

QUESTIONS ABOUT THE \$700 BILLION  
EMERGENCY ECONOMIC STABILIZATION  
FUNDS

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THE FIRST REPORT OF THE CONGRES-  
SIONAL OVERSIGHT PANEL FOR ECO-  
NOMIC STABILIZATION



DECEMBER 10, 2008.—Ordered to be printed

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CONGRESSIONAL OVERSIGHT PANEL FOR ECONOMIC STABILIZATION

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<sup>1</sup>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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## QUESTIONS ABOUT THE \$700 BILLION EMERGENCY ECONOMIC STABILIZATION FUNDS

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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.<sup>2</sup> In the last three months, 1.2 million Americans lost their jobs; 533,000 in November 2008 alone.<sup>3</sup> Service sector employment levels, in particular, fell far faster than expected last month.<sup>4</sup> One in ten mortgage holders is now in default, unable to make payments on their homes.<sup>5</sup> More than 200,000 families and small businesses filed for bankruptcy protection in the last two months.<sup>6</sup> Middle- and lower-income families have watched nervously as reductions in state funding threaten college access and af-

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<sup>2</sup>Peter S. Goodman, *U.S. Jobless Rate Hits 14-Year High*, N.Y. Times, Nov. 8, 2008, at A1.

<sup>3</sup>Sudeep Reddy et al., *Job Losses Worst Since 74: 533,000 Shed in November*, Wall St. J., Dec. 6, 2008, at A1.

<sup>4</sup>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](http://news.yahoo.com/s/ap/20081203/ap_on_bi_ge/economy_services).

<sup>5</sup>James R. Hagerty & Deborah Soloman, *U.S. News: Rising Number of Homeowners in Trouble*, Wall St. J., Dec. 6, 2008, at A2.

<sup>6</sup>Caroline Humer, *Consumer Bankruptcy Filings Jump Vs Year Ago*, Reuters, Dec. 3, 2008, available at <http://www.reuters.com/article/domesticNews/idUSTRE4B25U620081203>.

fordability.<sup>7</sup> Retail sales continue to fall,<sup>8</sup> credit card defaults are rising,<sup>9</sup> and savings rates hover at zero.<sup>10</sup> 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.<sup>11</sup>

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.<sup>12</sup>
- 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.<sup>13</sup>
- 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.<sup>14</sup>

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 war-

<sup>7</sup> Robert Tomsho, *For College-Bound, New Barriers to Entry—Their Budgets Squeezed, State Schools Cap Enrollment, Weigh Tuition Increases; Fears for Lower-Income Students*, Wall St. J., Dec. 3, 2008, at D1.

<sup>8</sup> Stephanie Rosenbloom, *In November, Shoppers Cut Spending Even More*, N.Y. Times, Dec. 3, 2008, at B6.

<sup>9</sup> 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>.

<sup>10</sup> Henry Kaufman, *How the Credit Crisis Will Change the Way America Does Business*, Wall St. J., Dec. 6, 2008, at A11.

<sup>11</sup> 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>.

<sup>12</sup> 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>.

<sup>13</sup> See, e.g., Dow Jones Industrial Average, MSN Money, available at <http://moneycentral.msn.com/investor/charts/chartdl.aspx?Symbol=%24indu.Dow>.

<sup>14</sup> Quarterly Banking Profile: Third Quarter 2008, FDIC 3 available at <http://www2.fdic.gov/qbp/2008sep/qbp.pdf>.

ranted.<sup>15</sup> The statute also created a Congressional Oversight Panel.<sup>16</sup> 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."<sup>17</sup>

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 program to guarantee approximately \$306 billion in Citigroup's troubled assets, Treasury receives \$4 billion of Citigroup preferred stock and warrants.<sup>18</sup> Together, these disbursements constitute approximately \$1,900 per American family, or almost 3% of the typical family's pre-tax income.<sup>19</sup>

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.<sup>20</sup>

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 Spe-

<sup>15</sup> Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343 § 115 (Oct. 3, 2008).

<sup>16</sup> *Id.*, at § 125.

<sup>17</sup> *Id.*, at § 2.

<sup>18</sup> 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](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.

<sup>19</sup> 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](http://pubdb3.census.gov/macro/032007/hhinc/new06_000.htm).

<sup>20</sup> *The Fed's evolving liquidity toolkit*, Reuters, Dec. 2, 2008, available at <http://www.reuters.com/article/bondsNews/idUSN2635039920081202?sp=true>.

cial Inspector General as soon as possible.<sup>21</sup> 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.<sup>22</sup>

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 have they leveraged the capital support to increase lending activity? Is this different from the way

<sup>21</sup>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>.

<sup>22</sup>*Troubled Asset Relief Program: Additional Actions Needed to Better Ensure Integrity, Accountability, and Transparency*, GAO, 09-161, December 2008.

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.<sup>23</sup> 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.<sup>24</sup>

- **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.”<sup>25</sup> Treasury indicated that it still intended to make purchases of mortgage-related assets from financial institutions.<sup>26</sup>

- **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.**<sup>27</sup> Instead, Secretary Paulson stated that Treasury was considering 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.<sup>28</sup>

- **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.**<sup>29</sup> 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

<sup>23</sup> Press Release, *FACT SHEET: Proposed Treasury Authority to Purchase Troubled Assets*, Sept. 20, 2008, available at <http://www.treas.gov/press/releases/hp1150.htm>.

