates of deposit, bank notes, and commercial paper issued by highly rated financial institutions and having remaining maturities of 90 days or less. Eligible investors include U.S. money market mutual funds and over time may include other U.S. money market investors. Congress has also temporarily increased FDIC deposit insurance from $100,000 to $250,000 per depositor through December 31, 2009.

efforts to prevent, identify, and minimize conflicts of interest of those involved in its operations. In response to this mandate, this report addresses (1) the nature and purpose of activities that have been initiated under TARP as of November 25, 2008; (2) the structure of OFS, its use of contractors, and its system of internal controls; and (3) preliminary indicators of TARP performance.

Scope and Methodology

To determine the nature and purpose of TARP activities since the passage of the act on October 3, 2008, through November 25, 2008, we reviewed documents from OFS that described the amounts, types, and terms of Treasury's purchases of preferred stocks and equity warrants under the Capital Purchase Program (CPP).[5] We reviewed documentation and interviewed officials from OFS and the four primary banking regulators that are responsible for reviewing CPP applications—FDIC, Federal Reserve, Office of the Comptroller of Currency (OCC), and Office of Thrift Supervision (OTS)—on the process for selecting financial institutions to participate in CPP. We compared the evaluation criteria used by each of the regulators to determine that they were consistent with the criteria approved by Treasury and reviewed additional guidelines provided by the banking regulators to their regional offices. For the first eight institutions that received CPP funds, we reviewed the individual case memorandums documenting Treasury's decision to invest in these institutions.[6] We are in the process of reviewing the regulators' and Treasury's guidance. To understand the requirements of CPP, we reviewed the standard agreements signed by the participating institutions and interviewed senior officials from OFS and the banking regulators. In addition, we reviewed documentation from and interviewed senior officials at the eight participating institutions on how their participation in the program would affect their operations, including how they planned to use the capital injection and whether they intended to report separately on their activities associated with capital investments. Specifically, the institutions included in this review are the Bank of America Corp.; Bank of New York Mellon Corp.; Citigroup, Inc.; Goldman Sachs Group, Inc.; JPMorgan Chase & Co.; Morgan Stanley; State Street Corp.; and Wells Fargo & Co. We also met with OFS and regulatory officials to discuss their plans for ensuring

[5]An equity warrant is an option to buy the common stock of the debt issuer at a predetermined price on or before a specified expiration date.

[6]Treasury has announced a $10 billion capital purchase for Merrill Lynch & Co., pending completion of its merger with Bank of America.

compliance with the requirements of the agreements between Treasury and participants, including those limiting executive compensation and restricting CPP participants from increasing dividend payments or repurchasing common stock. We also reviewed Treasury's interim final rule and notices implementing the act's executive compensation rules. To determine the status of OFS's progress in establishing a program to insure troubled assets—a program that Treasury chose to implement through OFS in conjunction with TARP—we reviewed OFS's request for public comments on potential program design and the comments Treasury received, and met with OFS officials. For other approaches that Treasury was considering and had not fully implemented, we met with officials from OFS and reviewed public statements by Treasury officials to determine the status of their efforts to address TARP requirements.

To determine how Treasury had structured OFS, we reviewed a draft organizational chart and other planning documents to understand the number and types of positions OFS was planning to fill. We also met with Treasury and OFS officials regularly to discuss their approach to staffing the office in the near and long terms. We also discussed with them Treasury's plan for the transition to the next administration. As part of our responsibility for monitoring internal controls for TARP and its agents and representatives, we began regular meetings with OFS officials to learn what the office was doing to develop such controls for the office's operations and for programs such as CPP. We also reviewed information provided by PricewaterhouseCoopers, the firm that Treasury retained to help develop a system of internal control, and met with PricewaterhouseCoopers officials to learn about the approach they are taking. We also met with Ernst & Young officials who are helping OFS develop accounting procedures for TARP. Because CPP is the first TARP program to disburse funds, we reviewed documentation provided by OFS and PricewaterhouseCoopers that described the controls established for the initial disbursements and steps taken to implement these controls. We also met with officials from the Bank of New York Mellon to discuss the system of internal control for functions related to services the bank plans to provide for TARP, as well as to review the bank's internal audit process and recent reports. Our review included a report by the Bank of New York Mellon's external auditor on the internal controls over the Bank of New

York Mellon's trust and custodial services and selected internal audit reports on key functions that will support TARP services.[7]

To assess Treasury's approaches to acquiring services in support of TARP, we reviewed the financial agency agreement Treasury entered into and the contracts that Treasury awarded between October 3, 2008, and November 25, 2008.[8] We also reviewed Treasury's procurement strategy, solicitations, and other agency documents related to those agreements and contracts, as well as the statutes, regulations, and guidance governing the award of financial agency agreements and contracts. As part of this review, we examined documentation outlining the steps Treasury had taken to promote the use of small business concerns—including those owned and controlled by women, minorities, veterans, and socially and economically disadvantaged individuals—in carrying out TARP, such as Treasury guidance on small business participation in procurements under the act. We reviewed the proposals submitted by the firms that signed the financial agency agreement or were awarded contracts in order to identify the approaches those firms proposed for using small businesses. In addition, we examined documentation outlining actual and potential conflicts of interest identified by the financial agents and contractors, as well as their proposed plans for mitigation of those conflicts. We also reviewed Treasury's interim guidelines for conflicts of interest related to the authorities granted under the act and the statutes and regulations related to organizational and personal conflicts of interest, postemployment restrictions, and standards of ethical conduct.

Finally, to identify a preliminary set of indicators on the state of credit and financial markets that might be suggestive of the performance and effectiveness of TARP, we consulted Treasury officials and other experts and analyzed available data sources and the academic literature. We selected a set of preliminary indicators that offered perspectives on different facets of credit and financial markets, including perceptions of

[7]"Reports on the Processing of Transactions by Service Organizations" (Statement of Auditing Standards [SAS 70]) provides guidance on the factors an independent auditor should consider when auditing the financial statements of an entity that uses a service organization to process certain transactions.

[8]A financial agency agreement is the document that establishes and governs the relationship between Treasury and its financial agent. A financial agent is a financial institution that has authority to hold deposits of public money and perform related services. See 31 U.S.C. pt. 202. A financial agent has a principal-agent relationship with Treasury and owes a fiduciary duty of loyalty and fair dealing to the United States.

risk, cost of credit, and flows of credit to businesses and consumers.[9] We assessed the reliability of the preliminary indicators presented and found that despite certain limitations and the fact that others could interpret these indicators differently, they were sufficiently reliable for our purposes. The data used to construct the indicators in this report came largely from the Federal Reserve. As these data are widely used, including by GAO and the Federal Reserve, and are considered to be a reliable and often definitive source for banking sector data, we conducted only a limited review of the data but ensured that the trends we found were consistent with other research. We also relied on data from the Chicago Board Options Exchange (CBOE), *Inside Mortgage Finance*, and Global Insight. We have relied on CBOE and Global Insight data for past reports, and we determined that considered together, these auxiliary data were sufficiently reliable for the purpose of presenting and analyzing trends in financial markets.

We conducted this performance audit in October 2008 and November 2008 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Results in Brief

As of November 25, 2008, Treasury's focus in implementing TARP has been on investing directly in regulated financial institutions through CPP, which is intended to provide financial institutions with additional capital through purchases of senior preferred stock. Treasury stated that it chose to implement CPP because it concluded that the worsening conditions in the financial market required a more immediate response than would have been possible through the purchase of mortgage-related assets. This shift in the direction of the program heightened the need for Treasury to proactively provide sufficient information to external stakeholders about not only the change in strategy but also the rationale for the new focus. As of November 25, 2008, Treasury had allocated $250 billion to CPP and purchased $115 billion in senior preferred shares of 8 national financial

[9]No indicator on its own provides a definitive perspective on the state of markets; collectively, the indicators should provide a broad sense of stability and liquidity in the financial system and could be suggestive of the program's impact. However, it is difficult to draw conclusions about actual causality.

institutions and almost $36.5 billion in senior preferred shares of 44 financial institutions.[10] Treasury has stated that by building capital, CPP should help increase the flow of financing to U.S. businesses and consumers and support the U.S. economy. Treasury also has indicated that it intends to use CPP to encourage financial institutions to work to modify the terms of existing residential mortgages. Treasury has not yet determined if it will impose reporting requirements on the participating financial institutions. Such requirements would enable Treasury to monitor, to some extent, how the infusions were being used. Treasury and the banking regulators have taken important steps to ensure consistency in evaluating applications, but the extent to which regulators have provided guidance to their staff concerning denials of applications has varied. Institutions participating in CPP must comply with certain requirements regarding executive compensation—for example certain senior executives must repay any incentive or bonus compensation that was based on materially inaccurate financial statements. Treasury has not yet determined how it will monitor compliance with this or other requirements such as limitations on dividend payments and stock repurchases. It is also unclear what other approaches Treasury will pursue to meet the purposes of the act, including insuring mortgage-related assets. Treasury recently stated that it intends to purchase mortgage-related assets only on a targeted basis. In addition, Treasury has taken initial steps to gather comments on ways of using its authority to insure troubled assets and is exploring approaches to supporting loan modification efforts. Without a strong oversight and monitoring function, Treasury's ability to help ensure an appropriate level of accountability and transparency will be limited. Moreover, a strengthened communication strategy could help avoid information gaps as market conditions and TARP continue to evolve.

Treasury quickly established an overall organizational structure for OFS, filled key leadership roles, and contracted for support services. Currently, it is working to hire the full complement (perhaps as many as 200 full-time-equivalent positions) of staff, and OFS officials said that about 48 employees were assigned to TARP as of November 21, 2008, including those from other Treasury offices, federal agencies, and organizations who were providing assistance on a temporary basis and 5 permanent hires. Identifying and hiring the numbers and types of staff needed to successfully operate TARP will be challenging because of the evolving

[10]One additional purchase of $10 billion is pending until a merger is complete.

nature of the program and the transition to a new administration. While Treasury has filled key positions on an interim basis, these same issues may limit its ability to ensure that key leadership positions at OFS remain filled both during and after the transition, potentially creating uncertainty about the direction of the program and impeding efforts to effectively implement TARP. In addition to using permanent staff, OFS plans to rely on contractors and financial agents in several key areas. Treasury used expedited solicitation procedures and structured the agreements to allow for flexibility in procuring the required services. For the most part, the contracts awarded as of November 25, 2008, are priced on a time-and-materials basis, which provides for payments to the contractors based on a set labor rate for hours billed plus the cost of any materials. This type of pricing arrangement requires enhanced oversight. Treasury has also taken steps to help promote the use of small businesses in carrying out TARP and issued interim guidelines to address potential and actual conflicts of interest. As required by Treasury, the financial agent and contractors selected have identified a variety of potential and actual conflicts of interest and proposed a variety of solutions to mitigate identified conflicts. However, the agent and contractors have provided few written details on how they intend to implement mitigation plans or communicate related issues to OFS, and OFS has not yet developed a process for monitoring conflicts of interest. Recognizing the importance of internal controls, Treasury awarded one of the first contracts to PricewaterhouseCoopers to assist OFS in developing and implementing a comprehensive system of internal controls over TARP activities, including a risk-assessment framework. However, the rapid pace of implementation and evolving nature of the program have hampered efforts to put a comprehensive system of internal control in place. Instead OFS has focused on specific transaction controls as programs such as CPP are implemented. While OFS and PricewaterhouseCoopers are working to implement a comprehensive system of internal control, until such a system is fully developed and implemented, there is heightened risk that the interests of the government and taxpayers may not be adequately protected and that the program objectives may not be achieved in an efficient and effective manner.

It is too soon to determine whether the program is having the intended effect on credit and other markets. While TARP's CPP could improve confidence in participating financial institutions and may have beneficial effects on credit markets, attributing any such improvement solely to TARP is problematic because of the range of actions that have been and are being taken to address the current crisis. These include coordinated efforts by the global community and U.S. regulators—namely, FDIC, the Federal Reserve, and the Federal

Housing Finance Agency (FHFA)—as well as actions by financial institutions to mitigate foreclosures. We have identified a set of preliminary indicators that we will monitor for indications of improvements in credit and financial markets, such as the narrowing of various interest rate spreads that signal perceptions about the level of risk associated with lending among banks, in corporate debt markets, and throughout the general economy and reductions in the cost of credit for banks, businesses, and consumers. Over time, additional effects might be apparent in credit flows that capture key developments in mortgage markets and the level of defaults and foreclosures. While these indicators may be suggestive of TARP's ongoing impact, which we will be monitoring, no single indicator or set of indicators will provide a definitive determination of the program's impact. Moreover, we plan to report on additional indicators as more data become available and as economic and credit conditions evolve.

We recognize that less than 60 days has passed since the program was created and the inherent difficulty of setting up any new program, especially during turbulent economic conditions. However, we have identified a number of areas that warrant Treasury's ongoing attention. Therefore, we are recommending that Treasury take a number of actions aimed at improving the integrity, accountability, and transparency of TARP. Specifically, Treasury should

- work with the bank regulators to establish a systematic means of determining and reporting in a timely manner whether financial institutions' activities are generally consistent with the purposes of CPP;
- develop a means to ensure that institutions participating in CPP comply with key requirements of their agreements with Treasury, including those covering limitations on executive compensation, dividend payments, and the repurchase of stock;
- formalize the existing communication strategy to ensure that external stakeholders, including Congress and the public, are informed about the program's current strategy and activities as well as the rationale for changes in this strategy to avoid information gaps and surprises;
- develop a definitive transition plan by building on and formalizing ongoing activities to facilitate a smooth transition to the new administration, including ensuring that key OFS leadership positions are filled during and after the transition to the new administration;

- continue OFS hiring efforts in an expeditious manner to ensure that Treasury has the personnel needed to carry out and oversee TARP;
- ensure that sufficient numbers of personnel are assigned and appropriately trained to oversee the performance of all contractors, especially those performing under contracts priced on a time and materials basis, and move toward greater reliance on fixed-price arrangements whenever possible as program requirements are better defined over time;
- continue to develop a comprehensive system of internal controls over TARP including policies, procedures, and guidance for program activities that are robust enough to ensure that government's and taxpayers' interests are protected and that the program objectives and requirements are being met;
- issue final regulations on conflicts of interest concerning its contractors and financial agents as expeditiously as possible and review and renegotiate mitigation plans as necessary to enhance specificity and compliance with the new regulations once they are issued; and
- institute a system to effectively manage and monitor the mitigation of conflicts of interest.

We provided a draft of this report to Treasury for review and comment. We also provided excerpts of the draft report to the Federal Reserve, FDIC, OCC and OTS for review and comment. In written comments, Treasury generally agreed with the report and eight of the nine recommendations (see app. I). Treasury had a different perspective on what should be done to evaluate how institutions were using funds received under CPP, opting for development of general metrics for evaluating the overall success of CPP rather than working with bank regulators to establish a systematic means for determining whether financial institutions' uses of CPP funds were consistent with the purposes of the program, as we recommended. In technical comments, the Federal Reserve also expressed concern about whether Treasury needed to monitor individual institutions' use of CPP funds. As discussed in the draft, we agree that it will be important to develop a range of metrics to evaluate the overall success of CPP and we welcome continued discussions with Treasury and the bank regulators on general metrics to achieve this purpose. However, given the magnitude of funds provided to this program, these types of metrics alone will not provide the necessary transparency and accountability needed to ensure

that participating institutions are using the funds in a manner that is consistent with the purposes of the act. As stated in the report, Treasury should build on the existing oversight mechanisms of the banking regulators to minimize any additional regulatory burden and develop a means of reviewing and reporting on planned and actual actions taken by participating financial institutions resulting from the additional funding received through CPP. Obtaining such information could help Treasury better monitor participating institutions' activities and provide an appropriate level of accountability and transparency. Moreover, such information aggregated across the participants would also provide an alternative basis to assess the effect of TARP in restoring liquidity and stability to the financial system. Treasury, the Federal Reserve, FDIC, OCC, and OTS also provided technical comments that we incorporated in the report, as appropriate.

Background

The dramatic correction in the U.S. housing market precipitated a decline in the price of financial assets that were associated with housing, in particular mortgage assets based on subprime loans that lost value as the housing boom ended and the market underwent a dramatic correction. Some institutions found themselves so exposed that they were threatened with failure—and some failed—because they were unable to raise the necessary capital as the value of their portfolios declined. Other institutions, ranging from government-sponsored enterprises such as Fannie Mae and Freddie Mac to Wall Street firms, were left holding "toxic" mortgages that became increasingly difficult to value, were illiquid, and potentially had little worth. Moreover, investors not only stopped buying securities backed by mortgages but also became reluctant to buy securities backed by many types of assets. Because of uncertainty about the financial condition and solvency of financial entities, the prices banks charged each other for funds rose dramatically, and interbank lending effectively came to a halt. The resulting credit crunch made the financing on which businesses and individuals depend increasingly difficult to obtain as cash-strapped banks held onto their assets. By late summer of 2008, the potential ramifications of the financial crisis ranged from the continued failure of financial institutions to increased losses of individual savings and corporate investments and further tightening of credit that would exacerbate the emerging global economic slowdown that was beginning to take shape.

In September 2008, the Secretary of the Treasury announced that he was working with the chairmen of the Federal Reserve and the Securities and Exchange Commission (SEC) and congressional leaders to develop a

comprehensive approach to the crisis facing financial institutions and markets. Until that time, the administration had responded to the ongoing problems in the financial sector on a case-by-case basis, facilitating JPMorgan Chase's purchase of Bear Stearns, addressing problems at Fannie Mae and Freddie Mac, working with market participants to prepare for the failure of Lehman Brothers, and lending to American International Group (AIG) to allow it to sell some of its assets in an orderly manner. Although Treasury had begun to take a number of broader steps, including establishing a temporary guarantee program for money market funds in the United States, it decided that additional and comprehensive action was needed to address the root cause of the financial system's stresses. On September 20, 2008, Treasury proposed draft legislation to allow it to purchase up to $700 billion in troubled mortgage-related assets. Although the legislation was initially rejected by the House of Representatives on September 29, the Senate passed an expanded version of the legislation on October 1, and on October 3, the act was passed by the House of Representatives and signed into law by the President.

The act, as it relates to TARP, provides Treasury with the authority to purchase and insure certain types of troubled assets for the purposes of providing stability to and preventing disruptions in the economy and financial system and protecting taxpayers. The purposes of the act are to immediately provide authority and facilities that Treasury can use to restore liquidity and stability to the U.S. financial system and to ensure that these activities are consistent with protecting home values, college funds, retirement accounts, and life savings; preserving homeownership and promoting jobs and economic growth; maximizing overall returns to U.S. taxpayers; and providing public accountability for the exercise of authority under the act.

In exercising its authorities, the act further states that Treasury must consider a variety of additional factors, including the following:

- minimizing the impact on the national debt;
- providing stability for and preventing disruption to financial markets;
- considering the long-term viability of financial institution in determining whether a direct purchase represents the most efficient use of funds under the act;
- ensuring that all financial institutions are eligible to participate in the program, regardless of size, geographic location, form of organization, or amount of assets eligible for purchase under the act;

- providing financial assistance to financial institutions—including those serving low- and moderate-income populations and other underserved communities, and that have assets of less than $1 billion; that were well or adequately capitalized as of June 30, 2008; and that as a result of the devaluation of the preferred government-sponsored enterprises, will see their stock drop one or more capital levels—in a manner sufficient to restore the financial institutions to at least an adequately capitalized level;
- ensuring stability for U.S. public instrumentalities, such as counties and cities, that may have suffered significant increased costs or losses in the current market turmoil;
- considering the retirement security of Americans by purchasing troubled assets held by or on behalf of an eligible retirement plan;[11] and
- considering the utility of purchasing other real estate owned and instruments backed by mortgages on multifamily properties.

The act also requires several new and existing entities, in addition to the U.S. Comptroller General, to oversee the activities of OFS and TARP. For example, the legislation created the Financial Stability Oversight Board, which includes the Chairman of the Federal Reserve; the Secretary of the Treasury; the Director of FHFA; the Chairman of SEC, and the Secretary of Housing and Urban Development (HUD).[12] Moreover, it created a

[11]As described in clause (iii), (iv), (v), or (vi) of section 402(c)(8)(B) of the Internal Revenue Code of 1986 (IRC), except that such authority shall not extend to any compensation arrangements subject to section 409A of the IRC.

[12]The Chairman of the Federal Reserve was selected as the Chairman of the Oversight Board.

Special Inspector General for the program as well as a Congressional Oversight Panel.[13]

Treasury and federal and state regulators all play a role in regulating and monitoring the financial system. Historically, Treasury's mission has been to act as steward of U.S. economic and financial systems and to participate in and influence the global economy. As such, Treasury is responsible for a wide range of activities, helping to frame economic and financial policies and encourage sustainable economic growth. Among its many activities is working to predict and prevent economic and financial crises, positioning Treasury to take a leading role in addressing underlying issues such as those currently facing the U.S. financial system. The key federal banking regulators include the following:

- Federal Reserve, which is responsible for (among other things) conducting the nation's monetary policy by influencing the monetary and credit conditions in the economy in pursuit of maximum employment, stable prices, and moderate long-term interest rates; supervising and regulating bank holding companies and banks that are members of the Federal Reserve System; and maintaining the stability of the financial system and containing systemic risk that may arise in financial markets;
- FDIC, an independent agency created to help maintain stability and public confidence in the nation's financial system by insuring deposits, examining and supervising state-chartered banks that are not members of the Federal Reserve System, and managing receiverships;
- OCC, which charters and supervises national banks; and
- OTS, which supervises savings associations (thrifts) and savings association holding companies.

[13]The Congressional Oversight Panel consists of five members, with the Speaker of the House, the House Republican Leader, the Senate Majority Leader, and the Senate Republican Leader each selecting one member. The fifth member is a joint selection by the Speaker of the House and the Senate Majority Leader. Its members are Richard H. Neiman, Superintendent of Banks in New York (appointed by the Speaker of the House); Representative Jeb Hensarling (appointed by the House Republican Leader); Elizabeth Warren, Harvard Law School (appointed by the Senate Majority Leader); Senator Judd Gregg (appointed by the Senate Republican Leader); and Damon Silvers, of the AFL-CIO Associate General Counsel, (jointly appointed by the Speaker of the House and the Senate Majority Leader). Others with oversight responsibilities include the Congressional Budget Office and the Office of Management and Budget.

As discussed in the next section of this report, these bank regulators have a role in reviewing the applications of financial institutions applying for CPP.

Treasury Has Moved Quickly to Establish CPP, but Plans for Other Approaches for Strengthening Financial Markets Are Ongoing

Treasury's focus on implementing TARP thus far has been on directly investing in regulated financial institutions through CPP, with federal banking regulators playing a role in evaluating potential participants. Treasury had purchased more than $150 billion in senior preferred shares of 52 financial institutions as of November 25, 2008. Treasury has stated that it intends to use CPP to encourage U.S. financial institutions to increase the flow of financing to U.S. businesses and consumers and to support the U.S. economy. Treasury has also indicated that it intends to use CPP to encourage financial institutions to work to modify the terms of existing residential mortgages. OFS has not yet determined if it will impose reporting requirements on the participating financial institutions that could enable OFS to monitor, to some extent, how the financial institutions are using capital infusions. Institutions participating in CPP have agreed to comply with certain requirements, such as limitations on executive compensation, dividend payments, and repurchases of stock. However, Treasury has not yet determined how it will ensure compliance with these requirements. The extent to which Treasury will pursue other approaches to strengthening financial markets, including insuring troubled assets, to meet the purposes of the act also remains uncertain. But without effective oversight, Treasury cannot ensure that those receiving funds are complying with CPP requirements.

Treasury's Focus Has Shifted Away from the Purchase of Mortgage-related Assets

The act authorized the Secretary of the Treasury to purchase mortgages and MBS, and, in consultation with the Chairman of the Federal Reserve, to purchase other financial instruments if such purchases were deemed necessary to promote financial market stability. On October 13, 2008, consistent with conditions prescribed by the act, Treasury notified Congress that Treasury officials had determined that it would be necessary under TARP to purchase preferred stocks and warrants issued by certain financial institutions.[14] On October 14, Treasury announced that it would make direct capital investments in financial institutions in exchange for

[14]See Section 3(9)(B) of the act. Treasury transmitted its determination to the appropriate committees of Congress on October 13, 2008.

preferred stocks and warrants through CPP.[15] Treasury stated that strengthening capital via investments under this program was the swiftest mechanism to stabilize the financial markets, encourage interbank lending, and increase confidence in lenders and investors. Further, at the time Treasury stated that it planned to continue developing a program to purchase mortgages and MBS and would seek public comments on structuring a program to insure these assets. On November 12, Treasury announced that it would move away from purchasing mortgages and MBS as originally planned because it believed that such purchases were not the best use of TARP funds, although targeted purchases of such assets were still under consideration. Instead, Treasury planned to focus on extending capital investments to nonbank financial institutions and providing federal financing to investors of highly rated asset-backed securities (ABS) to lower the cost of and increase the availability of credit for consumers. The ABS market provides liquidity to financial institutions that provide small business loans and consumer lending such as auto loans, student loans, and credit cards. In addition, Treasury stated that it would develop strategies to stabilize the real estate market by encouraging loan modifications. While Treasury has used a variety of mechanisms to make sure the program is transparent, the shift in the direction of the program to CPP highlighted the need for Treasury to more actively provide sufficient information to external stakeholders (e.g., Congress and the public) about changes in its planned strategy and activities as well as the rationale for any shift to avoid future information gaps and surprises.

Treasury Has Invested More than $150 Billion in 52 Financial Institutions

Treasury had made more than $150 billion in capital investments in 52 financial institutions as of November 25, 2008. On October 14, 2008, in conjunction with similar actions by foreign governments and coordinated actions by the Federal Reserve and FDIC, Treasury announced that it planned to use $250 billion to purchase senior preferred shares in a broad array of qualifying financial institutions.[16] Treasury approved $125 billion in capital purchases for nine of the largest public financial institutions considered by the federal banking regulators and Treasury to be

[15]Generally, financial institutions include qualifying U.S.-controlled banks, savings associations, and certain bank and savings and loan holding companies.

[16]The act authorized Treasury to draw up to $250 billion for immediate use and provided for an additional $100 billion if the President certifies that the additional funds are needed. A written certification that the additional $100 billion was necessary has been submitted. A final $350 billion is available under the act but is subject to congressional review.

systemically significant to the operation of the financial system. Together, these institutions hold about 55 percent of U.S. banking assets. These nine institutions provide a variety of services, including retail and wholesale banking, investment banking, and custodial/processing services. According to Treasury officials, the nine financial institutions agreed to participate in part to signal the importance of the program to the stability of the financial system. On October 28, 2008, Treasury settled the capital purchase transactions with eight of these institutions for a total of $115 billion.[17] According to Treasury, the remaining $10 billion will be settled when the merger of Bank of America Corporation and Merrill Lynch & Co., Inc. is complete, sometime before January 31, 2009. Table 1 provides information about the first eight institutions selected for capital investment as well as other investments.[18]

[17]In its October 2008 Monthly Treasury Statement of Receipts and Outlays of the United States Government, Treasury reported the $115 billion it paid for the senior preferred shares as cash outlays. The Congressional Budget Office (CBO), in its Monthly Budget Review dated November 7, 2008, reported that, in its view, these stock purchases "should not be recorded on a cash basis but on a net present value basis, accounting for market risk, as specified in the Emergency Economic Stabilization Act." CBO's preliminary estimate for the present value cost of the stock purchases is $17 billion as compared to the $115 billion cash basis amount reported by Treasury. This cost reflects the estimated net amount of payments made and received by Treasury under the agreements, discounted for market risk and for interest in future years. The treatment of these stock purchases is being reviewed as part of our ongoing work.

[18]As required under the act, Treasury publicly disclosed a description of the assets purchased, and the amounts and pricing of those assets for the capital purchases within 2 business days of completion. See section 114(a) of the act.

Table 1: Amount of Capital Investment and Characteristics of the Qualified Financial Institutions Participating in the Capital Purchase Program, as of November 25, 2008

Name of qualified financial institution (Location of qualified financial institution)	Capital purchased by Treasury (in millions)	Total company assets as of September 2008 (in millions)
Purchases on October 28, 2008		
Bank of America Corp. (Charlotte, N.C.)	$15,000	$1,831,000
Bank of New York Mellon Corp. (New York City, N.Y.)	3,000	268,000
Citigroup, Inc. (New York City, N.Y.)	25,000[a]	2,050,000
Goldman Sachs Group, Inc. (New York City, N.Y.)	10,000	1,082,000[b]
JPMorgan Chase & Co. (New York City, N.Y.)	25,000	2,251,000
Morgan Stanley (New York City, N.Y.)	10,000	987,000[c]
State Street Corp. (Boston, Mass.)	2,000	286,000
Wells Fargo & Co. (San Francisco, Calif.)	25,000	1,371,000[d]
Subtotal	**$115,000**	**$10,126,000**
Purchases on November 14, 2008		
Bank of Commerce Holdings (Redding, Calif.)	$17	$651
1st FS Corporation (Hendersonville, N.C.)	16	670
UCBH Holdings, Inc. (San Francisco, Calif.)	299	13,044
Northern Trust Corporation (Chicago, Ill.)	1,576	79,244
SunTrust Banks, Inc. (Atlanta, Ga.)	3,500	174,777
Broadway Financial Corporation (Los Angeles, Calif.)	9	404
Washington Federal Inc. (Seattle, Wash.)	200	11,795
BB&T Corp. (Winston-Salem, N.C.)	3,134	137
Provident Bancshares Corp. (Baltimore, Md.)	152	6,410
Umpqua Holdings Corp. (Portland, Ore.)	214	8,328
Comerica Inc. (Dallas, Tex.)	2,250	65,153
Regions Financial Corp. (Birmingham, Ala.)	3,500	144,292

Name of qualified financial institution (Location of qualified financial institution)	Capital purchased by Treasury (in millions)	Total company assets as of September 2008 (in millions)
Capital One Financial Corporation (McLean, Va,)	3,555	154,803
First Horizon National Corporation (Memphis, Tenn.)	867	32,804
Huntington Bancshares (Columbus, Ohio)	1,398	54,661
KeyCorp (Cleveland, Ohio)	2,500	101,290
Valley National Bancorp (Wayne, N.J.)	300	14,288
Zions Bancorporation (Salt Lake City, Utah)	1,400	53,974
Marshall & Ilsley Corporation (Milwaukee, Wisc.)	1.715	63,501
U.S. Bancorp (Minneapolis, Minn.)	6,599	247,055
TCF Financial Corporation (Wayzata, Minn.)	361	16,511
Subtotal	**33,562**	**1,235,464**
Purchases on November 21, 2008		
Ameris Bancorp (Moultrie, Ga.)	52	2,258
Associated Banc-Corp (Green Bay, Wisc.)	525	22,487
Banner Corporation/Banner Bank (Walla Walla, Wash)	124	4,650
Boston Private Financial (Boston, Mass.)	154	7,022
Cascade Financial Corporation (Everett, Wash.)	39	1,552
Centerstate Banks Of Florida Inc. (Davenport, Fla.)	28	1,235
City National Corporation (Beverly Hills, Calif.)	400	16,331
Columbia Banking System, Inc. (Tacoma, Wash.)	77	3,105
First Community Bancshares Inc. (Bluefield, Va.)	42	1,967
First Community Corporation (Lexington, S.C.)	11	634
First Niagra Financial Group (Rockport, N.Y.)	184	9,008
First Pactrust Bancorp, Inc. (Chula Vista, Calif.)	19	846
Heritage Commerce Corp (San Jose, Calif.)	40	1,512

Name of qualified financial institution (Location of qualified financial institution)	Capital purchased by Treasury (in millions)	Total company assets as of September 2008 (in millions)
Heritage Financial Corporation (Olympia, Wash.)	24	905
Hf Financial Corp. (Sioux Falls, S. Dak.)	25	1,128
Nara Bancorp, Inc. (Los Angeles, Calif.)	67	2,598
Pacific Capital Bancorp (Santa Barbara, Calif.)	181	7,689
Porter Bancorp Inc (Louisville, Ky.)	35	1,596
Severn Bancorp, Inc. (Annalopis, Md.)	23	964
Taylor Capital Group (Rosemont, Ill.)	105	4,075
Trustmark Corporation (Jackson, Miss.)	215	9,086
Webster Financial Corporation (Waterbury, Conn.)	400	17,516
Western Alliance Bancorporation (Las Vegas, Nev.)	140	5,229
Subtotal	**$2,910**	**$123,393**
Grand Total	**$151,472**	**$11,484,857**

Sources. Treasury and SEC (Form 10-Q).

Note: Table does not include the $10 billion purchase of Merrill Lynch & Co. preferred stock because the settlement of this purchase is pending completion of its merger with Bank of America.

[a]On November 23, 2008, Treasury announced that it was purchasing an additional $20 billion in preferred shares from Citigroup, Inc. TARP funds were used, but this additional purchase was not part of CPP.

[b]Data as of August 29, 2008.

[c]Data as of August 31, 2008.

[d]Based on estimated 12-31-08 Pro Forma financial statements to reflect the purchase of Wachovia Corporation.

Treasury made the remaining $125 billion available for additional qualified financial institutions. The period for public financial institutions to apply for the capital purchase ended on November 14, 2008. As shown in table 1, Treasury purchased almost $33.6 billion of senior preferred stock in 21 financial institutions on November 14, 2008 and an additional $2.9 billion in 23 financial institutions on November 21, 2008. The institutions varied in size, and purchases ranged from $9 million to $6.6 billion per institution. According to Treasury, it intends to make final eligibility and purchase decisions for qualifying financial institutions by the end of 2008.

Terms of the Capital Purchase Program Agreements

Under CPP, a qualified financial institution can receive a minimum investment of 1 percent of its risk-weighted assets, up to the lesser of $25 billion or 3 percent of those risk-weighted assets.[19] In exchange for the investment, Treasury receives shares of senior preferred stock that will pay dividends at a rate of 5 percent annually for the first 5 years and 9 percent annually thereafter. Such shares are nonvoting, except with respect to protecting investors' rights. The financial institutions can redeem their shares at their face value after 3 years. At any time before that time, however, the shares can be redeemed if the financial institution has received a minimum amount from "qualified equity offerings" of any Tier 1 perpetual preferred or common stock.[20] Treasury may also transfer the senior preferred shares to a third party at any time.

Treasury will also receive warrants to purchase a number of shares of common stock with a total market value equal to 15 percent of the senior preferred investment for publicly traded securities and 5 percent for privately held securities. The exercise price on the warrants will generally be based on the market price of the participating institution's common stock at the date of the Treasury's acceptance of the financial institution's application to participate in CPP. The exercise price is reduced by 15 percent of the original exercise price on each 6-month anniversary of the issue date of the warrants if certain shareholder approvals are not obtained, subject to a maximum reduction of 45 percent of the original exercise price.[21] In addition, the number of shares of common stock underlying the warrant held by Treasury are reduced by half if the qualified financial institution completes one or more "qualified equity offerings" and receives proceeds equal to the amount of the preferred

[19]Risk-weighted assets are the total of all assets held by the bank that are weighted for credit risk according to a formula established in regulation by the Federal Reserve.

[20]Tier 1 capital is the core measure of a bank's financial strength from a regulator's point of view. It consists of the types of capital considered the most reliable and liquid, primarily common stock and preferred stock. A "qualified offering" is the sale and issuance of Tier 1 qualifying perpetual preferred stock, common stock, or a combination of such stock for cash. Senior preferred may only be redeemed prior to 3 years from the date of investment if the proceeds of "qualified enquity offerings" result in aggregate gross proceeds to the financial institution of not less than 25 percent of the issue price of the senior preferred. Banks are required to hold 8 percent capital for regulatory purposes and historically, on average hold closer to 10 percent. Therefore, in terms of total capital, Treasury's capital infusions could equal about one-quarter to one-third of an institution's capital.

[21]The issue date is the date that Treasury made the capital purchase of preferred stocks and warrants. In the case of the initial eight financial institutions that have reached settlement, this date is October 28, 2008.

shares prior to December 31, 2009. Bank officials we spoke with said that the option to reduce the number of shares underlying the warrants provided a powerful incentive to replace public capital with private capital before this date.

The standardized terms require that dividends on the senior preferred stock be payable quarterly in arrears. According to a Treasury official, the first dividend payments will be due in December 2008 for some financial institutions, with the dividend accrual period beginning on October 28, 2008. These institutions are expected to pay a rate of 5 percent of the capital investment per annum. As custodian, the Bank of New York Mellon will receive the dividends and wire the proceeds to the general fund of Treasury.[22]

Treasury also plans to make capital investments in privately held financial institutions and on November 17, 2008, issued new program terms for investing in these institutions. The deadline for privately held institutions to submit applications is December 8, 2008. Treasury is also developing program terms for S Corporations and mutual organizations (mutuals) but OFS officials noted that there were a number of challenges associated with structuring terms for these types of organizations.[23] As of November 21, 2008, no final decisions had been made about the timing of any such program.

Treasury Is Relying on Recommendations from the Bank Regulators to Select Qualified Financial Institutions for CPP

Treasury officials stated that they were relying extensively on the primary federal banking regulators in determining which institutions would be allowed to participate in CPP. Because the program is intended to provide capital to those institutions that can demonstrate their overall financial strength and long-term viability, OFS is relying on the banking regulators' examinations and experience with these institutions when it makes a final determination regarding their financial condition. The final decision

[22]Bank of New York Mellon is also a participant in CPP. We plan to review how OFS intends to mitigate and manage the conflict between Bank of New York Mellon's role as custodian and its participation in the program.

[23]An S Corporation is a corporation that makes a valid election to be taxed under Subchapter S of Chapter 1 of the Internal Revenue Code and thus does not pay any income taxes. Instead, the corporation's income or losses are divided among and passed through to its shareholders. A mutual organization is a company that is owned by its customers rather than by a separate group of stockholders. Many thrifts and insurance companies (for example, Metropolitan and Prudential) are mutual companies.

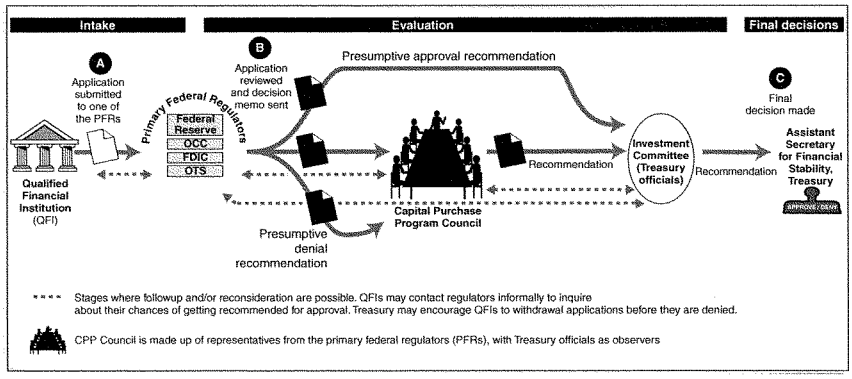
regarding the selection of institutions to participate in CPP is made by OFS. Qualified financial institutions seeking capital to participate in the program were to send their applications directly to their primary federal banking regulators.[24]

Treasury, in consultation with the banking regulators, has developed a standardized process for evaluating the financial strength and viability of applicants. Specifically, financial institutions are encouraged to consult with their primary regulators for help about deciding whether to apply. For those institutions that decide to apply, the federal banking regulators evaluate applications based on certain factors, such as examination ratings, selected performance ratios. Federal banking regulators may also consider information on the intended deployment of capital injections, although guidance on this possibility varied across regulators. Institutions with the highest examination ratings are to receive presumptive approval from the banking regulators, and the regulators' recommendations are to be forwarded to OFS's Investment Committee for its advice and recommendation.[25] Institutions with lower examination ratings or other considerations require further review and are to be referred to the CPP Council, which is made up of representatives from the four federal banking regulators, with Treasury officials as observers. Regulators and the CPP Council may consider other factors, such as the existence of a signed merger agreement involving the institution, confirmed private equity investment in the institution, and other factors that may offset the effect of lower examination ratings. Finally, those institutions with the lowest examination ratings are to receive a presumptive denial recommendation from the banking regulators. In these instances, the primary bank regulators may have further discussions with the applicants and encourage the institution to withdraw its application. The banking regulator or the CPP Council is to forward approval recommendations to OFS's Investment Committee, which further reviews the applications and may request additional analysis or information from the regulators or the CPP Council. Figure 1 provides an overview of the process for assessing and approving applications for capital purchases.

[24]The primary federal regulator is generally the regulator overseeing the lead bank of the institution. Where the institution is a bank holding company, the primary federal regulator also consults with the Federal Reserve.

[25]The committee membership includes the OFS's Chief Investment Officer (committee chair) and the assistant secretaries for Financial Markets, Economic Policy, Financial Institutions, and Financial Stability at Treasury.

Figure 1: Process for Accepting and Approving CPP Applications, as of November 21, 2008



Sources GAO analysis, Treasury, Art Explosion (images)

Once its review is complete, the Investment Committee is to make recommendations to the Assistant Secretary for Financial Stability for final approval. According to OFS officials, denied applicants will not be publicly announced, and as of November 21, 2008, the primary regulators also told us that they had not recommended denial for any financial institutions. However, regulatory officials stated that institutions could withdraw their applications at any point in the process if it was unlikely that their applications would be approved. And according to bank regulators, some institutions have withdrawn their applications. The extent to which regulators provided additional internal guidance on processing applications that might not be approved varied. For example, three bank regulators provided additional written guidance to staff on how to handle applications that were not likely to be recommended for approval, while one bank regulator did not provide any additional guidance. We are also examining the reasonableness of steps taken to ensure that CPP and regulators' procedures are being consistently followed and will report our results in subsequent reports.

OFS and the Regulators Have Not Decided How to Monitor Banks' Use of CPP Funds or How to Ensure Compliance with Purchase Agreements

It is unclear how OFS and the regulators will monitor participating institutions' use of the capital investments. The standard agreement between Treasury and the participating institutions includes a number of provisions, some in the "recitals" section at the beginning of the agreement and others that are detailed in the body of the agreement. The recitals refer to the participating institutions' future actions in general terms—for example, that "the Company agrees to expand the flow of credit to U.S. consumers and businesses on competitive terms" and "agrees to work diligently, under existing programs, to modify the terms of residential mortgages." Treasury and the regulators have publicly stated that they expect these institutions to use the funds in a manner consistent with the goals of the program, which include both the expansion of the flow of credit and the modification of the terms of residential mortgages. But it is unclear how OFS and the banking regulators will monitor how participating institutions are using the capital investments and whether these goals are being met. The standard agreement between Treasury and the participating institutions does not require that these institutions track or report how they plan to use, or do use, their capital investments.

We spoke with representatives of the eight large institutions that initially received funds under CPP, and they told us that their institutions intended to use the funds in a manner consistent with the goals of CPP. Generally, the institutions stated that CPP capital would not be viewed any differently from their other capital—that is, the additional capital would be used to strengthen their capital bases, make business investments and acquisitions, and lend to individuals and businesses. With the exception of two institutions, institution officials noted that money is fungible and that they did not intend to track or report CPP capital separately. We will continue to monitor the activities of these institutions as well as the plans of others in future reports as well as any oversight provided by Treasury and its agents or the regulators. The banking regulators indicated that they had not yet developed any additional supervisory steps, such as requiring more frequent provision of certain call report data for participating institutions, to monitor participating institutions' activities.[26] For example, it is unclear whether Treasury plans to leverage bank regulators, which in the case of the largest institutions have bank examiners on site, to conduct any oversight or monitoring related to CPP requirements. However, unless Treasury does additional monitoring and regular reporting, Treasury's

[26]A call report is a bank/thrift regulatory quarterly report that allows a regulator to monitor institution's financial condition.

ability to help ensure an appropriate level of accountability and transparency will be limited.

In addition to the general recitals, the standard terms of the securities purchase agreements include specific requirements. Participating institutions' dividend payments are restricted for as long as Treasury's senior preferred shares are outstanding, and the institutions cannot redeem these senior preferred shares for 3 years except with proceeds from new capital obtained from the market. Treasury is in the early stages of determining how it plans to monitor compliance with these requirements. The agreements require that the financial institutions' benefit plans comply with the requirements for executive compensation contained in the act and guidance issued by Treasury before the date of Treasury's purchase of the preferred shares. On October 20, 2008, Treasury published in the *Federal Register* an interim final rule to provide guidance on the executive compensation provisions in the act applicable to participants in CPP. The interim final rule outlines four executive compensation requirements that apply to senior executive officers of institutions while Treasury holds equity or debt in the institution. Senior executive officers are generally the chief executive officer, the chief financial officer, and the three most highly compensated officers. A participating financial institution must meet the following requirements:

- The institution's compensation committee must (1) review the senior executive officers' incentive and bonus compensation arrangements within 90 days of the CPP purchase to ensure the arrangements do not encourage unnecessary or excessive risk taking, (2) the compensation committee must meet at least annually with senior risk officers to review the relationship between the institutions' risk-management policies and the senior executive officer incentive arrangements, and (3) certify that it has completed the reviews.

- Payments of bonus or incentive compensation that are made based on materially inaccurate earnings must be refunded to the institution by the senior executive officers.

- No golden parachute payments will be made.[27]
- The institution must agree not to deduct for tax purposes executive compensation in excess of $500,000 per executive.

Treasury officials said that they intended to develop a plan to ensure that participating institutions adhere to these requirements, including having Treasury's equity asset managers (yet to be selected) monitor financial institutions' compliance with certain requirements such as executive compensation and dividend restrictions. As discussed later in this report, internal controls are a major part of efficiently and effectively managing a program, and developing a process for monitoring participating financial institutions will be critical to identifying and addressing any potential problems in these institutions' compliance with program requirements. Treasury officials noted that once they have examined all public comments, they might add clauses or other components to the executive compensation rules to strengthen oversight of the executive compensation requirements. But at this point, the officials have not determined how Treasury will monitor executive compensation compliance. Bank regulators varied in their views about their oversight responsibilities related to compliance with executive compensation requirements and other required terms of CPP. For example, one regulator noted that it would rely on the institution's board of directors to assess compliance, and another regulator stated that it was Treasury's responsibility to provide such oversight. Without a consistent process for monitoring participating institutions, Treasury's ability to identify and address any potential problems in these institutions' compliance with program requirements will be limited.

The Extent to Which Treasury Will Pursue Other Programs under TARP Remains Uncertain

The TARP legislation provides Treasury with broad authorities to establish programs that can purchase or insure "troubled assets." As previously mentioned, these assets can include mortgage-related assets and other financial instruments that Treasury, after consultation with the Federal Reserve, determines to be necessary to promote financial stability. Treasury has established a Systemically Significant Failing Institutions

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

(SSFI) program under TARP. According to Treasury, unlike CPP, which is broad-based, a financial institution's participation in SSFI will be considered on a case-by-case basis. Moreover, there is no deadline for participation in this program. For example, on November 10, 2008, Treasury announced that it would purchase $40 billion in senior preferred stock from AIG as part of a comprehensive plan to restructure federal assistance to this company, which Treasury views as systemically significant.[28] These funds were disbursed on November 25, 2008.

Treasury has also taken other targeted action. On November 23, Treasury announced that it would invest an additional $20 billion in Citigroup from TARP in exchange for preferred stock, with an 8 percent dividend to Treasury. Citigroup is to comply with enhanced executive compensation restrictions and implement FDIC's mortgage modification program. Treasury and FDIC will provide protection against unusually large losses on a pool of loans and securities on the books of Citigroup. The Federal Reserve will backstop residual risk in the asset pool through a nonrecourse loan.

We plan to continue to monitor activities associated with both of these transactions in future reports.

Treasury Decided Not to Pursue Further Development of the Mortgage-related Assets Purchase Programs

On November 12, 2008, Treasury announced that it had examined the benefits of purchasing troubled mortgage-related assets, including mortgage-backed securities and whole loans, and concluded that this approach would not be the best use of TARP funds at this time. Prior to this announcement, despite the creation of CPP, purchases of these assets were considered a key part of Treasury's planned strategy for stabilizing financial markets. Treasury had worked with the financial agent it had selected to provide custodian services to TARP (Bank of New York Mellon), bank regulators, and others to develop mechanisms for identifying and pricing mortgage-backed securities and whole loans. In addition, OFS started to identify asset managers to oversee acquired mortgage-backed securities and whole loans, but given that it would not be purchasing these mortgage-related assets, OFS officials said that it would not be seeking the services of these asset managers at this time.

[28]The restructuring plan also includes actions by the Federal Reserve aimed at restructuring the terms of its previous agreement.

Treasury Has Taken Preliminary Steps to Establish a Program to Insure Troubled Assets

Under the act, Treasury is required to establish a program that insures troubled assets and protects investors from losses.[29] On October 16, 2008, Treasury published in the *Federal Register* a request for public comment to identify potential approaches to structuring such an insurance program.[30] In the notice, Treasury solicited comments on how to structure the program, identify institutions and assets for inclusion, and calculate premiums. In addition, Treasury requested comments on the types of events that should lead to an insurance payout and on approaches to setting a value for the payout. When the comment period closed, on October 28, Treasury had received 66 comment letters from, among others, holding companies and financial services firms, consulting firms, and trade industry groups on how to structure the program. Treasury, as of November 21, 2008, had made no final decision regarding the design of the program. The comments suggested a range of program options. Recommendations focused on insuring asset-backed securities, in particular securities backed by consumer loans; providing insurance for guarantors' losses on their portfolios; and insuring loans to small businesses to facilitate lending. Many comments targeted securitized assets, and some comments indicated that the program should encompass a variety of assets and not just those related to mortgages.

Treasury Is Examining Strategies to Mitigate Mortgage Foreclosures

Having decided against large purchases of troubled mortgage assets under TARP, Treasury stated that the agency was considering other ways to meet Congress' expectation that Treasury would work with lenders "to achieve aggressive loan modification standards" to mitigate foreclosures. As of November 25, 2008, it had not yet announced any specific programs. OFS has established and hired a chief for the Office of the Chief of Homeownership Preservation within OFS. The Director of Treasury's Community Development Financial Institutions Fund (CDFI) is serving as the interim chief for homeownership until a permanent chief is hired. According to OFS officials, the effort to staff this office with housing policy, community development, and economic research experts is ongoing. As of November 21, 2008, seven positions had been filled with federal government detailees, according to the Chief, and the recruitment and hiring process had begun for permanent positions. OFS has stated that it is working with other federal agencies, including FDIC, HUD, and FHFA,

[29]The act specifies that the program would insure only troubled assets originated or issued prior to March 14, 2008.

[30]73 Fed. Reg. 61452 (Oct. 16, 2008), Department of the Treasury: Development of a Guarantee Program for Troubled Assets (Notice and Request for Comments).

to explore alternatives to help homeowners under TARP. As OFS reviews foreclosure mitigation program options, it is considering a number of factors, including the cost of the program, the extent to which the program minimizes the recidivism of borrowers helped out of default, and the number of homeowners the program has helped or is projected to help remain in their homes, according to a senior official. A senior OFS official stated that the agency had considered loan modification strategies such as the program FDIC developed to convert nonperforming mortgages owned or serviced by IndyMac Federal Bank into affordable loans. Possible loan modification measures under such programs include interest rate reductions, extended loan terms, and deferred principal.

Other similar programs under review, according to OFS, include strategies to guarantee loan modifications by private lenders. The HOPE for Homeowners program at the Federal Housing Administration (FHA) is one such program.[31] According to FHA, lenders benefit by turning failing mortgages into performing loans. Other loan modification programs include those announced by FHFA in partnership with Treasury, such as a streamlined loan modification program for at-risk borrowers, to prevent foreclosures and mitigate losses. According to an OFS official, OFS is also considering what policy actions might be taken under CPP to encourage participating institutions to modify mortgages that are at risk of or in default. Although OFS has stated that it is contemplating these and other foreclosure mitigation strategies, including strategies that involve TARP funds and strategies that do not involve TARP funds, it has not announced a specific program structure.

Treasury's Strategy Continues to Evolve and Will Focus More on Consumer Credit

In addition to CPP, the insurance program, and potential foreclosure mitigation programs, Treasury is considering additional strategies under TARP. According to the Treasury Secretary, the agency is evaluating a program to leverage TARP funds with matching capital from private investors. This type of program could address the needs of nonbank financial institutions that are not eligible to participate in CPP. However, OFS acknowledged that many nonbank credit providers were not directly regulated, possibly making taxpayer protection, a key goal of the act, more difficult to achieve. OFS is also considering strategies to increase the

[31]Under the new FHA program, lenders can have loans in their portfolios refinanced into FHA-insured 40-year loans with fixed interest rates. The new insured mortgages cannot exceed 96.5 percent of the current appraised value of the homes, a provision that could require lenders to write down the existing mortgage amounts. Borrowers must also share a portion of the equity resulting from the new mortgage and the value of future appreciation.

availability of consumer financing by improving the liquidity of the asset-backed securitization market. According to Treasury, a freezing of credit in this market has limited financing options for consumers for car loans, student loans, and credit card borrowing. According to the Secretary, Treasury has been looking for strategies to use its authority and funds under TARP to encourage private investors to purchase highly rated ABS to expand the flow of consumer credit. Treasury and the Federal Reserve Bank of New York announced on November 25, 2008, the creation of the Term Asset-Backed Securities Loan Facility (TALF), under which the Federal Reserve Bank of New York will lend up to $200 billion to holders of newly issued ABS for a term of at least 1-year. This credit facility is intended to create consumer credit by providing liquidity to ABS holders to issue new consumer credit-driven bonds. Using the funds available under TARP, Treasury will provide $20 billion in credit protection to the Federal Reserve for loans. This credit facility may expand to include other asset classes, such as commercial and certain residential mortgage-backed assets.

Efforts to Establish the Office of Financial Stability Are Ongoing

Treasury has taken a number of major steps to set up OFS, including (1) establishing an organizational structure and filling key leadership positions and a number of staff positions within that structure, (2) selecting contractors and a financial agent to support TARP activities, and (3) beginning to develop an overall system of internal control for the program. However, OFS faces a number of challenges in completing its organizational activities. First, hiring the number and type of staff needed to successfully operate TARP, as well as ensuring that key leadership positions remain filled, will be challenging due to the rapid evolution of program activities and the fact that the office will soon be transitioning to a new administration. Further, Treasury has used contractors and a financial agent to play key roles in supporting the program, and it is taking initial steps to address conflicts of interest posed by their roles. But Treasury is still developing an oversight process for conflicts of interest involving its contractors and financial agents. These and other gaps in internal controls have resulted from the need to begin program activities before policies and procedures have been fully developed and implemented. While OFS recognizes the need to quickly develop and implement a comprehensive system of internal control for all TARP activities, these efforts have also been challenged by recent changes in the strategic direction of the program and uncertainties about further changes that may result once the new administration is in place. Successfully meeting all of these challenges is key to ensuring the efficient and effective operation of TARP now and in the future.

An Organizational Structure Has Been Established for OFS

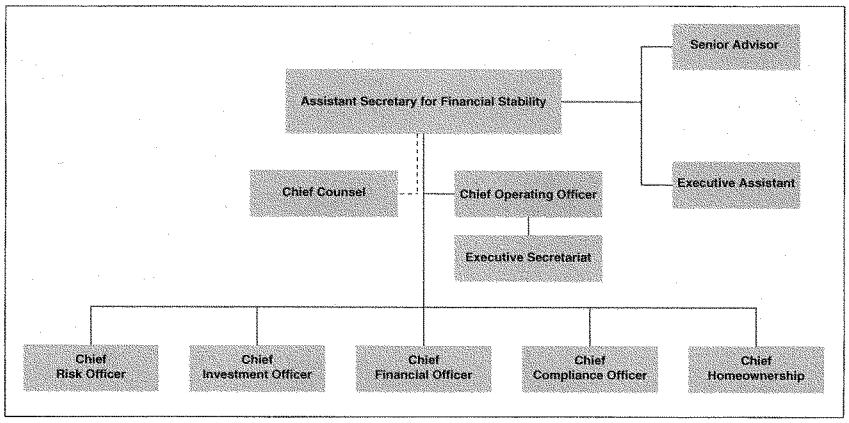
On October 6, 2008, in order to implement TARP and address growing concerns about the stability of the financial markets and the functioning of credit markets, Treasury established OFS and appointed an Interim Assistant Secretary of Financial Stability as its head. OFS is organized within Treasury's Office of Domestic Finance and reports to the Under Secretary for Domestic Finance. Soon after establishing OFS, Treasury created several functional areas within the office and hired interim chiefs to manage each of the major OFS functions (fig. 2). According to OFS's current organizational outline, these interim chiefs and their major areas of responsibility are as follows:

- *Chief Investment Officer* is responsible for administering TARP programs, such as CPP, and approving and managing all TARP investments.
- *Chief Risk Officer* is responsible for identifying and assessing risks that TARP faces and for tracking and reporting measurements of those risks.
- *Chief Financial Officer* (CFO) is responsible for the budget, financial statement reporting, accounting, and internal controls.
- *Chief Compliance Officer* is responsible for ensuring program compliance with laws and regulations, including the executive compensation and conflicts of interest requirements under TARP.
- *Chief of Homeownership Preservation* is responsible for overseeing efforts to reduce foreclosures and identify opportunities to help homeowners keep and protect their homes while also protecting taxpayers.

In addition, OFS has a Chief Operating Officer (COO), who is responsible for helping to develop the infrastructure to support TARP, coordinating communications among the various units, and working with Treasury's administrative resources unit to ensure efficient and effective TARP operations. In addition, the COO is responsible for working with the CFO

to manage the TARP budget.[32] The OFS organizational structure also includes a Chief Counsel who is responsible for providing legal and policy advice to OFS on implementing TARP and complying with the provisions of the act, and a Senior Advisor, who provides direct support to the Assistant Secretary for Financial Stability in overseeing the implementation of TARP.

Figure 2: Organization of the Office of Financial Stability, as of November 21, 2008



Source: Treasury

Note: The Chief Counsel reports directly to Treasury's Office of General Counsel.

[32]In our prior work, we have reported that top leadership must set the direction, pace, and tone for agencies undergoing significant transformation and that the appointment of a chief operating officer is among the key practices available to help elevate attention on management issues and transformational change. See GAO, *Results-Oriented Cultures: Implementation Steps to Assist Mergers and Organizational Transformations*, GAO-03-669 (Washington, D.C.: July 2, 2003).

Treasury recognized that it needed to move quickly to fill the interim chief positions, for several reasons. First, the escalating financial crisis called for TARP to become operational as soon as Congress passed legislation to establish the program. Second, even before OFS was established, Treasury had contemplated engaging in various strategies to address the credit crisis and conducting a large number of financial transactions. Third, Treasury anticipated that a variety of factors could affect the timing, nature, and extent of the activities that OFS would administer. According to Treasury, its short-term strategy for staffing high-level OFS positions was to identify government employees inside Treasury and other federal agencies with the necessary skills and knowledge who could fill leadership positions on a temporary basis and establish a structure for administering the program going forward. The five interim chiefs have come from across government and beyond, including from OCC, the Federal Reserve, CDFI, the Export-Import Bank, and the International Monetary Fund (IMF), an international organization whose mission is to foster global monetary cooperation and secure financial stability. According to Treasury officials, the overall structure of OFS will remain appropriate for continuing to administer TARP regardless of the program's overall strategic direction.

Effective Implementation of OFS's Organizational Structure Depends on Timely Hiring and Well-Coordinated Transition Planning Efforts

Treasury is in the process of recruiting and hiring well-qualified career staff who will be able to stay on in their positions on a long-term basis. OFS officials said that it had about 48 employees assigned to TARP as of November 21, 2008, including those from other Treasury offices, federal agencies, and organizations, who are providing assistance on a temporary basis. OFS's interim chiefs have each developed a needs assessment for their areas and have submitted these assessments to the COO, who is working with Treasury's human resources department to meet those needs. The chiefs identified about 130 positions, although OFS officials have said that the office may require more (up to 200 full time equivalent employees) or less staff depending on the type and complexity of the various activities that OFS initiates under TARP and that hiring could be adjusted accordingly. Treasury is making efforts to meet the current estimate of needed staff by the end of December and is prioritizing its hiring process by filling senior career positions first. Consistent with the need to fill a large number of positions, Treasury officials said that they were reviewing a number of résumés from within and outside of the federal government to staff the organization as quickly as possible. As of November 21, 2008, Treasury had filled five permanent positions.

OFS is also taking steps to help ensure that the key positions remain filled during and after the transition to the new administration. While Treasury

officials said that some interim chiefs might be asked to stay to serve under the new administration, at present it is unclear how many of them ultimately will continue in their existing roles or for how long. Consequently, the interim chiefs have been tasked with developing a description of their current roles and responsibilities and helping identify their potential replacements. While Treasury expects that there will be many qualified candidates interested in chief officer positions, uncertainty over leadership and the strategic direction of the program may inhibit some of OFS's efforts to fill these key positions. OFS officials said that they planned to meet frequently with the incoming administration's transition team and that they planned to hire senior career staff who could effectively manage TARP activities during and after the transition. Filling needed positions will be a key step in the successful transition of the program to the new administration, and we plan to continue to monitor these activities as the transition to the new administration continues.

Contractors and Financial Agents Will Provide Key Services for TARP

Treasury has used a financial agency agreement and a variety of contracts to acquire a range of services in support of TARP. To promote a timely and flexible approach to implementing the program, Treasury used expedited procedures to enter into the agreement and award the contracts and structured these arrangements to allow for flexibility in ordering the services required. Treasury has also taken steps to help promote the inclusion of small businesses in carrying out TARP.

Contracts and Other Agreements Entered into by Treasury Provide for a Range of Services to Support TARP

Treasury has used two approaches to acquire the necessary services to support TARP. First, Treasury exercised its authority under the act to retain financial agents to provide services on its behalf. Treasury said that it would use financial agents when the required services involved managing public assets. Second, Treasury has entered into a variety of contracts and blanket purchase agreements under the Federal Acquisition Regulation (FAR) for legal, investment consulting, accounting, and other services that are generally available in the commercial sector. While the financial agency agreement and certain contracts were awarded primarily to assist with the purchase of troubled assets, Treasury officials explained that they were redirecting requirements within the scope of the contracts to support TARP's shift to CPP and made similar modifications to the financial agency agreement.

Between October 3 and November 25, 2008, Treasury entered into one financial agent agreement and seven contractual arrangements in support of TARP, the details of which are summarized in table 2. In addition, we

have preliminary information on three other contracts ranging from about $8,500 to $2.2 million for a budget model, legal services, and leased office space. We are continuing to review all contracts and agreements, including these three additional contracts.

Table 2: Financial Agency Agreement and Contracts Awarded, as of November 25, 2008

	Purpose	Date signed	Value	Agreement structure	Pricing structure	Competition
Financial Agency Agreement						
Bank of New York Mellon	To provide custodian and cash management services	10/14/2008	To be calculated based on percentage of value of assets managed	Financial agency agreement	Percentage of value of assets managed	Open competition: Submissions received: 70 Submissions meeting qualifications: 10 Responses considered: 3
Contracts						
Simpson, Thacher & Bartlett, LLP	To serve as a legal adviser for implementing the Emergency Economic Stabilization Act	10/10/2008	$5,000-$500,000	Indefinite delivery/ indefinite quantity contract	Time and materials or firm-fixed price task orders	Other than full and open based on unusual and compelling urgency exception. Offerors solicited: 6 Offers received: 2
EnnisKnupp & Associates, Inc.	To support development and maintenance of investment policies and guidelines and assist with the oversight of asset managers	10/11/2008	$25,000 - $2,500,000	Indefinite delivery/ indefinite quantity contract	Firm-fixed price task orders	Other than full and open based on unusual and compelling urgency exception. Offerors solicited: 6 Offers received: 3
Pricewaterhouse Coopers, LLP	To help establish internal controls	10/16/2008	Total amount of services ordered to date: $191,469	Blanket purchase agreement	Time and materials or firm-fixed price task orders	Request for quotes from 6 firms on the General Services Administration's (GSA) Federal Supply Schedules (the Schedule) Quotes received: 6
Ernst & Young, LLP	To provide general accounting support and expert accounting advice	10/18/2008	Total amount of services ordered to date: $492,007	Blanket purchase agreement	Time and& materials or firm-fixed price task orders	Request for quotes from 7 firms on the GSA Schedule Quotes received: 6
Hughes Hubbard & Reed, LLP	To provide legal services in connection with the capital purchase program	10/29/2008	Total amount of services ordered to date: $1,411,300	Blanket purchase agreement	Time and materials or firm-fixed price task orders	Request for quotes from 5 firms on the GSA Schedule Quotes received: 4

	Purpose	Date signed	Value	Agreement structure	Pricing structure	Competition
Squire Sanders & Dempsey, LLP	To provide legal services in connection with the capital purchase program	10/29/2008	Total amount of services ordered to date: $1,380,000	Blanket purchase agreement	Time & materials or firm-fixed price task orders	Request for quotes from 5 firms on the GSA Schedule Quotes received: 4
Lindholm & Associates	To provide Human Resources Support	10/31/2008	$174,720 for base period of 6 months. Total value of base period plus all options is $710,528.	Order under the GSA Schedule	Time and materials task orders	Quotes sought and received from 3 small businesses

Source GAO analysis of Treasury documents

Treasury Used Expedited Procedures to Award the Agreement and Contracts

Treasury used a variety of methods to expedite the process for entering into its agreement and awarding contracts for TARP. For the financial agency agreement, Treasury posted notices on its Web site on October 6 seeking proposals to provide asset management and custodian services. Proposals were due by October 8. Although Treasury had not selected asset managers as of November 21, it moved quickly to complete the custodian agreement. Treasury said that of the 70 custodian proposals it received, 10 met minimum eligibility requirements, and 3 institutions were invited to submit formal proposals and make face-to-face presentations. Treasury evaluated the three proposals and on October 14, 2008, selected Bank of New York Mellon to be the custodian for the asset purchase program for a term of 3 years. The parties later amended the agreement to provide for services under CPP.

Treasury also used other than full and open competition to expedite the award of two contracts for services. To obtain legal services and the expertise of an investment consultant firm, Treasury used existing statutory authority as the basis to award contracts using other than full and open competition procedures. The specific exception Treasury used under this authority was unusual and compelling urgency.[33] Using market research that it had conducted, Treasury invited several firms to submit

[33]The Competition in Contracting Act authorizes agencies to limit competition when an unusual and compelling urgency precludes the use of full and open competition and delaying the contract would result in serious financial or other harm to the government. 41 U.S.C. § 253(c)

proposals on an expedited basis. Treasury received two proposals for legal services and three for investment services and was able to make awards in accordance with its announced criteria. Treasury also made five awards under schedules maintained by the General Services Administration (GSA). In all cases, Treasury solicited and awarded the contracts within a matter of days.

Contracts Have Been Structured to Accommodate Treasury's Need for Flexibility

Treasury used contract structures and pricing arrangements designed to allow for flexibility in ordering the services required. Specifically, Treasury established blanket purchase agreements with several firms based on contracts previously awarded to those firms by the GSA. These blanket purchase agreements contain the basic terms and conditions governing the types of services the firms will provide to Treasury in support of TARP. As specific needs arise, the blanket purchase agreements allow Treasury to issue task orders to the firms describing the specific services required, establishing time frames, and setting pricing arrangements. Treasury established two 3-year agreements; other agreements were established for periods ranging from 6 to 24 months. In other instances, Treasury awarded new indefinite delivery/indefinite quantity contracts that, like the blanket purchase agreements, contain all necessary contract terms and conditions. As specific needs arise, Treasury issues a task order under the indefinite delivery/indefinite quantity contract. These contracts were established for 1 year or less. In general, the task orders under these contracts were awarded for periods of performance ranging from 2 weeks to 6 months.

For the most part, the contracts and task orders awarded as of November 25, 2008, including the blanket purchase agreements, are priced on a time and materials basis. This pricing mechanism provides for payments to the contractors based on set labor rates and the number of hours worked, plus the cost of any materials. Our prior work on such contracts recognized both the inherent flexibility of such arrangements and the highlighted need for close government supervision to ensure that costs are contained. Specifically, time and materials contracts are considered high risk for the government because they provide no positive incentive to the contractor for cost control or labor efficiency. Thus, the onus is on the government to monitor contractors to ensure that they are performing the work efficiently and controlling costs.[34]

[34]GAO, *Defense Contracting: Improved Insight and Controls Needed over DOD's Time-and-Materials Contracts*, GAO-07-273 (Washington, D.C.: Sept. 17, 2007).

A Treasury procurement official stated that time and materials pricing for its task orders had been necessary because of the uncertain nature of the work that would be required. As TARP requirements become more established, Treasury may award future task orders using fixed-price arrangements. Furthermore, the official outlined several steps his office was taking to ensure appropriate management and oversight of the time and materials contracts awarded as of November 25, 2008, including assigning additional oversight personnel to TARP procurements, ensuring that training requirements were met, and providing specific training on the tracking of billable costs. However, Treasury has not yet established a specific timetable for completing these steps.

Treasury Has Taken Some Steps to Promote the Use of Small Businesses in TARP Activities

In a memo issued through its Web site, Treasury provided guidelines to small businesses for pursuing procurement opportunities. Treasury noted that while there were no requirements under its financial agent authority to set aside work for various designations of small businesses—including small business concerns owned and controlled by women, minorities, veterans, and socially and economically disadvantaged individuals—use of these groups was an evaluation factor during the selection process. Treasury further noted that any small businesses that did not meet the minimum requirements for award of the financial agency agreement could participate as subcontractors.

For services obtained through procurement contracts, Treasury considered offerors' efforts to promote small business participation as part of its selection criteria. Specifically, for three of the contractual agreements it has awarded, Treasury evaluated the proposals received based in part on the offerors' approach to ensuring that small businesses had opportunities to participate. One of the contracted firms is a small business, while other awardees offered the following approaches to using small businesses:

- One vendor has teamed with a minority small business firm as a subcontractor.
- Another vendor plans to utilize two subcontractors: one woman-owned small business and one other small business. However, Treasury noted that the subcontractors' combined participation would amount to less than 1 percent of the contract's total value.

- One other company stated that it intends to use a minority- and woman-owned small business enterprise as a subcontractor.

Three contract proposals did not contain a plan for utilizing small businesses.

Treasury Has Taken Initial Steps to Address Conflicts of Interest but Specific Policies and Procedures Have Yet to Be Established

Treasury's reliance on private sector resources to assist with implementing TARP has underscored the importance of addressing conflicts of interest issues. Treasury has taken some steps to address actual and potential conflicts of interest involving its financial agent and contractors, such as issuing interim guidelines and requiring that all those responding to solicitations provide a plan to mitigate any actual or potential conflicts of interest they or their proposed subcontractors may have. The financial agent and contractors that Treasury selected identified a variety of potential or actual conflicts of interest and proposed a variety of solutions to mitigate these conflicts. We plan to monitor closely the implementation of these mitigation plans.

Treasury Has Issued Interim Guidelines and Plans to Issue Regulations on Conflicts of Interest

On October 6, 2008, Treasury issued interim conflict of interest guidelines. The guidelines identify conflict of interest issues for contractors to consider when submitting their proposals to assist with the act's implementation. Treasury's interim guidelines

- contemplate that Treasury could obtain nondisclosure and conflict of interest agreements before supplying an offeror with a solicitation;
- encourage contractors to disclose all actual or potential conflicts of interest and develop mitigation plans;
- note that Treasury's solicitations could include evaluation factors and criteria to assess contractors' conflict of interest mitigation plans;
- restate Treasury's statutory authority and duty to oversee, evaluate, waive, negotiate, and mitigate conflicts of interest related to its contracts; and
- provide that a mitigation plan submitted in a proposal will become a binding contractual obligation.

The guidelines will remain in effect until Treasury issues the regulations that are currently being drafted.

Employees of Treasury's contractors and financial agents are not subject to the conflict of interest laws and regulations that govern the conduct of government employees. In prior work on defense contracting, GAO recommended that the Department of Defense contractually require its contractors to impose conflict of interest restrictions similar to those for federal employees on employees who were providing advice or assistance in mission-critical or in certain contracting matters.[35]

Treasury officials said that the agency intended to use existing statutory and regulatory postemployment restrictions to guide the actions of Treasury employees who might leave the agency. In addition, because these rules do not apply to employees of Treasury's contractors, Treasury's contracts awarded under TARP provide some postemployment limitations for contractors and their employees. For example, one solicitation for legal services prohibits attorneys assigned to work on the contract from representing other parties on issues related to the services performed both during the term of the contract and for 6 months thereafter.

Contractors and Agents Have Identified Potential and Actual Conflicts of Interest

For each solicitation, Treasury required respondents to identify any actual or potential conflicts of interest that they would encounter in providing the services described and to explain how they would avoid, mitigate, or neutralize any conflicts concerning the company, its corporate parents, subsidiaries, affiliates, and proposed subcontractors. Among other situations, Treasury identified areas of possible conflict for respondents to consider, including personal, business, or financial interests related to the requested services and participation in TARP. In their responses to Treasury's requirements, six of the eight service providers selected as of November 25, 2008, identified potential or actual sources of conflict. According to our review, the identified conflicts generally involve organizational conflicts of interest, though some also involve personal conflicts of interest:

[35]GAO, *Defense Contracting: Additional Personal Conflicts of Interest Safeguards Needed for Certain DOD Contractor Employees*, GAO-08-169 (Washington, D.C.: Mar. 7, 2008).

- Five contractors indicated that they either already had clients or could have clients who were receiving TARP assistance.
- One contractor indicated that a potential conflict of interest would arise if it received information proprietary to multiple clients with competing investment interests.
- One company identified conflicts regarding troubled assets owned either directly by the company or by clients that were eligible for assistance under TARP.

Contractors and Agents Have Proposed Plans to Mitigate Conflicts of Interest but Have Provided Few Details on Implementing Them

The financial agent and contractors have proposed various approaches to mitigating any actual or potential conflicts of interest. Awardees indicated that they would use their codes of conduct, company policies and procedures, senior executive meetings, confidentiality agreements, specialized information security methods, and open communication with Treasury to mitigate conflicts of interest. For example, two contractors indicated that their companies would create a secure information environment, provide training to relevant employees, and monitor their compliance with requirements. Another contractor said that it would execute nondisclosure agreements, develop a mitigation plan, provide oversight and training, and conduct regular monitoring of compliance for any conflicts of interest involving its personnel. One company proposed using a third-party agent to facilitate the sale of its troubled assets and an independent accounting firm to oversee the transfer of those assets.

The submitted plans provided few details, however, on how the companies would notify and communicate with Treasury if conflicts were identified during the course of performance:[36]

- Two firms' plans indicated that they would either maintain an "open dialog" or would "work in good faith" with Treasury should conflicts of interest emerge.
- Two other plans did not describe how the firms would address conflicts of interest or how they would notify Treasury.

[36]A recent FAR amendment, effective December 12, 2008, will require contractors to disclose promptly credible evidence of fraud and conflicts of interest to the appropriate inspector general and contracting officer. 73 Fed. Reg. 67064 (Nov. 12 2008) (to be codified at 41 C.F.R. §52-203-13(b)(3)).

By comparison, one plan indicated that the company would provide information on conflicts of interest to Treasury in its weekly reports and offer recommendations for addressing each issue.

Treasury relies on its financial agents and contractors to disclose conflicts of interest. Treasury officials stated that while under current procedures, they might not know if an agent or contractor did not disclose a conflict, they believed that the consequences for nondisclosure were sufficiently severe to deter such behavior. Finally, Treasury has noted in its solicitations that it intends to oversee and enforce compliance with conflict of interest mitigation plans. For example, Treasury noted in one of its solicitations for legal services that it would incorporate the offeror's final negotiated conflict of interest mitigation plan into the contract and then oversee and enforce the contractor's compliance with the plan. At the time we conducted our work, however, Treasury was still in the process of developing an oversight mechanism for enforcing financial agents' and contractors' mitigation plans.

OFS's Internal Control Structure Is Evolving As Program Activities Are Implemented

A key challenge facing OFS is the need to develop a comprehensive system of internal controls at the same time that it must react quickly to financial market events. Effective internal control is a major part of managing any organization to achieve desired outcomes and manage risk. As shown in table 3, GAO's Standards for Internal Control include five key elements.[37] Internal controls include the program's policies, procedures, and guidance that help management ensure effective and efficient use of resources; compliance with laws and regulations; prevention and detection of fraud, waste, and abuse; and the reliability of financial reporting. OFS has hired PricewaterhouseCoopers to assist in the design and implementation of a system of internal control for TARP.[38] Because of the rapid evolution of TARP, controls are being developed as various aspects of the program become operational. For example, once CPP became active, OFS and PricewaterhouseCoopers focused on developing and implementing internal

[37]GAO, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: November 1999).

[38]According to PricewaterhouseCoopers, it plans to use the *Committee of Sponsoring Organizations of the Treadway Commission's (COSO)–Enterprise Risk Management–Integrated Framework* as the basis for providing assistance in developing the internal control model. COSO is a voluntary private sector organization whose purpose is to help businesses and other entities assess and enhance their internal control systems. This framework is consistent with GAO's Standards for Internal Control.

controls related to the capital purchase transactions and documenting the control activities as they occurred. However, many key controls remain to be developed. Specific examples, which we noted earlier, are that OFS has not yet developed sufficient policies and processes for overseeing its contractors or overseeing whether participating institutions are adhering to the executive compensation requirements under CPP.

Table 3: GAO's Standards for Internal Control in the Federal Government

(1) *Control environment*—creating a culture of accountability by establishing a positive and supportive attitude toward improvement and the achievement of established program outcomes.
(2) *Risk assessment*—performing comprehensive reviews and analyses of program operations to determine if risks exist and the nature and extent of risks have been identified.
(3) *Control activities*—taking actions to address identified risk areas and help ensure that management's decisions and plans are carried out and program objectives met.
(4) *Information and communication*—using and sharing relevant, reliable, and timely financial and nonfinancial information in managing programs.
(5) *Monitoring*—tracking improvement initiatives over time and identifying additional actions needed to further improve program efficiency and effectiveness.

Source: GAO, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21 3.1 (Washington, D.C.: November 1999).

Going forward, it will be essential that OFS continue developing a comprehensive internal control structure that addresses all five standards.

- A strong *control environment* will depend on OFS's management's ability to set and maintain an environment based on integrity and core values and on the competence of staff hired to manage and perform program operations. As noted earlier, OFS has taken the first steps by developing an organizational structure that defines lines of authority and has begun to hire permanent staff, but OFS may need to adjust these initial steps as the focus of TARP evolves.

- A *risk assessment* for TARP will include consideration of all significant interactions between OFS and other parties, including banks receiving funds under CPP and the custodian for TARP activities, as well as internal factors that increase risk. This assessment is important, but again OFS will be challenged as the strategies developed to achieve TARP's objectives continue to evolve, a fact that could also affect the risks facing the program. Because TARP is a new and unique program dealing with unusual circumstances, the program will likely be faced with unique and complex risks.

- *Control activities* for TARP will consist of the policies, procedures, and guidance that enforce management's directives and achieve effective internal control over specific program activities. Examples of such policies and procedures particularly relevant to TARP are (1) proper execution and accurate and timely recording of transactions and events, (2) controls to ensure compliance with program requirements, (3) establishment and review of performance measures and indicators, and (4) management reviews of performance and agency achievements. As noted earlier, the development of policies and procedures is occurring concurrently with program execution, thereby increasing the risk that the programs will not be implemented as intended or that transactions will not be processed properly. Further, documented policies, procedures and guidance will be critical tools for OFS staff, many of whom have yet to be hired and were not involved in the initial transactions.

- *Information and communication* will be important to OFS managers in helping them achieve their responsibilities and goals within an effective internal control structure. Communication is particularly important because of the dynamic environment in which OFS is currently operating. OFS has begun to address external communication issues by posting information on Treasury's Web site as it becomes available, holding press conferences, speaking at industry events, and testifying at congressional hearings.

- *Monitoring activities* include the systemic process of reviewing the effectiveness of the operation of the internal control system. These activities are conducted by management, oversight boards and entities, and internal and external auditors. *Monitoring* enables stakeholders to determine whether the internal control system continues to operate effectively over time. It also improves the organization's overall effectiveness and efficiency by providing timely evidence of changes that have occurred, or might need to occur, in the way the internal control system addresses evolving or changing risks.

A robust system of internal control specifically designed to deal with the unique and complex aspects of TARP will be key to helping OFS management achieve the desired results from TARP. While OFS plans to implement such a system, there is heightened risk that without it the interests of the government and taxpayers may not be adequately protected and that the programs' objectives may not be achieved in an efficient and effective manner. Our ongoing monitoring efforts will continue to focus on the steps OFS is taking to develop and implement an effective internal control structure.

Measuring the Impact of TARP on Credit Markets and the Economy Will Be Challenging

TARP's activities could improve market confidence in banks that choose to participate and have beneficial effects on credit markets, but several factors will complicate efforts to measure any impact. If TARP is having its intended effect, a number of developments might be observed in credit and other markets over time, such as reduced risk spreads, declining borrowing costs, and increased lending. However, several factors will make isolating and measuring the impact of TARP challenging, including simultaneous changes in economic conditions, changes in monetary and fiscal policy, and other programs introduced by the Treasury, the Federal Reserve, FDIC, and FHFA to support banks, credit markets, and other struggling institutions. As a result, any improvement in capital markets cannot be attributed solely to TARP nor will a slow recovery necessarily reflect its failure because of the effects of market forces and economic conditions outside of the control of TARP. Nevertheless, we have preliminarily identified some indicators that may be suggestive of TARP's impact over time. These indicators include measures of the perception of risk in interbank lending, consumer lending, corporate debt markets, and the overall economy. We have also identified a number of other indicators that we are also monitoring and may include in future reports.

TARP Could Have a Number of Effects on Credit Markets and the Economy, but Several Factors Complicate Measuring the Impact

TARP activities as of November 25, 2008—specifically CPP—could improve market confidence in participating banks by improving their balance sheet, cash flow, and capital positions; reducing their perceived risk; and allowing them to borrow and raise capital at more favorable rates. To the extent that confidence in participating banks improves, the banks should be able to increase lending at lower rates and pass on some of their lower funding costs to their own customers. Moreover, the capital infusions could also increase the confidence of participating banks so that the banks increase business, interbank, and consumer lending rather than hoarding the capital or using it to purchase low-risk assets. However, some tension exists between the goals of improving banks' capital position and promoting lending—that is, the more capital banks use for lending, the less their overall capital position will improve.

If TARP does have its intended impact, a number of these effects should appear in credit and other markets over time. Since the first eight banks received capital injections on October 28, 2008, it may well be too early to expect noticeable changes. However, if confidence in banks improves, the perceived risk of lending to banks should decline, and this development would be observed in declining risk premiums (the difference between risky and risk-free interest rates, such as rates on U.S. Treasury securities) for interbank lending and bank debt. With an improved capital position

and lower funding costs, over time banks should be able to increase lending and pass some of their lower borrowing costs on to their customers. Further, improved market conditions may permit some borrowers to avoid foreclosures by enhancing the capacity and willingness of banks to refinance certain loans or modify others.[39] Potentially, this development would lower risk premiums for and raise volumes of consumer and business lending. Because bank financing and capital markets are close substitutes for large businesses, declines in borrowing costs from banks could also reduce borrowing costs in capital markets.[40] Over the long term, improvements in credit markets should have effects on real economic activity as lower borrowing costs boost demand for goods and services. Asset prices, such as stock prices, and risk premiums, although imperfect, are also important leading indicators of real economic activity.[41]

Changes in credit market conditions may not provide conclusive evidence of TARP's effectiveness, however, as other important policies and interventions can influence these markets. A number of government agencies, including FHFA, FDIC, Treasury (through approaches other than TARP), and the Federal Reserve have worked in a collaborative manner to attempt to restore financial stability. For example, FDIC announced that it would temporarily guarantee the senior debt of all FDIC-insured institutions and their holding companies. This guarantee may affect the interest rates on bank-issued debt and improve confidence in banks. In addition to lowering the federal funds rate and providing liquidity facilities for a range of assets and institutions, the Federal Reserve has begun intervening in the market for commercial paper, a move that is also intended to reduce the cost of borrowing in those markets. Moreover, as of November 21, the Federal Reserve had almost $900 billion in loans outstanding to financial institutions. FHFA placed Fannie Mae and Freddie Mac in conservatorship in response to their deteriorating financial condition.

[39]In an interagency statement, Treasury, FDIC, and the Federal Reserve encouraged banks and their regulators to work collectively to meet the needs of creditworthy borrowers and work with existing borrowers to avoid preventable foreclosures.

[40]Capital markets are a larger source of business borrowing than banks, but consumers and small businesses do not generally have access to capital markets.

[41]Real economic activity generally refers to measures of national income and the production of goods and services, such as gross domestic product and industrial production.

In addition, Treasury announced that, under authority provided by the Housing and Economic Recovery Act of 2008, it planned to purchase mortgage-backed securities guaranteed by Fannie Mae and Freddie Mac on the open market. As of September 30, 2008, Treasury reported that it had purchased about $3.3 billion in Fannie and Freddie MBS and intended to purchase additional securities.[42] Moreover, on November 25, 2008, the Federal Reserve announced that it was initiating a program to purchase up to $500 billion in mortgage-backed securities guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae and up to $100 billion in direct obligations of Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. According to the Federal Reserve, the action was intended to support housing markets and foster improved conditions in financial markets more generally. Because banks hold a significant amount of securities guaranteed by these institutions, which are central to liquid secondary mortgage markets, these actions may also affect investor and bank confidence and interest rates. Moreover, FHFA, in partnership with Treasury, has implemented a supplemental loan modification program for at-risk borrowers to prevent foreclosures and mitigate losses.

General market forces will also complicate a determination of TARP's effectiveness. For example:

- Recent and expected declines in general economic activity are likely to reduce lending and heighten perceived credit risk despite a host of U.S. government interventions.
- Further declines in housing prices are possible as values fall to levels consistent with incomes and rents in local areas, possibly leading to additional foreclosures, asset write-downs, and an increase in the perceived risk of banks and other financial institutions with exposure to mortgage assets.[43]
- In the face of increased risk, banks may not raise interest rates much (if at all) but instead ration credit so that only borrowers with pristine

[42]Treasury agreed to commit only up to $100 billion per government-sponsored enterprise to cover the enterprises' negative net worth.

[43]Some changes in financial markets could occur because market participants may alter their behavior based on the announcement of a program in anticipation that specific action will be taken. In other words, if market participants believe risk will decline in the future, they will charge less for that risk in the present, assuming that the announcement is credible and the program is viewed as effective.

credit receive loans. Furthermore, changes in both the supply of and demand for credit can influence interest rates, and interest rates charged by banks may also reflect the customers they choose rather than the cost of bank credit for all borrowers.

Finally, any changes attributed to TARP may well be changes that (1) would have occurred anyway, (2) are enhanced or counteracted by other market fundamentals, or (3) can be attributed to other policy interventions, such as the actions of FDIC, the Federal Reserve, or other financial regulators. For these and other reasons, we will not know what would have happened in the absence of TARP. As a result, determining the effect of TARP as it is being implemented will be a challenge.

Changes in Select Indicators over Time May Provide Insights about CPP's Impact

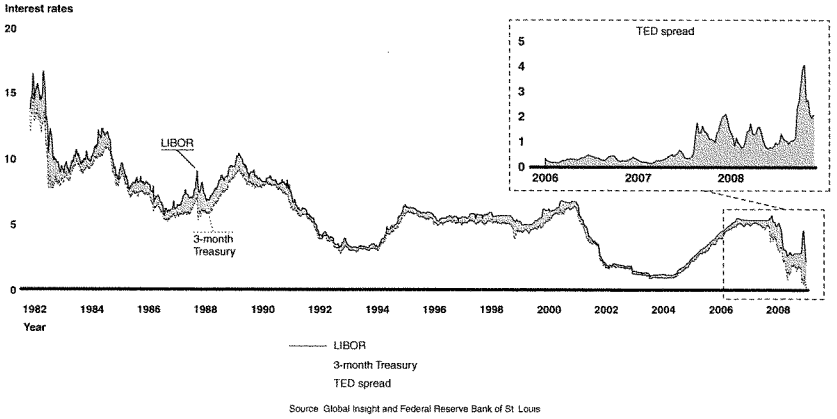
We considered a number of indicators that, although imperfect, may be suggestive of TARP's impact on credit and other markets. Currently, we have identified a number of preliminary indicators that are likely to capture interbank, mortgage, and nonbank lending activity as well as financial market risk perceptions and variables that are predictive of future real economic activity. At the very least, improvements in these measures would indicate improving conditions in credit markets. Further, given that CPP's goal is to improve the capital position of banks and promote lending, going forward we expect to monitor indicators that can provide some insight into the potential effects of the plan on capital ratios, the structure of liabilities, and net changes in lending at participating institutions. We continue to consider a variety of additional indicators, and as more data become available and as economic and credit conditions evolve, we plan to include them in future reports.

Treasury-London Interbank Offered Rate (LIBOR) Spread (TED Spread)

The TED Spread is the difference between an average of interest rates offered in the London interbank market for 3-month, dollar-denominated loans (known as LIBOR) and the interest rate on U.S Treasury bills with the same maturity. It is considered a key indicator of credit risk that gauges the willingness of banks to lend to other banks. Increases in the TED spread imply a bigger aversion to risk. That is, investors have a preference for safe investments (e.g., Treasuries) and charge a higher premium for loans to other institutions to compensate for greater perceived default risk. Figure 3 shows both the historical TED spread as well as an inset that focuses on the TED spread since 2006. The figure shows that the weekly TED spread increased to roughly 2 percentage points (or 200 basis points) in early December 2007 and

peaked at over 400 basis points for the week including October 17, 2008.[44] Between the announcement of the creation of CPP the week of October 14 and the week before Treasury disbursed capital injections to the eight banks initially participating in CPP (week of October 20), the spread declined 146 basis points. Decreases in the TED spread could reflect the fact that banks are more willing to lend to lend to other banks on terms that reflect greater confidence in the banking system (i.e., without demanding a large interest rate premium). From the date of the initial capital injections on October 28 to November 14, the TED spread declined by about 60 basis points. The LIBOR itself has declined, but so has the Treasury yield. However, during the week ending November 21, 2008, the LIBOR rate and the TED spread began to rise.

Figure 3: Three-Month LIBOR and 3-Month Treasury Bill Yield, as of November 21, 2008



Source Global Insight and Federal Reserve Bank of St Louis

Note: Rates and yields are weekly percentages. Area between LIBOR and Treasury yield is the TED spread.

[44]A basis point is a common measure used in quoting yield on bills, notes, and bonds and represents 1/100 of a percent of yield. It should be noted that while the spread is large, the actual LIBOR rate is lower than the average rate for 2005 through mid-2007.

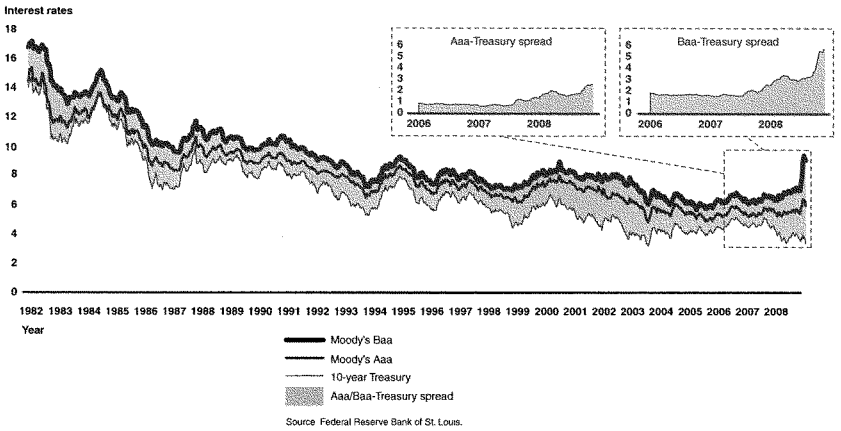
Corporate Spreads

The economywide risk premium is measured in a number of ways, most commonly as the difference (spread) between Moody's Investors Service (Moody's) Baa bond rate and Moody's Aaa rate or between these rates and the relevant government bond yield.[45] These spreads represent a premium lenders demand for taking on risk—that is, when spreads are high, market participants perceive more risk, warranting a higher rate of return. When credit market conditions improve, some narrowing of these spreads would be expected.[46] Moody's describes Aaa bonds as "of the highest quality, with minimal credit risk" and Baa bonds as "subject to moderate credit risk" that "may possess certain speculative characteristics." As shown in figure 4, the various interest rate spreads show a common pattern—an increase in negative perceptions about risk, resulting in increasing spreads as seen over the past year (as shown in the inset) and at various points in the past 25 years, including the mid-1980s and early 2000s. Declines in these spreads would be indicative of improving credit conditions, but because these spreads may have been too narrow during the period leading up to the credit market turmoil (risk was underpriced), it is not clear how much these premiums should decline. Treasury has noted that although interbank lending rates have improved, U.S. companies continue to experience difficulties in issuing long-term debt at attractive rates. As of November 21, 2008, both corporate spreads were higher than they were the week prior to the initial capital injections.

[45]Moody's Investors Service performs financial research and analysis on commercial and government entities. It also ranks the creditworthiness of borrowers using a standardized ratings scale. These spreads can also reflect a liquidity and/or prepayment premium. Moreover, some economic research also suggests that such interest rate spreads have predictive power for the real economy, although the inferences to be drawn vary across time and instruments and may send false signals.

[46]Moreover, economic research also suggests that such interest rate spreads have predictive power for several real economy variables, such as industrial production, durable orders, the unemployment rate, personal income, capacity utilization, and consumption.

Figure 4: Yields on Corporate Bonds (Aaa and Baa) Relative to 10-year Treasury



Source Federal Reserve Bank of St. Louis.

Note: Rates and yields are weekly percentages. The average for the week of November 21, 2008, is a midweek estimate.

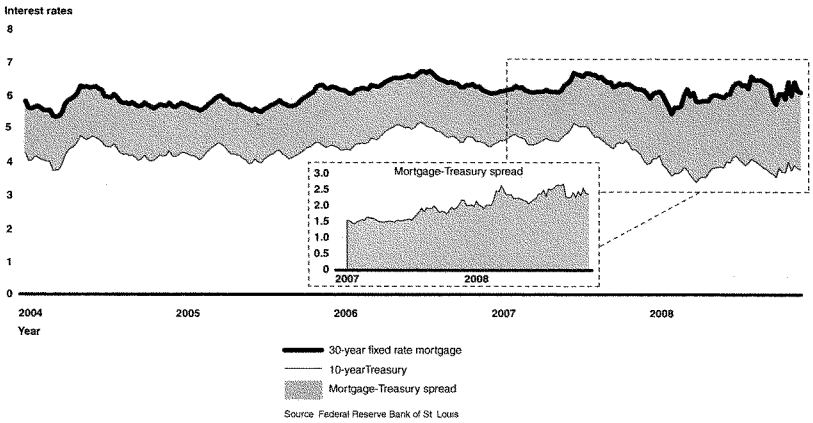
Mortgage Rates

The credit turmoil has raised concern about consumers' abilities to obtain funds, including mortgages, at rates consistent with economic fundamentals and individual risk characteristics. One of TARP's explicit goals is to enhance liquidity and promote lending to consumers, but high spreads between mortgage rates and Treasury yields indicate relatively high risk and low liquidity. Therefore, to the extent that credit and economic conditions improve, these spreads would narrow. Figure 5 shows that the weekly spread between conforming mortgage rates and Treasuries has widened significantly since 2004.[47] As shown in the inset to the figure, from October 2007 through October 2008, there was some

[47]Conforming mortgages are mortgage loans that can be purchased by Fannie Mae and Freddie Mac.

improvement in this measure since peaking in early September 2008, however, the spread increased for the week ending November 21.

Figure 5: Mortgage Rates (30-Year Fixed Rate, Conforming) and Treasury Yields, as of November 20, 2008



Source Federal Reserve Bank of St Louis

Note: Rates and yields are weekly percentages.

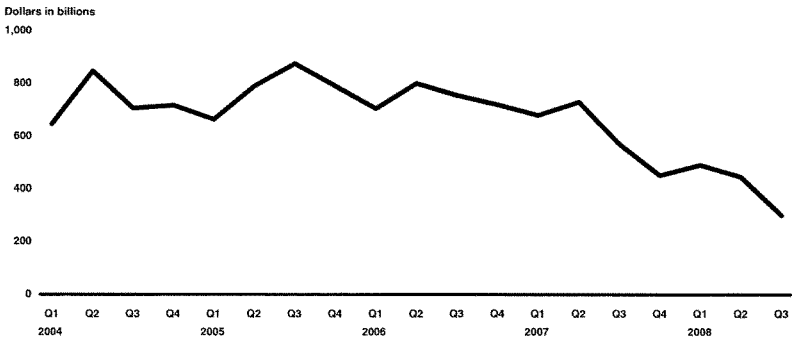
Mortgage Originations

Like other bank interest rates, mortgage rates may reflect the customers banks choose to lend to rather than the cost of credit for all potential customers. As such, the volume of new mortgage lending may also indicate the availability of credit, changes in credit risk, or demand for credit. As shown in figure 6, quarterly mortgage originations in the United States have fallen by over 50 percent since 2005.[48] While increases in mortgage interest rates have remained moderate, mortgage lending has decreased. To the extent that credit and economic conditions improve over time and interest rates remain stable, we would expect mortgage

[48]This dropoff is consistent with the change in household mortgage debt as measured by the Federal Reserve's flow of funds data.

originations to stop declining and eventually rise, although it is not clear that this measure would or should return to the level seen in the period leading up to the credit market turmoil.

Figure 6: Mortgage Originations, as of September 2008



Source: [illegible]

Note: Estimates of originations are based on information from FHA, VA, mortgage-backed securities and lenders and include refinances.

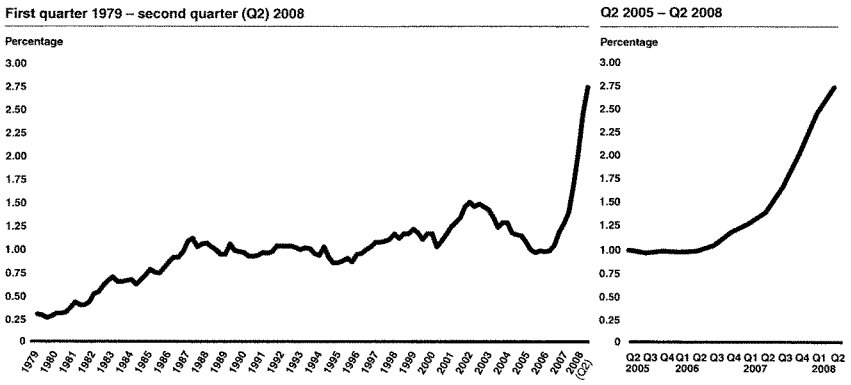
Mortgage Foreclosures and Defaults

Going forward, we also plan to report on trends in foreclosures and delinquencies. Treasury officials have urged banks to work to modify and restructure loans whenever reasonable to avoid preventable foreclosures.[49] Moreover, if CPP is effective, banks may be more able to refinance mortgage loans for creditworthy borrowers to keep monthly payments affordable. While it is too early to expect material changes in foreclosures and the most recent data preclude an assessment of trends since September 30, figure 7 establishes the historical context for continued monitoring. As the figure shows, the percentage of total loans foreclosures

[49]FDIC, Treasury, and the Federal Reserve have stated that lenders and servicers should (1) determine whether a loan modification would enhance the net present value of the loan before proceeding to foreclosure and (2) ensure that loans currently in foreclosure have been subject to such analysis.

has reached 2.75—a level unseen in recent history. As noted earlier, outside of TARP a variety of parties are taking a number of actions to address the rising foreclosure rate.

Figure 7: Percentage of Loans in Foreclosure, as of June 30, 2008



Source GAO analysis of Global Insight data

Other Financial and Credit Market Indicators May Be Useful as TARP Evolves

In addition to the preliminary indicators previously identified, we are evaluating the potential usefulness of a number of other indicators. This list is not definitive or exhaustive, and we expect to add new indicators and modify or drop others as we engage with Treasury, Federal Reserve, and other informed market participants. Moreover, some measures included may become more appropriate indicators as time progresses.

- *Prime lending rate (Federal Reserve).* The prime lending rate is an interest rate banks charge to their most creditworthy customers and usually moves with the target Fed funds rate—an overnight interbank lending rate. Many variable rate consumer loans such as credit cards are linked to the prime rate. Like mortgage rates, the prime lending rate does not necessarily indicate the cost of credit to all potential borrowers.

- *Survey of lending standards (Federal Reserve).* This survey asks senior loan officers at U.S. banks whether lending standards have tightened or eased. The most recent survey suggests a tightening in credit standards for approving applications for commercial and industrial loans. It also shows increased spreads of loan rates over banks' cost of funds, especially for riskier loans, in part because of the uncertain economic outlook, reduced tolerance for risk, and liquidity issues.

- *Commercial paper interest rates (Federal Reserve).* Interest rates on financial and nonfinancial commercial paper should be indicative of liquidity and perceptions of risk in short-term debt markets. The spread between financial commercial paper and nonfinancial commercial paper indicates the cost of raising capital for financial institutions relative to their nonfinancial counterparts.

- *Changes in assets held by commercial banks (Call Report Data).* Banks provide quarterly call report information to their regulators, including information on loan assets, among other things. This information could provide information about the quality and flow of credit.

- *Changes in household and business debt (Federal Reserve).* These are indicators of the quantity and flow of credit.

- *Stock prices (Lexis Nexis Historical Quotes).* Stock prices represent an important component of the cost of capital for publicly traded companies and impact the ability to secure loans. Stabilization of stock prices for banks participating in CPP and the financial sector in general would indicate a rebuilding of investor confidence and improve the ability of these companies to raise capital on the public market. Stock prices are also a leading indicator of real economic activity.

- *House prices (S&P/Case-Shiller, Office of Federal Housing Enterprise Oversight).* By increasing liquidity, rebuilding confidence, and lowering borrowing costs, CPP may lead to improvements in both housing prices and foreclosure rates.[50] The stabilization of housing markets is

[50]While dominant causal effect may run from housing prices to foreclosures, foreclosures can also affect prices. To the extent that at-risk borrowers are able to refinance or restructure mortgages, prices may stabilize. Similarly, price stabilization can reduce foreclosure rates. However, independent of foreclosures, housing prices may simply be returning to their fundamental values after a long period of overvaluation.

important to the valuation of MBS and other financial instruments central to current market conditions.

- *VIX (Chicago Board Options Exchange).* The VIX is a measure of expected stock market volatility over the next 30 days, calculated as an index of the prices of options on the Standard & Poor's 500 Index. It is an indicator of uncertainty about the future price of stocks and general uncertainty about the economy.

Conclusions

TARP is a new program that involves taking a number of steps to help revive the U.S. and global economies as they struggle through the current economic crisis. Given changing market conditions and the need to coordinate efforts both domestically and globally, Treasury must continue to strengthen its communication with external stakeholders, including Congress and the public, to ensure that members and the public understand Treasury's rationale for shifts in OFS's strategic direction. Because TARP is relatively new, and because the crisis makes immediate action imperative, Treasury is operating on a number of fronts concurrently. It is setting up programs and establishing oversight policies and procedures at the same time. As a result, we are seeing some lag in administrative efforts—for example, in internal controls—as the programs proceed. Treasury and the banking regulators have publicly stated that they expect participating institutions to use CPP funds in a manner consistent with the goals of the program by working to expand the flow of credit to promote sustained economic growth and modifying the terms of residential mortgages to strengthen the housing market. But Treasury has not yet set up policies and procedures to help ensure that CPP funds are being used as intended. Similarly, institutions participating in CPP are subject to specific restrictions on dividend payments or repurchasing shares as long as Treasury has preferred shares outstanding. But Treasury also has no policies and procedures in place for ensuring that the institutions are complying with these requirements or that they are using the capital investments in a manner that helps meet the purposes of the act. Although Treasury has hired a third party to help establish a system of internal controls, until control are in place to ensure that specific program requirements are met, Treasury cannot effectively hold participating institutions accountable for how they use the capital injections or provide strong oversight of compliance with the requirements under the act.

Further, while Treasury has made progress in setting up OFS, it faces a number of ongoing challenges that must be addressed. First, timely completion of hiring efforts to bring OFS up to its full complement of

staff, as well as effective succession planning for likely changes in key OFS leadership positions, is critical to ensuring the integrity of TARP both during and after the transition to the new administration. Second, Treasury has not yet finalized necessary oversight procedures for its growing number of contractors and financial agents, even though the use of time and materials contracts requires enhanced oversight of contractor performance. Third, while the financial agent and contractor arrangements will enhance Treasury's capabilities to administer TARP, the substantial reliance on the private sector raises issues related to the potential for conflicts of interest. Lacking a comprehensive and complete system to monitor conflicts of interest, Treasury runs the risk that it may not be able to ensure that conflicts are fully identified and appropriately addressed. This area is just one of several in which internal controls have yet to be established for TARP activities. While OFS is in the process of developing a comprehensive system of internal control, there is heightened risk that the interests of the government and taxpayers may not be adequately protected and that OFS may not achieve its mission in an effective and efficient manner.

Finally, evaluating the impact of Treasury's efforts under TARP, which are intended to improve conditions in credit and other markets, will be challenging for a number of reasons. As we have noted, little time has passed since the initial infusion of capital into the institutions, and a variety of other programs and efforts directed at bolstering the economy and helping homeowners are still being considered. Further, in addition to TARP, U.S. regulators as well as foreign governments continue to take a variety of actions, including many coordinated efforts, aimed at stabilizing markets and the economy. Moreover, a number of other interventions and market forces themselves will affect future developments and make it difficult to isolate the effects of any program or action, not just TARP. To facilitate our assessment of TARP's activities going forward, we have identified a number of preliminary indicators that, when viewed collectively, should signal whether TARP as well as other programs are functioning as intended. Among these preliminary indicators are interest rate spreads, mortgage rates, and mortgage originations. We also have identified other indicators that may prove useful as TARP evolves. Together, these indicators should provide additional information to policymakers and others on the overall stability of our financial markets.

Recommendations for Executive Action

We recognize that less than 60 days has passed since the program was created and the inherent difficulty of setting up any new program, especially during turbulent economic conditions. However, we have identified a number of areas that warrant Treasury's ongoing attention. Therefore, we are recommending that Treasury take a number of actions aimed at improving the integrity, accountability, and transparency of TARP. Specifically, Treasury should

- work with the bank regulators to establish a systematic means of monitoring and reporting on whether financial institutions' activities are consistent with the purposes of CPP and help ensure an appropriate level of accountability and transparency;
- develop a means to ensure that institutions participating in CPP comply with key requirements of program agreements, including those covering limitations on executive compensation, dividend payments, and the repurchase of stock;
- formalize the existing communication strategy to ensure that external stakeholders, including Congress and the public, are informed about the program's current strategy and activities as well as the rationale for changes in this strategy to avoid information gaps and shocks;
- develop a definitive transition plan by building on and formalizing ongoing activities to facilitate a smooth transition to the new administration, including ensuring that key OFS leadership positions are filled during and after the transition to the new administration;
- continue OFS hiring efforts in an expeditious manner to ensure that Treasury has the personnel needed to carry out and oversee TARP;
- ensure that sufficient personnel are assigned and appropriately trained to oversee the performance of all contractors, especially those performing under contracts priced on a time and materials basis, and move toward greater reliance on fixed-price arrangements, whenever possible, as program requirements are better defined over time;
- continue to develop a comprehensive system of internal control over TARP, including policies, procedures, and guidance for program activities that are robust enough to ensure that program's objectives and requirements are being met;
- issue final regulations on conflicts of interest involving Treasury's agents, contractors, and their employees and related entities as

expeditiously as possible, and review and renegotiate mitigation plans, as necessary, to enhance specificity and compliance with the new regulations once they are issued; and

- institute a system to effectively manage and monitor the mitigation of conflicts of interest going forward.

Agency Comments and Our Analysis

We provided a draft of this report to the Department of the Treasury for review and comment. We also provided segments of the draft report to the Federal Reserve, FDIC, OCC and OTS for review and comment. In written comments, Treasury generally agreed with the report and eight of the nine recommendations (see app. I). Treasury stated that it had taken aggressive measures to stabilize credit markets, such as investing over $150 billion in financial institutions through CPP. Treasury also said that it had made significant progress in building an infrastructure to carry out its ongoing responsibilities to develop other programs, measure risk, monitor compliance, and ensure robust internal financial controls and that our report's recommendations would be helpful in implementing the work that remained to be done in these areas. Treasury stated that it had made significant efforts to ensure transparency and good communication with external stakeholders but acknowledged that more could and would be done in these areas. Treasury agreed that it needed to develop procedures to determine whether financial institutions were complying with the requirements explicitly imposed on them in the CPP agreements and under the statute but had a different perspective from our recommendation on what should be done to evaluate how institutions were using funds received under CPP. Treasury said that it would welcome further discussion on general metrics for evaluating the overall success of CPP in addressing the purposes of the act. In technical comments, the Federal Reserve also expressed concern about whether Treasury needed to monitor individual institutions' use of CPP funds, because data from any single institution would not indicate that the program's goals had been achieved. Instead, achievement of the goals would be reflected in the level of functioning of the financial marketplace as a whole.

As discussed in the draft, we agree that it will be important to develop a range of metrics to evaluate the overall success of CPP, and we welcome continued discussions with Treasury and the regulators on general metrics to achieve this purpose. However, given the magnitude of funds provided to this program, these types of metrics alone will not provide the

necessary transparency and accountability needed to ensure that participating institutions are using the funds in a manner that is consistent with the purposes of the act. As stated in the report, Treasury should build on the existing oversight mechanisms of the banking regulators to minimize any additional regulatory burden and develop a means for reviewing and reporting on planned and actual actions taken by participating financial institutions that result from the additional funding received through CPP. Obtaining such information could help Treasury better monitor participating institutions' activities and provide an appropriate level of accountability and transparency. Moreover, the information could also feed into an overall assessment of the effect of TARP in restoring liquidity and stability to the financial system. Treasury, the Federal Reserve, FDIC, OCC, and OTS also provided technical comments that we incorporated in the report, as appropriate.

We are sending copies of this report to other interested congressional committees and members, Treasury, the federal banking regulators, and others. The report also is available at no charge on the GAO Web site at http://www.gao.gov.

If you or your staff have any questions about this report, please contact Richard J. Hillman at (202) 512-8678 or hillmanr@gao.gov, Thomas J. McCool at (202) 512-2642 or mccoolt@gao.gov, or Orice M. Williams at (202) 512-8678 or williamso@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix II.

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Acting Comptroller General
of the United States

The Honorable Robert C. Byrd
Chairman
The Honorable Thad Cochran
Ranking Member
Committee on Appropriations
United States Senate

The Honorable Christopher J. Dodd
Chairman
The Honorable Richard C. Shelby
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable Kent Conrad
Chairman
The Honorable Judd Gregg
Ranking Member
Committee on the Budget
United States Senate

The Honorable Max Baucus
Chairman
The Honorable Charles E. Grassley
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The Honorable David R. Obey
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The Honorable John M. Spratt, Jr.
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Committee on Financial Services
House of Representatives

The Honorable Charles B. Rangel
Chairman
The Honorable Jim McCrery
Ranking Member
Committee on Ways and Means
House of Representatives

Appendix I: Comments from the Department of the Treasury

ASSISTANT SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

November 28, 2008

Mr. Thomas J. McCool
Director, Center for Economics,
Applied Research and Methods
U.S. Government Accountability Office
441 G Street, N.W
Washington, D.C. 20548

Dear Mr. McCool:

Thank you for the opportunity to review the draft report entitled *Troubled Assets Relief Program: Additional Actions Needed to Better Ensure Integrity, Accountability, and Transparency*. The draft report fairly summarizes Treasury's progress in implementing the Emergency Economic Stabilization Act of 2008 (EESA), and we agree with the draft report's recommendations, except as noted below.

Less than 60 days have elapsed since Congress passed and the President signed EESA into law. During this short time, Treasury has taken aggressive measures to stabilize credit markets. We designed and implemented the Capital Purchase Program (CPP) to inject equity into healthy financial institutions, drawing upon the judgment and expertise of bank regulators. To date, we have invested over $150 billion in financial institutions (banks and savings institutions and their holding companies). Treasury also instituted a program to address the risks posed by systemically significant failing institutions. At the same time, Treasury has made significant progress building an infrastructure that will carry out our ongoing responsibility to develop other programs, measure risk, monitor compliance, and ensure robust internal financial controls. The draft report acknowledges Treasury's progress in these areas and makes helpful recommendations about the work that remains to be done.

We agree with the recommendations directed at building an Office of Financial Stability that is well-staffed and well-trained. We also agree that Treasury must continue to develop its internal controls, procedures, and policies for program activities. We believe that Treasury has made significant efforts to ensure transparency and good communication with our external stakeholders, but more can and will be done in these areas.

Treasury also agrees with the recommendation that it should develop means to determine whether financial institutions are complying with the requirements explicitly imposed on them in our purchase agreements and under the statute. We have a different perspective, however, on what is needed to evaluate how individual institutions participating in the CPP are spending the funds they receive under the program. Treasury designed the capital purchase program to further the goals of EESA, which included a number of

2

requirements applicable to individual financial institutions. Treasury is developing compliance programs for these requirements, and welcomes further discussion on general metrics for evaluating the overall success of the capital purchase program in addressing the purposes of EESA.

Thank you again for the work that went into this draft report and the opportunity to comment on it. We appreciate the cooperation you have extended to us in implementing this important legislation.

Sincerely,

Neel Kashkari
Interim Assistant Secretary
Office of Financial Stability

Appendix II: GAO Contacts and Staff Acknowledgments

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December 10, 2008

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The Honorable Spencer Bachus
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The Honorable Richard Shelby
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The Honorable Paul Kanjorski
Chairman
Subcommittee on Capital Markets, Insurance
and Government Sponsored Enterprises
2129 Rayburn House Office Building
Washington, DC 20521

Dear Chairmen and Ranking Members:

As part of your ongoing oversight of the financial sector and the Emergency Economic Stabilization Act of 2008 (EESA), I'd like to inform you of the significant role life insurers play in the capital and credit markets, our nation's economy, and why some life insurers desire to participate in the Treasury's Capital Purchase Program.

Life insurers play a unique role in America's financial landscape. In many ways, America's life insurers are the wholesale providers of credit, providing financing to America's businesses, while banks and other financial institutions have traditionally served retail clients.

Life insurers have played this role for many years, serving as one of the nation's largest providers of long term investment capital, vital to the success of the economic recovery. As of year end 2007, assets held by life insurers totaled some $5.1 trillion, with approximately 38% invested in corporate bonds. Indeed, life insurers are the single largest U.S. source of corporate bond financing.

Life insurers are in the business of long term protection through such products as life insurance, annuities with guaranteed lifetime income and long term care insurance. As a result, life insurers invest in assets with extended durations that match the extended nature of their obligations. More than 42% of

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the corporate bonds purchased by life insures have maturities in excess of 20 years and the average maturity of all corporate bonds held by life insurers is 17 years.

The stated purpose of Capital Purchase Program is to encourage U.S. financial institutions to build capital to increase the flow of financing to U.S. businesses and consumers and to support the U.S. economy. Given the investment activities of life insurance companies described above, these companies' participation in the Capital Purchase Program is not only appropriate on its face but also an initiative that would further that program's objective of helping lift the nation out of the economic crisis.

As your committees examine ongoing efforts to stabilize the economy and consider steps to reform our financial regulatory system, it is important to keep in mind the sharp distinctions between the life and property casualty insurance businesses. The economic foundations of these two industry segments, including their investment operations, are markedly different. One consequence of these differences is the involvement of life but not property casualty insurance companies in the Capital Purchase Program. Another is the fact that life insurance companies and agents are strongly united in their commitment to insurance regulatory reform, with an optional federal charter a top priority in that regard.

Thank you for the opportunity for me to elaborate upon our life insurance industry's unique perspective during these difficult economic times and we look forward to working closely with you in the next Congress.

Sincerely,

Frank Keating

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December 2, 2008

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Washington, DC 20510

The Hon. Paul Kanjorski
Chairman
Subcommittee on Capital Markets, Insurance
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2129 Rayburn House Office Building
Washington, DC 20521

Dear Chairmen and Ranking Members:

The American Insurance Association (AIA), the nation's leading trade association of property-casualty insurers, is writing to provide a property-casualty perspective on the recently-enacted Emergency Economic Stabilization Act of 2008 (EESA) and Treasury's implementation of EESA, as well as related initiatives by the Federal Reserve and the Federal Deposit Insurance Corporation. AIA supported the need for enactment of EESA to stabilize the financial markets and the U.S. economy, as well as its inclusive definition of financial institutions to ensure the maintenance of a level competitive playing field. As these federal initiatives have evolved and government intervention in the market as business owner becomes more prevalent, Congress must exercise its oversight responsibility to ensure that the limited purposes of these initiatives do not result in outcomes that distort private markets and create conflicts with the government's role as market regulator.

For the property-casualty industry, government's role as market participant during the current crisis has been signified by the Federal Reserve's intervention with AIG and by the Treasury's creation of a Capital Purchase Program (CPP) under which it has designated $250 billion for qualified financial institutions in the form of equity stakes. As we understand it, the purposes of these actions were to provide capital to those financial institutions to increase liquidity and to deal with systemic risks to the financial system resulting from counterparty failure.

With respect to the CPP, on October 27, after surveying the members of our Board of Directors, AIA released a public statement noting that a substantial majority of the AIA Board members do not support the inclusion of property-casualty insurers in Treasury's CPP and that those members would elect not to participate in the CPP even if it were made available.

AIA's views are informed by the principles involved when government decides to provide subsidized capital to companies and to take ownership positions in them, and the risks and benefits that must be carefully balanced and managed in carrying out these programs. When the government functions as a market participant, rather than as a regulator, it is particularly important to ensure that government-subsidized capital is used for well-defined and tightly-controlled purposes that flow from the unavailability of private market capital for those purposes. In the case of the CPP, the governmental focus has been on restoring liquidity to frozen credit markets and, with the Federal Reserve rescue of AIG, the emphasis was on providing stability to an institution determined to pose a systemic risk to the broader capital markets. If the government does not ensure that the provision of capital tracks with these underlying purposes, that capital may be used for other unintended purposes such as gaining market share of financial institutions that are accessing private capital at market rates, presenting a substantial risk of market distortion.

The potential for private market distortion grows where government provides subsidized capital in exchange for an ownership stake in private companies. As it exercises oversight responsibility, Congress must ensure that government ownership of private companies does not produce regulatory policy at the state or federal level that gives those institutions a marketplace advantage over their competitors as government seeks to protect its investment.

In addition, there is a significant risk that the provision of subsidized government capital will perpetuate the view among companies that access to that capital is essential to keep pace with market competition. The number of companies and industry sectors now seeking access to government capital under EESA provides strong evidence that this concern is justified, as institutions may feel compelled to participate in a dramatically discounted alternative to the capital markets. If this happens, the fundamental purpose behind these government programs gives way to the misperception that government is needed as a permanent market participant in order to maintain the level of competition, rather than to provide emergency stabilization of the economy as a whole.

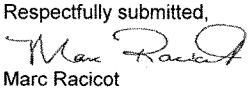
The insurance industry has historically been one of the most competitive sectors of the U.S. economy, and a major point of that competition is accessing available private capital through navigation of market forces. While government infusion of taxpayer capital at below-market rates in exchange for partial ownership may be one response to market-wide problems, it must neither be permitted to disrupt and distort those normal market forces that are the hallmarks of competition among private enterprises, nor should it be allowed to turn a "crisis correction" mechanism into an ongoing government subsidy program that erodes private markets and perpetuates government involvement in those markets. Both Congress and the federal agencies administering these initiatives have a duty to ensure that these risks do not become reality.

Equally important, and as part of its ongoing oversight of the financial sector, we urge Congress to closely examine the financial services regulatory framework to determine whether the state-by-state system of insurance regulation is capable of protecting consumers from widespread financial market crisis, and whether certain rigidly-applied accounting standards actually contributed to market dysfunction. We do not view this as a Congressional exercise designed to identify regulatory scapegoats, but instead as an examination of the inherent limitations and regulatory gaps that exist today and must be corrected going forward. As insurers, we have been regulated on a state-by-state basis pursuant to differing and often inconsistent regulatory standards. AIA, along with our colleagues at the American Council of Life Insurers, have long supported the National Insurance Act (NIA), and we believe that this legislative vehicle deserves serious consideration with respect to any federal oversight of insurance. The NIA would have allowed the federal insurance commissioner to serve as a single national voice during this crisis. More specifically, it would have given the commissioner the ability to review the financial statements of all insurance and non-insurance affiliates within a financial holding company structure, as long as a single insurance affiliate was federally chartered. While this may not have averted the current crisis, it certainly would have provided an additional oversight and coordination mechanism that does not exist today, and cannot exist under the current insurance regulatory structure.

Finally, as regulatory functions and standards are examined, it is critical to address strict application of the fair value accounting standard in the current market environment. Alternative approaches for determining fair value must be developed to allow companies flexibility to adapt to changing and dysfunctional markets. FAS 157 did not cause the current turmoil in the capital markets. However, its application has contributed to a series of actions that have now led to serious disruptions in the markets for certain securities.

We appreciate the opportunity to provide our views on the government response to the financial turmoil, the potential dangers of government intervention in markets, and the need to unite behind an improved regulatory framework for the financial sector. AIA looks forward to participating in the debate before Congress and advancing the property-casualty perspective, as we strive for stable, healthy, efficient, and well-regulated capital markets that promote competition and work to the benefit of all Americans. In this regard, we respectfully request that this letter be made part of the record at the next available and relevant opportunity.

Respectfully submitted,



Marc Racicot
President

Congress of the United States
Washington, DC 20515

December 5, 2008

The Honorable Henry M. Paulson, Jr.
Secretary of the Treasury
United States Department of Treasury
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Room 3330
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The Honorable Gene L. Dodaro
Acting Comptroller General
Government Accounting Office
441 G Street, NW
Room 7100
Washington, DC 20548

Dear Secretary Paulson and Acting Comptroller Dodaro:

As members of the Financial Services Committee, we are writing to follow up on our recent hearing and to further inquire regarding our concerns that the U.S. Department of Treasury and the GAO may not have the necessary technological tools to provide the Congress and the taxpayers with the appropriate transparency called for in the Emergency Economic Stabilization Act of 2008, specifically relating to Section 114(b) and Section 116.

Now that the United States taxpayers are taking an equity position in the financial institutions, we believe there needs to be specific additional information provided to Congress to enable the Congressional oversight which is contemplated by the EESA and to create the requisite transparency and confidence in the overall process. We want to ensure that your agencies have the appropriate technological tools and information to conduct real-time review of the ongoing activities and performance of Troubled Assets Relief Program (TARP) and make that information promptly available to the Congress.

In order to properly monitor the program and ensure that taxpayer funds are being used appropriately, it will be necessary for all the publicly available data for the relevant agencies (e.g. including the SEC, FDIC, CFTC, OCC, etc.) as well as private sector data to be compared to the regulatory information to insure the proper compliance with disclosure laws. We also want to ensure that there is complete disclosure of all securitized instruments in order to fully understand the real exposure of troubled institutions. These comparisons and disclosure must be done in a standardized format to enable meaningful review and oversight.

Do your agencies have the ability to combine private sector and government data collected by multiple agencies together in a standardized format? Do your agencies have the ability to gather this information in real time and in a standardized format so that your agencies and the Congress can ensure that any inappropriate activities are flagged and investigated?

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Please provide us with each of your agencies' plans and ability for providing the type of comprehensive, timely analysis described above. If that capability does not currently exist, please inform us of your plans for doing so and the time frame in which you intend to implement these plans.

Sincerely,

Carolyn B. Maloney
Chair,
Subcommittee on Financial Institutions
and Consumer Credit

Gregory Meeks
Member of Congress

Melissa Bean
Member of Congress

Dennis Moore
Member of Congress

Questions About the $700 Billion Emergency Economic Stabilization Funds

The First Report of the
Congressional Oversight Panel for Economic Stabilization

December 10, 2008

Congressional Oversight Panel for Economic Stabilization

Panel Members

Elizabeth Warren, Chair

Rep. Jeb Hensarling[1]

Richard H. Neiman

Damon Silvers

[1] Rep. Hensarling did not approve this report. See Press Release, Hensarling Statement on First Congressional Oversight Panel Report, Office of Representative Jeb Hensarling (R-TX), Dec. 9, 2008.

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INTRODUCTION

The U.S. and the global economy have been in a steadily accelerating downward spiral since the early spring of 2007. The American family is at the epicenter of this crisis.

The headlines may belong to the financial markets and mega-institutions, but the recession has visited every household in the country. The crisis affects Americans' ability to pay their bills, to secure their retirement, to continue their educations, and to provide for their families. The unemployment rate is the highest it has been in fourteen years.[2] In the last three months, 1.2 million Americans lost their jobs; 533,000 in November, 2008 alone.[3] Service sector employment levels, in particular, fell far faster than expected last month.[4] One in ten mortgage holders is now in default, unable to make payments on their homes.[5] More than 200,000 families and small businesses filed for bankruptcy protection in the last two months.[6] Middle and lower-income families have watched nervously as reductions in state funding threaten college access and affordability.[7] Retail sales continue to fall,[8] credit card defaults are rising,[9] and savings rates hover at zero.[10] Shrinking retirement funds have left millions of retired people to wonder how they will pay basic expenses and millions more to wonder if they must continue working until they die.[11]

A short summary of the economic history of the past few months is grim.

- Credit, when it is available, has become dramatically more expensive for all borrowers, and some worry it will get even more expensive next year.[12]

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[2] Peter S. Goodman, U.S. Jobless Rate Hits 14-Year High, N.Y. TIMES, Nov. 8, 2008, at A1.
[3] Sudeep Reddy et al., Job Losses Worst Since '74: 533,000 Shed in November, WALL ST. J., Dec. 6, 2008, at A1.
[4] Ellen Simon, Service Sector Shrinks As New Orders Fall In Nov., ASSOCIATED PRESS, Dec. 3, 2008, *available at* http://news.yahoo.com/s/ap/20081203/ap_on_bi_ge/economy_services.
[5] James R. Hagerty & Deborah Soloman, U.S. News: Rising Number of Homeowners in Trouble, WALL ST. J., Dec. 6, 2008, at A2.
[6] Caroline Humer, Consumer Bankruptcy Filings Jump Vs Year Ago, REUTERS, Dec. 3, 2008, *available at* http://www.reuters.com/article/domesticNews/idUSTRE4B25U620081203.
[7] Robert Tomsho, For College-Bound, New Barriers to Entry – Their Budgets Squeezed, State Schools Cap Enrollment, Weight Tuition Increases; Fears for Lower-Income Students, WALL ST. J., Dec. 3, 2008, at D1.
[8] Stephanie Rosenbloom, In November, Shoppers Cut Spending Even More, N.Y. TIMES, Dec. 3, 2008, at B6.
[9] Kristina Dell, With Defaults Rising, Is a Credit-Card Crisis Looming, Nov. 14, 2008, TIME, *available at* http://www.time.com/time/business/article/0,8599,1859224,00.html.
[10] Henry Kaufman, How the Credit Crisis Will Change the Way America Does Business, WALL ST. J., Dec. 6, 2008, at A11.
[11] Robert Powell, Crisis Forces About One-In-Five Savers To Tap Retirement Assets, MARKETWATCH, Dec. 4, 2008, *available at* http://www.marketwatch.com/news/story/crisis-forces-about-one-in-five-savers/story.aspx?guid=B2F244D0-CC95-4906-AF0F-4B8CB7AC2220.
[12] See John M. Berry, Borrowers Elbow for Position, BLOOMBERG.COM, Dec. 4, 2008, *available at* http://www.bloomberg.com/apps/news?pid=20601039&refer=columnist_berry&sid=aohbHGXFYtKU.

- U.S. stock markets have lost more than 40% of their value over the past year, and markets elsewhere in the world have also declined sharply.[13]

- In September, the federal government took control of the two largest mortgage financing intermediaries, generally known as Fannie Mae and Freddie Mac.

- All three major U.S.-based auto companies have told Congress they face the threat of imminent bankruptcy.

- The largest U.S. commercial bank, Citigroup, and the largest U.S. insurance company, AIG, have both received substantial infusions of capital from the U.S. government, with AIG under threat of imminent bankruptcy.

- Two major investment banks, Bear Stearns and Merrill Lynch, have disappeared in mergers. One major investment bank, Lehman Brothers, has filed for protection under the bankruptcy laws. The two largest remaining investment banks, Goldman Sachs and Morgan Stanley, have transformed themselves into bank holding companies.

- The largest thrift savings banks, Washington Mutual and IndyMac, have been taken over by their regulator.

- The Federal Deposit Insurance Corporation has placed 171 banks, with combined assets of $116 billion, on the problem list as of September 30, 2008.[14]

In response to the financial crisis, Congress passed the Emergency Economic Stabilization Act of 2008, authorizing the Treasury Department to commit up to $250 billion in taxpayer dollars, to be followed by another $100 billion and another $350 billion if warranted.[15] The statute also created a Congressional Oversight Panel.[16] The Act's purposes are to "restore liquidity and stability to the financial system of the United States . . . in a manner that (A) protects home values, college funds, retirement accounts, and life savings; (B) preserves homeownership and promotes jobs and economic growth; (C) promotes overall returns to the taxpayers of the United States; and (D) provides public accountability."[17]

From the passage of the Emergency Economic Stabilization Act of 2008 to the present date, Treasury has used its authority under the Act to provide 87 banks with $165 billion in exchange for preferred stock and warrants. Treasury further used its authority to provide AIG with $40 billion in exchange for preferred stock and warrants, and to provide Citigroup with a further $20 billion in preferred stock and warrants. As part of a

[13] See, e.g., Dow Jones Industrial Average, MSN MONEY, *available at* http://moneycentral.msn.com/investor/charts/chartdl.aspx?Symbol=%24indu.Dow.

[14] Quarterly Banking Profile: Third Quarter 2008, FDIC 3 *available at* http://www2.fdic.gov/qbp/2008sep/qbp.pdf.

[15] Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343 §115 (Oct. 3, 2008).

[16] Id., at § 125.

[17] Id., at § 2.

program to guarantee approximately $306 billion in Citigroup's troubled assets, Treasury receives $4 billion of Citigroup preferred stock and warrants.[18] Together, these disbursements constitute approximately $1,900 per American family, or almost 3% of the typical family's pre-tax income.[19]

This is not the full extent of the federal government's actions to date. Treasury has worked in coordination with the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System and other financial regulators. The Federal Reserve has injected trillions of dollars of liquidity into the financial system, dwarfing by an order of magnitude expenditures by Treasury under the Act.[20]

This is the first report of the Congressional Oversight Panel. We are here to investigate, to analyze and to review the expenditure of taxpayer funds. But most importantly, we are here to ask the questions that we believe all Americans have a right to ask: who got the money, what have they done with it, how has it helped the country, and how has it helped ordinary people?

These questions, in greater detail, form the heart of this report.

This report, issued two weeks after the Oversight Panel's first meeting, does not attempt to answer the questions Congress and the American people have about the use of the powers granted to Treasury under the Emergency Economic Stabilization Act of 2008. Rather we seek to pose those questions clearly in the context of the events that have occurred since the adoption of the Act in October. In doing so, we intend to set the agenda for our future work and to advise the Congress as to the issues that it will need to address in the next Administration.

In framing these questions, the Oversight Panel has benefited from its consultations with Treasury, Treasury's Inspector General, the Government Accountability Office, and the staff of the Federal Reserve Board. We intend to consult with the newly appointed Special Inspector General as soon as possible.[21] The Oversight Panel in particular has benefited from the report of the Government Accountability Office on the implementation of the Emergency Economic Stabilization Act of 2008, dated December 2, 2008.[22]

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[18] Capital Purchase Program Transaction Report, Nov. 25, 2008 *available at* http://www.treas.gov/initiatives/eesa/docs/TransactionReport-11262008.pdf; id.; Summary of Terms, Nov. 23, 2008 *available at* http://www.treas.gov/press/releases/reports/cititermsheet_112308.pdf; see also Troubled Asset Relief Program: Additional Actions Needed to Better Ensure Integrity, Accountability, and Transparency, GAO, 09-161, December 2008, at 16-20, 28.

[19] See Current Population Survey, 2007 Social and Economic Supplement, Table HINC-06, U.S. Census Bureau, *available at* http://pubdb3.census.gov/macro/032007/hhinc/new06_000.htm.

[20] The Fed's evolving liquidity toolkit, REUTERS, Dec. 2, 2008, *available at* http://www.reuters.com/article/bondsNews/idUSN2635039920081202?sp=true.

[21] Paul C. Light, Senate Confirms N.Y. Prosecutor As Inspector General for Bailout, WASH. POST, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2008/12/08/AR2008120803538.html

[22] Troubled Asset Relief Program: Additional Actions Needed to Better Ensure Integrity, Accountability, and Transparency, GAO, 09-161, December 2008.

In the months to come the Congressional Oversight Panel – COP – will do its best to guarantee that public actions are built on robust foundations that will strengthen the real economy. The American people have an important role to play in this process. As we continue our work on behalf of Congress and the American people, we will issue monthly reports. But we will always return to the American people, searching for answers and asking more questions.

TEN QUESTIONS FROM COP

1. **What is Treasury's Strategy?** What does Treasury think the central causes of the financial crisis are and how does its overall strategy for using its authority and taxpayer funds address those causes? What specific facts caused Treasury to change its strategy in the last two months? What specific facts changed that made the purchase of mortgage-backed assets a bad idea within days of the request and what specific facts changed again to make guaranteeing such assets a good idea a few weeks later?

2. **Is the Strategy Working to Stabilize Markets?** What specific metrics can Treasury cite to show the effects of the $250B spent thus far on the financial markets, on credit availability, or, most importantly, on the economy? Have Treasury's actions increased lending and unfrozen the credit markets or simply bolstered the banks' books? How does Treasury expect to achieve the goal of price discovery for impaired assets? Why does Treasury believe that providing capital to all viable banks, regardless of business profile, is the most efficient use of funds?

3. **Is the Strategy Helping to Reduce Foreclosures?** What steps has Treasury taken to reduce foreclosures? Have those steps been effective? Why has Treasury not generally required financial institutions to engage in specific mortgage foreclosure mitigation plans as a condition of receiving taxpayer funds? Why has Treasury required Citigroup to enact the FDIC mortgage modification program, but not required any other bank receiving TARP funds to do so? Is there a need for additional industry reporting on delinquency data, foreclosures, and loss mitigations efforts in a standard format, with appropriate analysis? Should Treasury be considering others models and more innovative uses of its new authority under the Act to avoid unnecessary foreclosures?

4. **What Have Financial Institutions Done with the Taxpayers' Money Received So Far?** What have the companies who received money from Treasury done with the money? Have the companies used the funds in the way Treasury intended when it disbursed them? How

have institutions supported under the Capital Purchase Program used their funds, and they have they leveraged the capital support to increase lending activity? Is this different from the way funds were utilized for institutions who received funds pursuant to the Systemically Significant Failing Institutions plan?

5. **Is the Public Receiving a Fair Deal?** What is the value of the preferred stock Treasury has received in exchange for cash infusions to financial institutions? Are the terms comparable to those received in recent private transactions, such as those with Warren Buffett and the Abu Dhabi Investment Authority?

6. **What is Treasury Doing to Help the American Family?** Does Treasury believe American families need to borrow more money? Have Treasury's actions preserved access to consumer credit, including student loans and auto loans at reasonable rates? What restrictions will Treasury put on credit issuers to assure that taxpayer dollars are not used to subsidize lending practices that are exploitive, predatory or otherwise harmful to customers? What is Treasury doing to ensure that its spending is directed in ways that maximize the impact on the American economy?

7. **Is Treasury Imposing Reforms on Financial Institutions that are taking Taxpayer Money?** Congress has told the auto industry to reform its current practices before it could be considered for taxpayer aid and the British are requiring reforms on their banks as a precondition for capital infusions. Has Treasury required banks receiving aid to:

    - Present a viable business plan;
    - Replace failed executives and/or directors;
    - Undertake internal reforms to prevent future crises, to increase oversight, and to ensure better accounting and transparency;
    - Undertake any other operational reforms?

8. **How is Treasury Deciding Which Institutions Receive the Money?** What factors is Treasury using to determine which institutions receive equity infusions, purchase of portfolio assets, or insurance of portfolio

assets? Is Treasury seeking to use TARP money to shape the future of the American financial system, and if so, how?

9. **What is the Scope of Treasury's Statutory Authority?** What is Treasury's understanding of the statutory limits on its use of funds? How does Treasury justify its decisions under the Act in relation to its view of these limits? How is Treasury carrying out its statutory mandate regarding credit insurance?

10. **Is Treasury Looking Ahead?** What are the likely challenges the implementation of the Emergency Economic Stabilization Act will face in the weeks and months ahead? Can Treasury offer some assurance that it has worked out contingency plans if the economy suffers further disruptions?

TEN QUESTIONS FROM COP: DISCUSSION

1. **What is Treasury's Strategy?** What does Treasury think the central causes of the financial crisis are and how does its overall strategy for using its authority and taxpayer funds address those causes? What specific facts caused Treasury to change its strategy in the last two months? What specific facts changed that made purchase of mortgage-backed assets a bad idea within days of the request and what specific facts changed again to make guaranteeing such assets a good idea a few weeks later?

Treasury has pursued a number of strategies using its authority under the Emergency Economic Stabilization Act:

- Strategy 1: Buying Mortgage-Related Assets. In September 2008, Secretary Paulson requested authority for Treasury to buy up to $700 billion in troubled mortgage-related assets.[23] According to the Secretary, purchasing the assets would reduce systemic risk and increase confidence in institutions holding these "toxic assets." Although Congress granted Treasury the authority to execute this plan on October 3, Treasury did not act on this authority.[24]

- Strategy 2: Purchasing Preferred Stocks and Warrants to increase the capital base of banks. On October 14, Treasury announced a plan to invest up to $250 billion into financial institutions in exchange for preferred stocks and warrants in order to "significantly strengthen financial institutions and improve their access to funding, enabling them to increase financing of the consumption and business investment that drive U.S. economic growth."[25] Treasury indicated that it still intended to make purchases of mortgage-related assets from financial institutions.[26]

- Strategy 3: On November 12, Treasury announced that it would not purchase troubled mortgage-related assets, as it had asked for authority to do in September.[27] Instead, Secretary Paulson stated that Treasury was considering

[23] Press Release, FACT SHEET: Proposed Treasury Authority to Purchase Troubled Assets, Sept. 20, 2008, *available at* http://www.treas.gov/press/releases/hp1150.htm.
[24] See GAO Report, supra note 17, at 1, 15-16.
[25] Press Release, Statement by Secretary Henry M. Paulson, Jr., on Actions to Protect the U.S. Economy, Department of Treasury, Oct. 14, 2008, *available at* http://www.treasury.gov/press/releases/hp1205.htm; see also Mark Lander, U.S. Investing $250 Billion in Banks; Dow Surges 936 Points, N.Y. TIMES, Oct. 14, 2008, at A1.
[26] GAO Report, supra note 17, at 16.
[27] See Press Release, Statement by Secretary Henry M. Paulson on Financial Rescue Package and Economic Update, Department of Treasury, Nov. 12, 2008, *available at* http://www.treasury.gov/press/releases/hp1265.htm.

programs that would allow non-bank financial institutions to participate in the CPP if they secure an equivalent amount of capital from private investors and providing federal financing to allow private investors to purchase asset-backed securities.[28]

- Strategy 4: On November 25, Treasury announced it would participate in the Federal Reserve's Term Asset-Backed Securities Loan Facility (TALF), a $200 billion program that would provide financing to investors of highly rated asset-backed securities, focused on student and auto loans, credit card debt, and small business loans.[29] According to Secretary Paulson's statement announcing the program, "[b]y providing liquidity to issuers of consumer asset-backed paper, the Federal Reserve facility will enable a broad range of institutions to step up their lending, enabling borrowers to have access to lower cost consumer finance and small business loans."[30]

- Other Strategies: It has been widely reported that Treasury is considering a plan to support the issuance of new mortgages at a 4.5% interest rate through mortgage-backed securities of Fannie Mae and Freddie Mac, which should enable some consumers to purchase homes.[31] In addition, Treasury has stated it is considering other strategies, such as FDIC Chairman Sheila Bair's proposal for restructuring residential mortgages, streamlined loan modification programs for at-risk borrowers, and guarantee of loan modifications by private lenders.[32]

In empowering Treasury, Congress provided substantial flexibility in the use of funds so Treasury could react to the fluid and changing nature of the financial markets. With these powers goes a responsibility to explain the reasons for the uses made of them. With these monies go a responsibility to ensure that the support to the economy from each dollar spent is maximized consistent with the purposes of the Act. We ask Treasury to articulate its vision of the problem, its overall strategy to address that problem, and how its strategic shifts in since September 2008 fit into that overall strategy.

For example, efforts to increase the availability of credit assume that the fundamental problem is a lack of liquidity. But if Americans are more worried about their own economic security – their employment prospects, their current expenses, and their debt levels – then increasing liquidity will have little impact on consumer spending.

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[28] See Press Release, Statement by Secretary Henry M. Paulson on Financial Rescue Package and Economic Update, Department of Treasury, Nov. 12, 2008, *available at* http://www.treasury.gov/press/releases/hp1265.htm.

[29] GAO Report, supra note 17, at 31; Press Release, Federal Reserve, Nov. 25, 2008, *available at* http://www.federalreserve.gov/newsevents/press/monetary/20081125a.htm.

[30] Press Release, Secretary Paulson Remarks on Consumer ABS Lending Facility, Department of Treasury, Nov. 25, 2008, *available at* http://www.treasury.gov/press/releases/hp1293.htm.

[31] See, e.g., Edmund L. Andrews, Washington's New Tack: Helping Home Buyers, N.Y. TIMES, Dec. 5, 2008, *available at* http://www.nytimes.com/2008/12/05/business/05housing.html; Robert Schmidt & Dawn Kopecki, Paulson Considers New Plan to Resuscitate U.S. Housing Market, BLOOMBERG.COM, Dec. 4, 2008, *available at* http://www.bloomberg.com/apps/news?pid=20601087&sid=aElD2EJR0B2k.

[32] Tami Luhby, FDIC's Bair Pushes Aggressive Mortgage Plan, CNNMONEY.COM, Nov. 14, 2008, *available at* http://money.cnn.com/2008/11/14/news/economy/fdic_bair; GAO Report, supra note 17, at 29-30.

Similarly, buying or guaranteeing some mortgage-backed assets could help place a floor on the value of those assets and move those toxic assets off the books of financial institutions, reducing systemic risk and leaving the institutions with higher-rated assets. But if those toxic assets were over-valued across the board, due in part to failures in the ratings systems,[33] then it is not clear that once Treasury has bought or guaranteed some securities that investors would want the remaining assets that Treasury had not purchased. Instead, investors may believe those assets remain toxic. Uncertainty—or skepticism—over the value of these assets would persist, making efforts to support the market largely unsuccessful.

In particular, Treasury needs to explain its understanding of the role played by each of the following factors and by their interaction: (1) capital inadequacy in financial institutions; (2) lack of reliable information in credit markets with respect to counterparty risk; (3) temporary liquidity shortfalls in particular financial markets; (4) falling real estate prices and rising foreclosure rates; (5) stagnant family incomes and rising unemployment; (6) changes in consumer borrowing capacity; (7) business and financial focus on short-term gains to the detriment of long-term growth; (8) effectiveness of regulatory oversight; (9) CPP participants' involvement in and exposure to off balance sheet vehicles and unregulated markets; and (10) broader long-term macroeconomic imbalances.

If Treasury's understanding of the relative importance of these issues and their interaction with each other is changing, Treasury needs to explain how the dynamics of that process and how their actions have changed in response. If other factors are central to Treasury's thinking, those factors should be identified and clearly explained.

The American people need to understand Treasury's conception of the problems in the economy and its comprehensive strategy to address those problems.

[33] See generally Gretchen Morgenson, Debt Watchdogs: Tamed or Caught Napping, N.Y. TIMES, Dec. 7, 2008, at A1.

2. **Is the Strategy Working to Stabilize Markets?** What specific metrics can Treasury cite to show the effects of the $250B spent thus far on the financial markets, on credit availability, or, most importantly, on the economy? Have Treasury's actions increased lending and unfrozen the credit markets or simply bolstered the banks' books? How does Treasury expect to achieve the goal of price discovery for impaired assets?

American taxpayers need to know that their money is having a tangible effect on improving financial stability, credit availability, and the economy as a whole. As a first step, Treasury needs to provide a detailed assessment of whether the funds it has spent so far have had any effect – for better or worse – in these areas.

It is difficult to disaggregate the effects of simultaneously-taken actions by the Federal Reserve, FDIC, and other entities from Treasury's actions. Nonetheless, the Oversight Panel believes it is a critical aspect of its mission to attempt to assess the role that Treasury's actions under the Act have played in the recent history of our economy.

The GAO has suggested a number of potential metrics for evaluation: The TED spread (the difference between an average of interests rates offered in the London interbank market and Treasury bills), corporate spreads based on Moody's Aaa and Bbb bond rates, mortgage rates, mortgage originations, mortgage foreclosures and defaults, in addition to other metrics such as call report data, stock prices, and house prices.[34]

Treasury itself should respond to the GAO report in part by attempting to define what the Department itself constitutes success. This is important in terms of assessing both whether changes need to be made in the Act and in terms of assessing when direct governmental participation in financial markets and financial institutions could be reduced.

In recent days Treasury has commented favorably on developments in certain credit spreads such as the TED spread. Treasury has not, however, explained the role it believes interbank lending costs play compared to the importance of other factors in both the credit markets and the economy that appear to have deteriorated over the same time period, such as corporate bond spreads, Treasury default swap costs, and foreclosure data.

The Oversight Panel intends over time to make its own assessment of the effectiveness of the TARP program in achieving the objectives set forth by Congress. The Oversight Panel would be greatly assisted in its effort if Treasury did the same.

[34] GAO, supra note 17, at 49-57.

3. **Is the Strategy Helping to Reduce Foreclosures?** What steps has Treasury taken to reduce foreclosures? How effective have those steps been? Why has Treasury not generally required financial institutions to engage in specific mortgage foreclosure mitigation plans as a condition of receiving taxpayer funds? Why has Treasury required Citigroup to enact the FDIC mortgage modification program, but not required any other bank receiving TARP funds to do so? Is there a need for additional industry reporting on delinquency data, foreclosures, and loss mitigations efforts in a standard format, with appropriate analysis? Should Treasury be considering others models and more innovative uses of its new authority under the Act to avoid unnecessary foreclosures?

Federal Reserve Board Chairman Bernanke recently reported that foreclosures in 2008 will number approximately 2.25 million.[35] Neighbors see their home prices decline from blighted nearby properties, and foreclosure sales saturate the real estate market with low-priced inventory, further pushing down home prices.[36] Foreclosures also place a double burden on local governments, as they impose direct costs from crime and fires while eroding the local tax base. Global asset write downs and credit losses relating to home mortgages currently exceed $590 billion and may eventually rise to $1.4 trillion by some estimates.[37] Moreover, foreclosure rates have continued to increase in recent months, and one in ten American mortgage holders are now in default or foreclosure.[38] Rapidly rising unemployment is likely to increase mortgage defaults and drive foreclosure rates even higher. Several economists have identified the unresolved foreclosure crisis as a key causal factor in financial instability and economic decline.

As rising foreclosure rates continue to put downward pressure on home prices, financial institutions will be forced to recognize even greater losses. Each time a family loses its home due to foreclosure, the value of every home within one eighth of a mile declines nearly 1%.[39] In 2002, when home prices were rising, researchers estimated that the

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[35] Speech: Chairman Ben S. Bernanke At the Federal Reserve System Conference on Housing and Mortgage Markets, Dec. 4, 2008, *available at* http://www.federalreserve.gov/newsevents/speech/bernanke20081204a.htm.

[36] See Steve Matthews & Scott Lanman, Fed's Kroszner Says Foreclosures Harming Middle-Income Areas, BLOOMBERG.COM, Dec. 3, 2008, *available at* http://www.bloomberg.com/apps/news?pid=20601213&sid=aSwRduPiiLjc.

[37] Yalman Onaran & Dave Pierson, Banks' Subprime-Related Losses Surge to $591 Billion, BLOOMBERG.COM, Sep. 29, 2008, *available at* http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aSlW.imTKzY8; IMF Urges Collective Central Bank Action, SYDNEY MORNING HERALD, Oct. 7, 2008, *available at* http://news.smh.com.au/business/imf-urges-collective-central-bank-action-20081008-4w01.html.

[38] Hagerty & Soloman, supra note 4.

[39] Dan Immergluck & Geoff Smith, The External Costs of Foreclosure: The Impact of Single-Family Mortgage Foreclosures on Property Values, 17 HOUS. POL'Y DEBATE 57, 69, 72, 75 (2006), *available at*

holders of a loan are forced to recognize an average loss of $58,792 each time they foreclose on a home.[40] Losses are much greater, however, when home prices are declining.

Standard & Poor's, a ratings service, estimates that for subprime mortgages originated in 2006, servicers will only be able to recover 55% of the total value of the loan on a foreclosed home. Total losses include direct costs, such as legal fees and maintenance that average around 26% of the value of a loan, as well losses from missed mortgage payments and declines in resale values.[41] These losses are exacerbated by the fact that the resale value for a foreclosed home is often 5% to 15% lower than the resale value of a comparable home sold by the homeowner.[42]

While Treasury has promoted voluntary mortgage assistance through its HOPE NOW program, it is unclear what effect this activity has had. Although there are data on the number of people who have contacted HOPE Now, there appear to be no systematic data on the number of people who have negotiated reductions in either the principal amounts of their mortgages or in their monthly payments.

Preserving homeownership is an explicit purpose of the Act. Under Section 109, the Treasury Secretary has the authority to "use loan guarantees and credit enhancements to facilitate loan modifications to prevent avoidable foreclosures." When the Act was passed, Congress expected the primary use of the authority under the Act to be to purchase troubled assets from financial institutions. In that context, Treasury is required to "implement a plan to maximize assistance to homeowners" and to encourage mortgage servicers to use the HOPE for Homeowners Program or loan guarantees and credit enhancements to facilitate loan modifications and prevent foreclosures "[t]o the extent that the Secretary acquires mortgages, mortgage-backed securities, and other assets secured by residential real estate."[43] Given Treasury's shift to direct equity investments in financial institutions, the Department should explain how its broad authority still reflects the purposes of the act.

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http://www.fanniemaefoundation.org/programs/hpd/pdf/hpd_1701_immergluck.pdf.

[40] Amy C. Cutts & Richard K. Green, Innovative Servicing Technology: Smart Enough to Keep People in Their Houses? (Freddie Mac, Working Paper No. 04–03, 2004), *available at* http://www.freddiemac.com/news/pdf/fmwp_0403_servicing.pdf (citing Craig Focardi, Servicing Default Management: An Overview of the Process and Underlying Technology (TowerGroup, Research Note No. 033-13C, 2002)).

[41] Francis Parisi, The Anatomy of Loss Severity Assumptions In U.S. Subprime RMBS, STANDARD & POOR'S, *available at* http://www2.standardandpoors.com/portal/site/sp/en/us/page.article/4,5,5,1,1204835910066.html.

[42] Deep Dive into Subprime Mortgage Severity, Fixed Income Research Report, Credit Suisse, June 19, 2008.

[43] Emergency Economic Stabilization Act, supra note 14, § 109(a) ("the Secretary shall implement a plan that seeks to maximize assistance for homeowners and use the authority of the Secretary to encourage the servicers of the underlying mortgages, considering net present value to the taxpayer, to take advantage of the HOPE for Homeowners Program under section 257 of the National Housing Act or other available programs to minimize foreclosures.")

Treasury is reported to be considering a possible new proposal for reducing rates on fixed 30-year mortgage to as low as 4.5% by directing Fannie Mae and Freddie Mac to guarantee and purchase these low-rate mortgages.[44] The low mortgage rate would be available only to those purchasing homes, not those who hope to refinance.[45] The goal of such a program would be to encourage new buyers to enter the housing market. The program does not appear to offer any help to already distressed homeowners. Even if it were expanded to permit refinancing, the nearly 20% of homeowners who have negative equity in their homes will remain unable to refinance their mortgages.[46]

If Treasury believes that offering low interest rates on purchase-money mortgages to new homebuyers will help stem foreclosures among existing homeowners, then Treasury should articulate more clearly the process by which this will occur. Is there a substantial body of potential homeowners who could take advantage of these low rates, but who did not purchase homes on easy credit during the mortgage bubble? Will lower rates create a large enough pool of new home buyers to lead to a general increase in home prices? As importantly, are the assumptions underlying Treasury's plan still valid in a time of great economic uncertainty for the households that would be expected to take advantage of the lower mortgage rates? Will lower interest rates induce demand for home ownership in the face of falling housing prices, consumer uncertainty about the future of the economy and employment, and the reasonable expectation that an even better deal might be available in the future?

Additionally, Treasury should explain what if any steps it is taking to encourage mortgage servicers, including affiliates of financial institutions that have received CPP or TALF funding, to engage in loan modifications, participate in the HOPE for Homeowners Program (in which none of the institutions receiving CPP funds have participated), or take other steps to minimize foreclosures. In particular, Treasury should explain why foreclosure relief was not a condition of CPP funds. Treasury should also consider the need for additional industry reporting on delinquency data, foreclosures, and loss mitigation in a standard format. Such data should be analyzed by an appropriate bank regulatory agency, to assess the effectiveness of each institution's efforts.

As part of its aid to Citigroup, Treasury required Citigroup to implement the FDIC's mortgage modification program.[47] Separately and not in connection with Citigroup, FDIC Chairman Sheila Bair has proposed a program that would provide additional incentives for loan modifications by paying servicers $1,000 to cover related expenses and by sharing up to 50% of the losses on modified loans that subsequently re-default. The FDIC estimates that such as plan could avoid 1.5 million foreclosures at a cost of $24.4 billion.[48]

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[44] Edmund L. Andrews, Washington's New Tack: Helping Home Buyers, N.Y. TIMES, Dec. 5, 2008, *available at* http://www.nytimes.com/2008/12/05/business/05housing.html.
[45] Id.
[46] See Dan Levy, More U.S. Homeowners Have Mortgage Higher Than House Is Worth, BLOOMBERG.COM, Oct. 31, 2008, *available at* http://www.bloomberg.com/apps/news?pid=20601213&refer=home&sid=aYyk2_TLjGao.
[47] GAO Report, supra note 17, at 28.

The Oversight Panel believes Treasury has an obligation to explain its objection to the FDIC proposal and why its objection to the FDIC proposal is not also relevant to Citigroup.

[48] Federal Deposit Insurance Corporation, FDIC Loss Sharing Proposal to Promote Affordable Loan Modifications, Nov. 20, 2008, *available at* www.fdic.gov/consumers/loans/loanmod/.

4. **What Have Financial Institutions Done with the Taxpayers' Money Received So Far?** What have the companies who received money from Treasury done with the money? Have the companies used the funds in the way Treasury intended when it disbursed them? How have institutions supported under the Capital Purchase Program used their funds, and they have they leveraged the capital support to increase lending activity? Is this different from the way funds were utilized for institutions who received funds pursuant to the Systemically Significant Failing Institutions plan? Is Treasury seeking to use TARP money to shape the future of the American financial system, and if so, how?

In the course of its meetings with Treasury, the Inspector General of Treasury, and the staff of the Federal Reserve, the Oversight Panel has confirmed that the Office of Financial Stabilization has administered the TARP program without seeking to monitor the use of funds provided to specific financial institutions.[49] Interim Assistant Secretary for Financial Stability Neel Kashkari has said that Treasury favors monitoring through "general metrics" that look at the overall economic effects of the disbursed funds.[50]

The decision to measure the efficacy of TARP through general economic metrics presents a difficult challenge. In the short run, it is impossible because systemic economic effects take time to manifest themselves. In the long run, such metrics are problematic because other actors such as the Federal Reserve, FDIC, and foreign governments are also taking aggressive action to address the crisis. Using general metrics could be a substitute for using no metrics at all, thus committing taxpayer resources with no meaningful oversight.

If the funds committed under TARP have an intended purpose and are not merely no-strings-attached subsidies to financial institutions, then it seems essential for Treasury to monitor whether the funds are used for those intended purposes. Without that oversight, it is impossible to determine whether taxpayer money is used in accordance with Treasury's overall economic stabilization strategy. Treasury cannot simply trust that the financial institutions will act in the desired ways; it must verify.

Such efforts to measure the impact of public funds on specific financial institutions have been underway in Great Britain. Chancellor of the Exchequer Alastair Darling and Lord Peter Mandelson, the Secretary for Business, Enterprise, and Regulatory Reform, have required recapitalized banks to lend to small and medium size enterprises.[51] To

[49] See also GAO Report, supra note 17, at 25.
[50] Id., at 10.
[51] Jenny Booth, Darling to Order Recapitalised Banks to Lend to Small Businesses, TIMES (LONDON), Oct. 21, 2008, *available at* http://www.timesonline.co.uk/tol/news/politics/article4985470.ece; Press Release, Financial Support to the Banking Industry, HM Treasury, *available at* http://www.hm-treasury.gov.uk/press_100_08.htm.

demonstrate compliance with the intended purpose of recapitalization, Chancellor Darling and Lord Mandelson are using 2007 levels of lending as a comparison.[52] Treasury should consider metrics it can use to measure compliance with the intended purposes of its funds.

The Oversight Panel believes the public has the right to know how financial institutions that have received public money are using that money. It also believes that Treasury should be responsible for holding individual institutions accountable for how they use the public's money.

[52] Press Release, Treasury statement on financial support to the banking industry, HM Treasury, Oct. 13, 2008, *available at* http://www.hm-treasury.gov.uk/press_105_08.htm.

5. **Is the Public Receiving a Fair Deal?** What is the value of the preferred stock Treasury has received in exchange for cash infusions to financial institutions? Are the terms comparable to those received in recent private transactions, such as those with Warren Buffett and the Abu Dhabi Investment Authority?

The Oversight Panel believes that a critical aspect of its mission is to determine whether the United States government has received assets comparable to its expenditures under the Emergency Economic Stabilization Act of 2008. To date, Treasury has made two types of expenditures under the Act. The majority of its expenditures have been cash infusions for which the Department has received preferred stock with associated warrants to purchase common stock. In the case of Citigroup, however, Treasury has participated, together with the Federal Deposit Insurance Corporation and the Federal Reserve Board, in a guarantee supporting a pool of assets held by Citigroup.

Several major TARP recipient companies have received major capital investments recently, including Mitsubishi's investment in Morgan Stanley, Warren Buffett's investment in Goldman Sachs, and the Abu Dhabi Investment Group's investment in Citigroup.

On October 14, 2008, Mitsubishi UFJ (MUFJ) Financial Group of Japan invested $9 billion in Morgan Stanley.[53] In exchange, MUFJ received a 21% stake in the company through perpetual preferred shares with a 10% annual dividend.[54]

Warren Buffett announced on September 23, 2008 that he would invest $5 billion into Goldman Sachs.[55] In return, Buffett's company, Berkshire Hathaway, received perpetual preferred shares with a 10% annual dividend. If Goldman Sachs wishes to buy back the preferred stock, it can do so at a premium of 10%. Berkshire Hathaway also received warrants to purchase common stock at $115 per share, up to $5 billion within the next five years.[56]

In November 2007, the Abu Dhabi Investment Authority invested $7.5 billion in Citigroup, amounting to 4.9% of Citigroup's equity.[57] The Abu Dhabi Investment Authority received equity units that pay an 11% annual dividend and will be converted into common stock in 2010 or 2011 at a price between $31.83 and $37.24.[58]

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[53] Aaron Lucchetti, Propped Up, Morgan Stanley Now Sets Forth to Right Itself, WALL ST. J., Oct. 14, 2008, at C1.
[54] Id.
[55] Ben White, Buffett Deal at Goldman Seen as a Sign of Confidence, N.Y.TIMES, Sep. 24, 2008, at A1.
[56] Id.
[57] Eric Dash & Andrew R. Sorkin, Citigroup Sells Abu Dhabi Fund $7.5 Billion Stake, N.Y. TIMES, Nov. 27, 2007, *available at* http://www.nytimes.com/2007/11/27/business/27citi.html?hp.
[58] Id.

Under the CPP terms, Treasury receives senior preferred shares paying annual dividends of 5% for five years and 9% thereafter, and the shares can be redeemed at face value after three years or, if the institution receives a minimum amount from "qualified equity offerings," prior to three years.[59] In addition, Treasury receives warrants to purchase common stock up to a market value of 15% of senior preferred investment for public securities or 5% for private securities.[60] The exercise price is the financial institution's market price of common stock on the day it is accepted into the Capital Purchase Program.[61] The exercise price of the common stock warrants is reduced each six months if shareholder approvals are not obtained or if the institution completes a qualified equity offering prior to December 31, 2009.[62]

The Oversight Panel intends to work with Treasury, the GAO, and the Congressional Budget Office to determine the value of the preferred stock acquired by Treasury at the time of acquisition, particularly in light of these comparable transactions, and to understand how these terms were negotiated and determined. The Oversight Panel will also seek to understand Treasury's plans for the terms of future capital investments through the Capital Purchase Program in private financial institutions, S-Corporations, and mutual organizations.[63]

Under Section 102(c), the Secretary of the Treasury must collect premiums from financial institutions whose financial assets are insured, and those premiums must provide sufficient reserves to meet any anticipated claims and to ensure that taxpayer funds are safeguarded.

Treasury, the Federal Reserve, and the FDIC announced on November 23 a plan to insure against the loss of $306 billion in loans and mortgage-related securities held by Citigroup.[64] Under the plan, Citigroup will take the first $29 billion in potential losses, plus 10% of any additional losses.[65] Treasury, the FDIC, and the Federal Reserve are responsible for any additional losses, which could be up to nearly $250 billion.[66] Citigroup will issue $4 billion in preferred stock to Treasury Department and $3 billion in preferred stock to the FDIC as a fee in exchange for the guarantee.[67]

In relation to the asset guarantees provided to Citigroup, Section 102 of the Emergency Economic Stabilization Act appears to govern all insurance policies and other guarantees of the value of financial institution assets. Section 102(c) requires that the Secretary of

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[59] TARP Capital Purchase Program, Summary of Senior Preferred Terms *available at* http://www.treas.gov/press/releases/reports/document5hp1207.pdf.
[60] Id.
[61] Id.
[62] Id., at 21-22.
[63] See id..
[64] Press Release, Joint Statement by Treasury, Federal Reserve and the FDIC on Citigroup, Department of Treasury, Nov. 23, 2008, *available at* http://www.ustreas.gov/press/releases/hp1287.htm.
[65] Dan Wilchins & Jonathan Stempel, Citigroup Gets Massive Government Bailout, REUTERS, Nov. 24, 2008, *available at* http://news.yahoo.com/s/nm/20081124/bs_nm/us_citigroup.
[66] Id.
[67] Summary of Terms, Department of Treasury, Nov. 23, 2008, *available at* http://www.ustreas.gov/press/releases/reports/cititermsheet_112308.pdf.

the Treasury collect premiums from financial institutions whose financial assets are insured through this program. The premiums must provide sufficient reserves to meet any anticipated claims and to ensure that taxpayer funds are safeguarded. The Oversight Panel will seek to understand whether the Citigroup guarantee falls under the requirements of Section 102, and if so, whether it conforms with these requirements.

6. **What is Treasury Doing to Help the American Family?** Does Treasury believe American families need to borrow more money? Have Treasury's actions preserved access to consumer credit, including student loans and auto loans at reasonable rates? What restrictions will Treasury put on credit issuers to assure that taxpayer dollars are not used to subsidize lending practices that are exploitive, predatory or otherwise harmful to customers? What is Treasury doing to ensure that its spending is directed in ways that maximize the impact on the American economy?

On November 25, 2008, Treasury announced that it would provide $20 billion of credit protection for the Federal Reserve's Term Asset-Backed Securities Loan Facility (TALF), which will finance investments in securities backed by automobile loans, credit card loans, student loans, and small business loans.[68] In addition, since the beginning of the CPP, American Express became a bank holding company, allowing it to apply for a capital infusion of over $3 billion.[69]

American families are already loaded with debt. According to Federal Reserve Board calculations, total U.S. consumer debt, excluding loans secured by real estate, increased at an average annual rate of 5.0% between 2003 and 2007, growing from approximately $2.1 trillion to approximately $2.55 trillion.[70] Total household debt outstanding in the U.S. now exceeds annual national personal income.[71] According to the 2004 Survey of Consumer Finances, 46% of American families carry monthly credit card balances, and the average level of credit card debt for those families is $5,100.[72]

The Oversight Panel believes that as the Treasury moves toward using public money to support the secondary market for credit card and other consumer debt, the Treasury, the public, and Congress need to understand better the financial strains affecting American families. While increased consumer spending is an important part of economic stimulation and recovery, for many families, incurring additional debt would only add to their financial stress. There is evidence that relying on borrowing by individuals as a form of economic stimulus has proved destructive. In addition, there are questions about the extent to which increased consumer spending stimulates the U.S. economy when

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[68] Press Release: Treasury Provides TARP Funds to Federal Reserve Consumer ABS Lending Facility, Nov. 25, 2008 *available at http://www.treas.gov/press/releases/hp1292.htm.*

[69] Eric Dash, American Express to Be Bank Holding Company, N.Y. TIMES, Nov. 11, 2008, at B2.

[70] Statistical Release, Consumer Credit G.19, Federal Reserve, *available at* http://www.federalreserve.gov/releases/g19/current/.

[71] See Credit Cards and Bankruptcy: Opportunities for Reform, Hearing Before the Senate Comm. on the Judiciary, 110th Cong. (Dec. 4 2008) (testimony of Prof. Robert M. Lawless), *available at* http://judiciary.senate.gov/pdf/08-12-04LawlessTestimony.pdf.

[72] 2004 Survey of Consumer Finances, Federal Reserve, *available at* http://www.federalreserve.gov/PUBS/oss/oss2/2004/scf2004home_modify.html.

marginal consumer dollars are spent on imports. Ultimately, sustainable consumer spending must depend upon rising incomes and broadly shared prosperity, not debt.

In addition to the massive amounts of debt, the complexity of individual credit products has made it impossible for even the most sophisticated consumers to understand the implications of debt for their future payment obligations.[73] The proliferation of intricate mortgage products – including hybrid ARMs, option ARMs, and other exotic species featuring teaser periods and balloon payments – contributed to the pattern of home buyers taking on mortgages that were initially affordable but that quickly became unmanageable. The Government Accountability Office reported that credit card issuers charge consumers up to three different interest rates depending on the transaction and high punitive rates (some in excess of 30%); in addition, average late payment fees have more than doubled between 1995 and 2005.[74] From the onset of the financial crisis, credit card issuers have been accused of increasing interest, accelerating fees and penalties and using more aggressive debt collection practices.[75]

In the context of consumer credit, it is also important to ask what restrictions Treasury will put on credit issuers to assure that taxpayer dollars are not used to subsidize lending practices that are exploitive, predatory, or otherwise harmful to customers.

In response to similar trends in the United Kingdom, the U.K. government has required credit card companies to work with consumers as a condition of receiving public funds. The U.K. has required credit card issuers to suspend payments for 60 days in many cases of financial hardship.[76]

Households that are struggling with debts – mortgages, student loans, credit cards, car loans, payday loans, and other credit devices – are at the center of the current crisis. Their defaults have driven the losses on asset-backed securities that have weakened balance sheets of financial institutions, and their reduction in purchasing has contributed to the contraction in economic activity. For Treasury's disbursements to be effective in the context of the broader economic downward spiral, Treasury must have a strategy that addresses this underlying problem.

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[73] See generally GAO, Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers, GAO-06-929, September 2006, *available at* http://www.gao.gov/new.items/d06929.pdf.

[74] Id., at 5, 14, 18.

[75] See, e.g., Liz Moyer, Holiday Surprise: More Credit Card Fees, FORBES, Dec. 5, 2008, *available at* http://www.forbes.com/business/2008/12/05/credit-card-fees-biz-wall-cx_lm_1205badcards.html; Abigail Bassett, As Debt Grows, Collections Boom, CNNMONEY.COM, Nov. 26, 2008, *available at* http://money.cnn.com/2008/11/25/pf/debt_collections/?postversion=2008112611.

[76] U.K. Credit Cards to Give Borrowers Extra 60 Days to Pay, WALL ST. J., Nov. 26, 2008, http://online.wsj.com/article/SB122773056319560653.html.

7. **Is Treasury Imposing Reforms on Financial Institutions that Are Taking Taxpayer Money?** Congress has told the auto industry to reform its current practices before it could be considered for taxpayer aid and the British are requiring reforms on their banks as a precondition for capital infusions. Has Treasury required banks receiving aid to:
    i. Present a viable business plan;
    ii. Replace failed executives and/or directors;
    iii. Undertake internal reforms to prevent future crises, to increase oversight, and to ensure better accounting and transparency;
    iv. Undertake any other operational reforms?

Treasury has provided capital to financial institutions under two programs, the CCP and SSFI. In general, the Act provides the Secretary of the Treasury with broad authority to set the conditions under which companies may receive aid. In particular, Congress required that the Secretary determine whether the public disclosure requirements for each financial institution are sufficient to provide the public with an accurate picture of that institution's true financial position.[77]

It is unclear whether there have been any efforts to assess the business plans, the management, or the accounting and general transparency of firms receiving aid from the CPP.[78] In order for the Big Three auto companies – Ford, Chrysler, and GM – to be considered for any taxpayer aid, however, Congress has proposed considerable reforms and presentation of viable business plans.[79] The British have imposed significant reforms on their banks in the context of government aid during the financial crisis. In exchange for recapitalization, the British Treasury has required that Banks maintain 2007 levels of lending to homeowners and small businesses, develop an effective scheme for people to stay in their homes, reform their compensation policies going forward, include the Government in decisions on dividend policy, and provide the Government with influence on the appointment of new independent non-executive directors.[80]

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[77] Emergency Economic Stabilization Act, supra note 14, § 114(b) ("the Secretary shall determine whether the public disclosure required for such financial institutions with respect to off-balance sheet transactions, derivatives instruments, contingent liabilities, and similar sources of potential exposure is adequate to provide to the public sufficient information as to the true financial position of the institutions. If such disclosure is not adequate for that purpose, the Secretary shall make recommendations for additional disclosure requirements to the relevant regulators.")

[78] See GAO Report, supra note 17, at 15.

[79] See David M. Herszenhorn, Big Bailout for Detroit Fails for Now, N.Y. TIMES, Nov. 21, 2008, at B1. Speaker Nancy Pelosi stated, "Until we see a plan where the auto industry is held accountable and a plan for viability on how they go into the future – until we see the plan, until they show us the plan, we cannot show them the money." Id.

[80] Press release, HM Treasury supra note 50; see also Steven Erlanger & Katrin Bennhold, Governments on Both Sides of the Atlantic Push to Get Banks to Lend, N.Y. TIMES, Nov. 7, 2008, at A6.

The Oversight Panel believes the public has a right to know to what extent conditions have been imposed on financial institutions receiving public funds, and if not, why not.

8. **How is Treasury Deciding Which Institutions Receive the Money?** What factors is Treasury using to determine which institutions receive equity infusions, purchase of portfolio assets, or insurance of portfolio assets? Is Treasury seeking to use TARP money to shape the future of the American financial system, and if so, how? Why does Treasury believe that providing capital to all viable banks, regardless of business profile, is the most efficient use of funds?

Treasury has informed both the Oversight Panel and the GAO that its process for determining which banks receive aid from TARP under the CPP is based on one criterion – the financial viability of the institution. In doing so, Treasury relies on recommendations from banking regulators to determine which institutions will receive equity infusions.[81] Bank regulators consider bank examination ratings, selected performance ratios, and, in some cases, the intended use of capital injections.[82] Treasury has stated that the process is consistent for all banks. Those with higher bank examination ratings are presumptively approved by the regulators, while those with low examination ratings are sent to the CPP Council, which may consider additional factors such as the existence of a signed merger agreement and private equity investment.[83] Although no bank has been denied, some institutions have withdrawn their applications.[84] As of December 9, Treasury had invested in 87 institutions.[85] Of these capital infusions, $115 billion has gone to 8 lenders.[86]

Some commentators are concerned that Treasury actions are designed to drive consolidation in the banking industry by directing funds to financial institutions that are willing to purchase weaker banks.[87] Opponents of concentration worry about the too-big-to-fail dynamic encouraging excessive risk taking by surviving institutions.

Others are concerned about too little thought about over-supply in banking and the need to concentrate taxpayer resources on backing up a more limited number of stronger banks.[88] Still others have expressed concern that with Treasury intervention, the banks that behaved prudently and whose balance sheets are strong are now losing their

[81] Press Release: Interim Assistant Secretary for Financial Stability Neel Kashkari Testimony before the Senate Committee on Banking, Housing and Urban Affairs, Oct. 23, 2008 *available at* http://www.treas.gov/press/releases/hp1234.htm.
[82] Id.,
[83] Id.
[84] Id.
[85] Capital Purchase Program Transaction Report, Dec. 9, 2008 *available at* http://www.treas.gov/initiatives/eesa/docs/CPPTransaction%20ReportDec%209.pdf.
[86] Id.,.
[87] Mark Landler, U.S. Is Said to Be Urging New Mergers in Banking, N.Y. TIMES, Oct. 21, 2008, at B1.
[88] See, e.g., Peter Cohan, Washington Likely to Put Capital Into Banks: A Great Idea if Done Right, BLOGGINGSTOCKS, *available at* http://www.bloggingstocks.com/2008/10/09/washington-likely-to-put-capital-into-banks-a-great-idea-if-don.

comparative advantage in a crisis.[89] Finally, concerns have been expressed by some banks that their decision not to seek TARP money has been perceived as a sign of weakness by investors and business partners.

The Citigroup experience and the AIG experience raise questions about assessments of institutional health and need by Treasury and bank regulators. In assessing the health of financial institutions, the Oversight Panel is interested in the extent to which Treasury and bank regulators involved in funding decisions have assessed future likely losses in derivatives and troubled assets, and the implications for funding levels necessary to restore specific institutions to the point where they can resume normal lending practices.

The Oversight Panel believes it is critical for Congress and the public, including participants in the banking industry, to understand exactly what the criteria are for receiving money under the TARP programs, what the strategic intentions of the criteria are, if any, what the strategic effects of the criteria are, and how the criteria advance the purposes of the Act.

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[89] See, e.g., E. Scott Reckard, Which Banks Live or Die? Wielding $250 Billion, U.S. May Decide, L.A. TIMES, Oct. 15, 2008, at A1; Nicole Gelinas, Storm Proofing the Economy, WALL ST. J., Oct. 28, 2008, *available at* http://online.wsj.com/article/SB122513954599373277.html; Evan Greenberg, The Insurance Industry Doesn't Need Subsidies, WALL ST. J., Oct. 31, 2008, *available at* http://online.wsj.com/article/SB122541594014986703.html.

9. **What is the Scope of Treasury's Statutory Authority?** What is Treasury's understanding of the statutory limits on its use of funds? How does Treasury justify its decisions under the Act in relation to its view of these limits? How is Treasury carrying out its statutory mandate regarding credit insurance?

The Emergency Economic Stabilization Act of 2008 granted the Secretary of the Treasury the authority both to purchase and to insure "troubled assets" held by "financial institutions."[90] Moreover, the Act defines "troubled asset" as any residential or commercial mortgage-backed security and related assets issued before March 14, 2008, and "any other financial instrument that the Secretary, after consultation with the Chairman of the Board of Governors of the Federal Reserve System . . . determines the purchase of which is necessary to promote financial market stability" so long as that determination is transmitted to Congress.[91]

The term "financial institution" is defined as *"any institution, including but not limited to* any bank, savings association, credit union, security broker or dealer, or insurance company."[92] The remainder of the definition limits the definition to U.S. institutions not owned by a foreign government. Treasury has purchased the preferred stock of banks relying upon these definitions.

Some have raised concerns that these purchases appear not to be contemplated by the overall language of the Act, and have questioned whether Treasury's interpretation of its authority in fact places any substantive limits on the assets it could buy, and from whom.

On the other hand, others, contemplating Treasury's refusal to date to provide aid to U.S. automakers, have asked whether in light of Treasury's generally broad interpretation of its mandate, the refusal to aid the automakers, given their significant role in the financial markets and the economy, is arbitrary and not supported by the statute's broad definition of both "troubled asset" and financial institution."[93]

The Term Asset-Backed Securities Loan Facility (TALF) program, authorized by the Federal Reserve Act, features $20 billion in TARP funds used to finance purchases of assets backed by auto, student, credit card, and small business loans, with any additional funding coming from the Federal Reserve Bank of New York (FRBNY).[94] This program will provide up to $200 billion on a non-recourse basis to holders of assets backed by

[90] Emergency Economic Stabilization Act, supra note 14, at § 101(a).
[91] Id., at § 3(9).
[92] Id., at §3(5) (emphasis added).
[93] See generally Greg Hitt, Auto Makers Force Bailout Issue – Government Finds It Difficult to Deny Aid to Detroit in Wake of Wall Street Rescue, WALL ST. J., Nov. 10, 2008, at A3.
[94] Press Release, Federal Reserve, supra note 28.

new and recent loans.[95] Under the TALF terms, the first $20 billion comes from TARP and is subordinated to any additional funds provided by FRBNY.[96]

The Citigroup loan guarantee discussed above similarly commits the TARP to a $20 billion investment in conjunction with guarantees offered by the FDIC and the Federal Reserve.[97]

It is unclear what Treasury believes its authority and obligations are surrounding guarantees in the context of the limits placed on insurance in Section 102 of the Act. It is also unclear what Treasury believes its limits are, if any, in working with other regulators and government bodies to jointly finance stabilization efforts. Lastly, it is unclear how Treasury intends to fulfill its obligation under Section 114 of the Act to ensure transparency when FRBNY is responsible for implementing the TALF.

The Oversight Panel believes Congress and the public have a vital interest in understanding how far Treasury sees its authority under the TARP extending.

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[95] Id.
[96] TALF Terms and Conditions, Federal Reserve, *available at* http://www.federalreserve.gov/newsevents/press/monetary/monetary20081125a1.pdf.
[97] Press Release, Joint Statement by Treasury, Federal Reserve and the FDIC on Citigroup, Department of Treasury, Nov. 23, 2008, *available at* http://www.ustreas.gov/press/releases/hp1287.htm.

10. **Is Treasury Looking Ahead?** What are the likely challenges the implementation of the Emergency Economic Stabilization Act will face in the weeks and months ahead? Can Treasury offer some assurance that it has worked out contingency plans if the economy suffers further disruptions?

While there has been much discussion about the speed with which the financial system seemed to deteriorate, there were many signs of serious problems. Defaults rates on home mortgages had been rising, concerns had been raised about the quality of the commercial rating systems, distrust in the valuations of asset-backed securities had surfaced, and the extraordinary risks associated with unregulated (and unmonitored) credit default swaps indicated that our financial system was not unshakeable.[98] While investors might be forgiven their focus on short-term profits, it is the job of our financial experts in the government to take the longer perspective, to be alert to the possibilities of shocks, and to have some thoughts about how those shocks might be addressed if they arose.

Even in the context of a massive crisis, we cannot manage one battle at a time. As we noted at the outset of this series of questions, we need to hear a coherent strategy for managing us out of this crisis. We note at the end of this series that we also need to think ahead, both to where the next failures may occur and to some principles which the government may follow by way of response.

The Oversight Panel is very interested in the thinking of Treasury and the other agencies with which it coordinates, such as the FDIC and the Board of Governors of the Federal Reserve, as to what the implications for the TARP program are of possible future events such as the resetting of Alt-A loans, a possible bankruptcy of one or more major auto makers, or a change in the environment for financing TARP funding.[99]

This question connects to the first of our questions. Planning for the future requires an overall strategic approach to trying to address our financial and economic crisis. The Oversight Panel does not expect Treasury to predict the future. We are interested in learning more about how our government is planning for it.

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[98] See generally Matt Apuzzo, They Warned Us: US Was Told To 'Expect Foreclosures, Expect Horror Stories', ASSOCIATED PRESS, Dec. 1, 2008, *available at* http://www.baltimoresun.com/business/nationworld/sns-ap-meltdown-ignored-warnings,0,1683858.story.

[99] See e.g. Charles Feldman, Alt-A Loans: The Crisis Yet to Come, BIGGERPOCKETS, *available at* http://www.biggerpockets.com/renewsblog/2008/05/20/alt-a-loans-the-crisis-yet-to-come; Bill Vlasic, G.M., Teering on Bankruptcy, Pleads for a Federal Bailout, N.Y. TIMES, Nov. 12, 2008; Nouriel Roubini, Desperate Measures by Desperate Policy Makers in Desperate Times: the Fed Moves to Radically Unorthodox Policies as Economy Is in Free Fall and Stag-Deflation Deepens, RGE MONITOR, Nov. 26, 2008, *available at* http://www.rgemonitor.com/roubini-monitor/254591/desperate_measures_by_desperate_policy_makers_in_desperate_times_the_fed_moves_to_radically_unorthodox_policies_as_economy_is_in_free_fall_and_stag-deflation_deepens.

ABOUT COP

In response to the escalating crisis, on October 3, 2008, Congress provided the U.S. Treasury with the authority to spend $700 billion to stabilize the U.S. economy. Congress created the Office of Financial Stabilization (OFS) within Treasury to implement a Troubled Asset Relief Program (TARP). At the same time, Congress created a Congressional Oversight Panel (COP) to "review the current state of financial markets and the regulatory system." COP is empowered to hold hearings, review official data, and write reports on actions taken by Treasury and financial institutions and their effect on the economy. Through regular reports, COP must oversee Treasury's actions, assess the impact of spending to stabilize the economy, evaluate market transparency, ensure effective foreclosure mitigation efforts, and guarantee that Treasury's actions are in the best interest of the American people. In addition, Congress has instructed COP to produce a special report on regulatory reform that will analyze "the current state of the regulatory system and its effectiveness at overseeing the participants in the financial system and protecting consumers."

On November 14, Senate Majority Leader Harry Reid and the Speaker of the House Nancy Pelosi appointed Richard H. Neiman, Superintendent of Banks for the State of New York, Damon Silvers, Associate General Counsel of the American Federation of Labor and Congress of Industrial Organizations (AFL-CIO), and Elizabeth Warren, Leo Gottlieb Professor of Law at Harvard Law School to the Oversight Panel. With the appointment on November 19 of Congressman Jeb Hensarling to the Oversight Panel by House Minority Leader John Boehner, the Oversight Panel had a quorum and met for the first time on November 26, 2008, electing Professor Warren as its chair.

This report was prepared under very tight time constraints. COP owes special thanks to Ganesh Sitaraman, Dan Geldon, John Beshears, and Cassie Walbrodt who helped with drafting, and Heather Slavkin and Catherina Celosse, who were careful editors. Students from the Harvard Law School provided critical research under tight deadlines; COP offers thanks to Neal Desai, Faisal Mohammed, Eric Nguyen, Jeff Pauker, Adam Pollet, Walter Rahmey, Saritha Tice and Ting Yeh for their service.

FUTURE OVERSIGHT ACTIVITIES

Public Hearings

In the weeks ahead, COP will hold a series of field hearings to shine light on the causes of the financial crisis, the administration of TARP, and the anxieties and challenges of ordinary Americans. The first of these hearings will occur next week in Las Vegas, Nevada. At each hearing, COP members will conduct a thorough investigatory process on behalf of American taxpayers, consumers, and workers.

Upcoming reports

Next month, COP will release two public reports. On Jan. 10, it will release a report that examines the administration of the TARP program, including the impact thereof on the economy to date. On Jan. 20, COP will release a report providing recommendations for reforms to the financial regulatory structure. This report will provide a roadmap for a regulatory system that would revitalize Wall Street, protect consumers, and ensure future stability in our financial markets. Through these reports, the Oversight Panel will reveal the results of its investigations to the American people.

Public Participation and Comment Process

COP will soon release a public website, which will provide resources pertaining to the financial crisis, the TARP program, and COP's ongoing efforts. The website will also offer opportunities for concerned citizens to share their stories, concerns, and suggestions with the Oversight Panel. By engaging in this dialogue, COP aims to enhance the quality of its ideas and advocacy on behalf of the American public.

APPENDIX: STATUTORY AUTHORITY OF THE CONGRESSIONAL OVERSIGHT PANEL

Emergency Economic Stabilization Act of 2008
Public Law No: 110-343

SEC. 125. CONGRESSIONAL OVERSIGHT PANEL.

(a) Establishment- There is hereby established the Congressional Oversight Panel (hereafter in this section referred to as the `Oversight Panel') as an establishment in the legislative branch.

(b) Duties- The Oversight Panel shall review the current state of the financial markets and the regulatory system and submit the following reports to Congress:

(1) REGULAR REPORTS-

(A) IN GENERAL- Regular reports of the Oversight Panel shall include the following:

(i) The use by the Secretary of authority under this Act, including with respect to the use of contracting authority and administration of the program.

(ii) The impact of purchases made under the Act on the financial markets and financial institutions.

(iii) The extent to which the information made available on transactions under the program has contributed to market transparency.

(iv) The effectiveness of foreclosure mitigation efforts, and the effectiveness of the program from the standpoint of minimizing long-term costs to the taxpayers and maximizing the benefits for taxpayers.

(B) TIMING- The reports required under this paragraph shall be submitted not later than 30 days after the first exercise by the Secretary of the authority under section 101(a) or 102, and every 30 days thereafter.

(2) SPECIAL REPORT ON REGULATORY REFORM- The Oversight Panel shall submit a special report on regulatory reform not later than January 20, 2009, analyzing the current state of the regulatory system and its effectiveness at overseeing the participants in the financial system and protecting consumers, and providing recommendations for improvement, including recommendations regarding whether any participants in the financial markets that are currently outside the regulatory system should become subject to the regulatory system, the rationale underlying such recommendation, and whether there are any gaps in existing consumer protections.

(c) Membership-

(1) IN GENERAL- The Oversight Panel shall consist of 5 members, as follows:

(A) 1 member appointed by the Speaker of the House of Representatives.

(B) 1 member appointed by the minority leader of the House of Representatives.

(C) 1 member appointed by the majority leader of the Senate.

(D) 1 member appointed by the minority leader of the Senate.

(E) 1 member appointed by the Speaker of the House of Representatives and the majority leader of the Senate, after consultation with the minority leader of the Senate and the minority leader of the House of Representatives.

(2) PAY- Each member of the Oversight Panel shall each be paid at a rate equal to the daily equivalent of the annual rate of basic pay for level I of the Executive Schedule for each day (including travel time) during which such member is engaged in the actual performance of duties vested in the Commission.

(3) PROHIBITION OF COMPENSATION OF FEDERAL EMPLOYEES- Members of the Oversight Panel who are full-time officers or employees of the United States or Members of Congress may not receive additional pay, allowances, or benefits by reason of their service on the Oversight Panel.

(4) TRAVEL EXPENSES- Each member shall receive travel expenses, including per diem in lieu of subsistence, in accordance with applicable provisions under subchapter I of chapter 57 of title 5, United States Code.

(5) QUORUM- Four members of the Oversight Panel shall constitute a quorum but a lesser number may hold hearings.

(6) VACANCIES- A vacancy on the Oversight Panel shall be filled in the manner in which the original appointment was made.

(7) MEETINGS- The Oversight Panel shall meet at the call of the Chairperson or a majority of its members.

(d) Staff-

(1) IN GENERAL- The Oversight Panel may appoint and fix the pay of any personnel as the Commission considers appropriate.

(2) EXPERTS AND CONSULTANTS- The Oversight Panel may procure temporary and intermittent services under section 3109(b) of title 5, United States Code.

(3) STAFF OF AGENCIES- Upon request of the Oversight Panel, the head of any Federal department or agency may detail, on a reimbursable basis, any of the personnel of that department or agency to the Oversight Panel to assist it in carrying out its duties under this Act.

(e) Powers-

(1) HEARINGS AND SESSIONS- The Oversight Panel may, for the purpose of carrying out this section, hold hearings, sit and act at times and

places, take testimony, and receive evidence as the Panel considers appropriate and may administer oaths or affirmations to witnesses appearing before it.

(2) POWERS OF MEMBERS AND AGENTS- Any member or agent of the Oversight Panel may, if authorized by the Oversight Panel, take any action which the Oversight Panel is authorized to take by this section.

(3) OBTAINING OFFICIAL DATA- The Oversight Panel may secure directly from any department or agency of the United States information necessary to enable it to carry out this section. Upon request of the Chairperson of the Oversight Panel, the head of that department or agency shall furnish that information to the Oversight Panel.

(4) REPORTS- The Oversight Panel shall receive and consider all reports required to be submitted to the Oversight Panel under this Act.

(f) Termination- The Oversight Panel shall terminate 6 months after the termination date specified in section 120.

(g) Funding for Expenses-

(1) AUTHORIZATION OF APPROPRIATIONS- There is authorized to be appropriated to the Oversight Panel such sums as may be necessary for any fiscal year, half of which shall be derived from the applicable account of the House of Representatives, and half of which shall be derived from the contingent fund of the Senate.

(2) REIMBURSEMENT OF AMOUNTS- An amount equal to the expenses of the Oversight Panel shall be promptly transferred by the Secretary, from time to time upon the presentment of a statement of such expenses by the Chairperson of the Oversight Panel, from funds made available to the Secretary under this Act to the applicable fund of the House of Representatives and the contingent fund of the Senate, as appropriate, as reimbursement for amounts expended from such account and fund under paragraph (1).

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DECEMBER 10, 2008

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On behalf of the 1.2 million members of the NATIONAL ASSOCIATION OF REALTORS®, we urge your strongest support for a package of critically needed measures to stimulate our nation's housing and real estate markets. We believe these measures are essential to stabilizing the housing market and stimulating our nation's economic recovery.

Critical to stabilizing the housing market are boosting homebuyer confidence and reducing the current foreclosure rate. As home values decrease in many markets, job losses escalate and the financial burden of American families continue to soar, homeowners seeking refinance their mortgage or sell their primary residence are left with few alternatives and are "walking away" from their mortgage obligations. This action increases housing inventory and further fuels a further depression of home.

To staunch this cycle, we are advocating a federal mortgage interest buy-down program financed through the Treasury Department's Troubled Asset Relief Program (TARP). The buy-down program would complement the loss mitigation elements of TARP and provide an incentive to buy homes which will reduce the huge inventory of houses in our nation's markets. This, in turn, will stabilize home values, further boost home sales activity and breathe new life into our nation's economy. NAR's economists have estimated that lowering the mortgage interest rate by one percentage point can result in an additional 500,000 - 700,000 home sales.

We are pleased to see that the leadership of the Treasury Department is seriously considering actions to lower mortgage interest rates, and we are encouraging the Treasury Department to move swiftly to implement a buy-down element to motivate homebuyers to act rather than continue to sit by on the sidelines. Housing has always led our economy out of downturns and lower interest rates coupled with foreclosure mitigation are the key ingredients to stabilizing our housing markets and preserving homes and communities.

We urge your strong support for our 4-point housing stimulus plan and particularly our federal mortgage interest buy-down proposal. Together with carefully considered measures to address the rising number of foreclosures, these four points can help to provide our nation's housing market with the stability it sorely needs.

NAR's 4-Point Housing Stimulus Plan

The current economic crisis is, at its core, the result of problems in the nation's housing and mortgage markets. This circumstance makes it imperative that efforts be taken immediately to foster a housing recovery, so that a recovery of the overall economy can occur.

NAR has developed a plan that includes:

1. Gets the Troubled Asset Relief Program (TARP) back on track by targeting funds for mortgage relief through a federal mortgage interest rate buy-down program

2. A consumer-driven provision that eliminates repayment feature of the first-time homebuyer tax credit and expands the credit to all homebuyers,

3. Makes the higher Economic Stimulus Act of 2008's FHA and GSE mortgage loan limits permanent, and

4. Prohibits banks from entering into real estate.

NAR strongly believes that the inclusion of all of these priorities in a stimulus package is imperative to move our nation out of this economic crisis. One component that we believe can provide a near immediate impact to the housing market and the overall economy is the proposed mortgage interest rate buy-down program.

Mortgage Interest Rate Buy-down Program

NAR supports getting TARP back on track by targeting funds to mortgage relief through the creation of a federal mortgage interest buy-down program. This program is one way the Federal government can quickly provide stimulus to the struggling housing market. The mortgage buy-down would have the government buying points to lower home buyers' mortgage rates. This program, estimated to cost in the $40 billion range, would bring buyers back into the housing market, quickly reduce inventory and thereby stabilize home prices. NAR estimates that the months' supply of inventory would fall to about 7.5 months – a level consistent with no further home price declines. Moreover, the impact of this type of program would be felt almost immediately, by the second month after implementation.

The positive effects of falling mortgage interest rates are illustrated by the U.S. Treasury Department's recent decision to purchase the debt and mortgage-backed security (MBS) offerings of Fannie Mae and Freddie Mac. The announcement of the decision has spurred a significant reduction in mortgage interest rates over the last two weeks, a decrease of 61 basis points. Over this period, many REALTORS® have reported a significant increase of consumer interest in "for sale" properties. The revival of consumer interest due to a small decrease in mortgage interest rates confirms our suspension that a significant reduction in mortgage interest rates, by any method, will bring a substantial number of consumers back to the housing market.

How the Buy-Down Program Works

Mortgage lenders often offer home buyers the option to purchase points up front as a way to lower the interest rate on the mortgage. Typically, each point equates to a 0.25 percent reduction in the interest rate. A point costs the borrower one percent of the mortgage amount. Under this proposal the government would assist the consumers in the purchase of these points. For instance, a one percent buy-down would equate to four points or four percent of the price of the home. For a home costing $183,300 (NAR's October median existing home sales price), the government's cost of buying down the mortgage rate one percent would be $7,332. It is estimated that this buy-down would cost the government about $40 billion ($7,332 multiplied by the 5.5 million annual sales figure, which assume 500,000 additional home sales from current 5 million unit pace).

A home buyer purchasing a home at $183,300 with a 30-year fixed interest rate mortgage of six percent has a monthly payment of $1,098.98. If there was an interest rate buy-down of a hundred basis points, the home buyer's monthly payment would be $983.99. That would save a consumer

$1,379.78 in annual payments. The yearly benefit to consumers under current sales figures would be about $6.9 billion. As a comparison, $300,000 house in the same scenario the home buyer's monthly payment would fall from $1,798.65 to $1,610.46.

These lower payments could offer incentive to potential home buyers. NAR estimates that a one percent buy-down will result in 500,000 to 700,000 additional home sales. This kind of stimulus help would reduce inventory and stabilize home prices.

Additional NAR Housing Stimulus Plan Components

In addition to the mortgage interest rate buy-down program, NAR's four point plan also includes the following components:

Permanent Homebuyer Tax Credit

NAR supports making the $7500 first-time homebuyer tax credit available to all buyers and eliminate repayment requirements. The credit's limited availability and repayment requirement severely limit the credit's use and effectiveness. A tax credit that is available to all homebuyers, first-time or repeat / trade-up buyers, will increase demand for the existing housing supply and kick-start the housing market.

Make the 2008 FHA, Fannie Mae and Freddie Mac Loan Limits Permanent

NAR believes that making the 2008 FHA and GSE loan limits permanent will expand mortgage affordability in a time when home sales and refinance activity are required to stabilize the housing market and move it towards recovery. Other sources of mortgage capital have dried up, increasing the importance of FHA and the GSEs.

Current law will reduce the agency's limits at the end of 2008. This will create a situation where some borrowers will find themselves facing potentially higher mortgage interest rates, more adverse terms and conditions, or unable to secure funding because they are in an area that is suddenly above the GSE and FHA loan limits. These significant changes in loan limits will act to amplify the existing problems within the housing market.

Making the 2008 limits permanent will assure that a wide range of borrowers will have access to fair and affordable mortgages, including those residing in high cost areas.

Permanently Bar Banks from Engaging In Real Estate

NAR supports a permanent ban on banks engaging in real estate brokerage or management. The banks have proven they have enough to do to simply manage the loan process. If banks had been allowed to engage in real estate brokerage, the current economic crisis would be much more severe. Allowing banking conglomerates to engage in commercial activities would create anti-competitive and anti-consumer concentrations of power within the financial services sector, an unlevel playing field among commercial competitors, and conflicts of interest. In the current economic environment, further consolidation of power would only act

to build more business concerns that the American taxpayer would be on the hook to "not let fail."

Conclusion

Our nation continues to face a significant challenge in dealing with the economic turmoil in today's housing market. We can only overcome this threat if we pursue avenues that will motivate the frightened and cautious housing consumer to enter the marketplace. NAR believes that the 4-Point Housing Stimulus Plan, in particular, the mortgage interest rate buy-down program, will encourage potential homebuyers, first-time and repeat, to enter the marketplace. Only then can the housing recovery begin, and only then can our nation's economy begin the long road home to stability.

The National Association of REALTORS® urges your strongest and immediate support for its 4-point Housing Stimulus plan.