<sup>24</sup> See GAO Report, *supra* note 18, at 1, 15–16.

<sup>25</sup> 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.

<sup>26</sup> GAO Report, *supra* note 18, at 16.

<sup>27</sup> 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>.

<sup>28</sup> 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>.

<sup>29</sup> GAO Report, *supra* note 18, at 31; Press Release, Federal Reserve, Nov. 25, 2008, available at <http://www.federalreserve.gov/newsevents/press/monetary/20081125a.htm>.

to have access to lower cost consumer finance and small business loans.”<sup>30</sup>

- **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.<sup>31</sup> 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.<sup>32</sup>

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 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.

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,<sup>33</sup> 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

<sup>30</sup> 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>.

<sup>31</sup> 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=aE1D2EJR0B2k>.

<sup>32</sup> 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/](http://money.cnn.com/2008/11/14/news/economy/fdic_bair/); GAO Report, *supra* note 17, at 29–30.

<sup>33</sup> See generally Gretchen Morgenson, *Debt Watchdogs: Tamed or Caught Napping*, N.Y. TIMES, Dec. 7, 2008, at A1.

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.

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.<sup>34</sup>

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.

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<sup>34</sup> GAO, *supra* note 18, at 49–57.

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.

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 other 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.<sup>35</sup> 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.<sup>36</sup> 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.<sup>37</sup> Moreover, foreclosure rates have continued to increase in recent months, and one in ten American mortgage holders are now in default or foreclosure.<sup>38</sup> 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%.<sup>39</sup> In 2002, when home prices were rising, researchers estimated that the holders of a loan are forced to recognize an average loss of \$58,792 each time they foreclose on a home.<sup>40</sup> Losses are much greater, however, when home prices are declining.

<sup>35</sup> 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>.

<sup>36</sup> See Steve Matthews & Scott Lanman, *Feds Kroszner Says Foreclosures Harming Middle-Income Areas*, BLOOMBERG.COM, Dec. 3, 2008, available at <http://www.bloomberg.com/apps/news?pid=20601213&sid=aSwRduPiiLjc>.

<sup>37</sup> 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=aSIW.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>.

<sup>38</sup> Hagerty & Soloman, *supra* note 5.

<sup>39</sup> Dan Immergluck & Geoff Smith, *The External Costs of Foreclosure: The Impact of Single-Family Mortgage Foreclosures on Property Values*, 17 HOUS. POLY DEBATE 57, 69, 72, 75 (2006), available at [http://www.fanniemae.foundation.org/programs/hpd/pdf/hpd\\_1701\\_immergluck.pdf](http://www.fanniemae.foundation.org/programs/hpd/pdf/hpd_1701_immergluck.pdf).

<sup>40</sup> 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](http://www.freddiemac.com/news/pdf/fmwp_0403_servicing.pdf) (citing Craig Focardi, *Servicing Default*

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 as losses from missed mortgage payments and declines in resale values.<sup>41</sup> 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.<sup>42</sup>

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.”<sup>43</sup> 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.

Treasury is reported to be considering a possible new proposal for reducing rates on fixed 30-year mortgages to as low as 4.5% by directing Fannie Mae and Freddie Mac to guarantee and purchase these low-rate mortgages.<sup>44</sup> The low mortgage rate would be available only to those purchasing homes, not those who hope to refinance.<sup>45</sup> 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

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*Management: An Overview of the Process and Underlying Technology* (TowerGroup, Research Note No. 033-13C, 2002).

<sup>41</sup> Francis Parisi, *The Anatomy of Loss Severity Assumptions In U.S. Subprime RMBS*, Standard & Poors, available at <http://www2.standardandpoors.com/portal/site/sp/en/us/page.article/4,5,5,1,1204835910066.html>.

<sup>42</sup> *Deep Dive into Subprime Mortgage Severity*, Fixed Income Research Report, Credit Suisse, June 19, 2008.

<sup>43</sup> Emergency Economic Stabilization Act, *supra* note 15, § 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.”)

<sup>44</sup> Edmund L. Andrews, *Washingtons New Tack: Helping Home Buyers*, N.Y. Times, Dec. 5, 2008, available at <http://www.nytimes.com/2008/12/05/business/05housing.html>.

<sup>45</sup> *Id.*

who have negative equity in their homes will remain unable to refinance their mortgages.<sup>46</sup>

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.<sup>47</sup> 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 a plan could avoid 1.5 million foreclosures at a cost of \$24.4 billion.<sup>48</sup>

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.

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 have they leveraged the capital support to increase lending activity? Is this different from the way

<sup>46</sup> 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](http://www.bloomberg.com/apps/news?pid=20601213&refer=home&sid=aYyk2_TLjGao).

<sup>47</sup> GAO Report, *supra* note 18, at 28.

<sup>48</sup> Federal Deposit Insurance Corporation, FDIC Loss Sharing Proposal to Promote Affordable Loan Modifications, Nov. 20, 2008, available at [www.fdic.gov/consumers/loans/loanmod/](http://www.fdic.gov/consumers/loans/loanmod/).

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.<sup>49</sup> 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.<sup>50</sup>

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.<sup>51</sup> To demonstrate compliance with the intended purpose of recapitalization, Chancellor Darling and Lord Mandelson are using 2007 levels of lending as a comparison.<sup>52</sup> 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.

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

<sup>49</sup> See also GAO Report, *supra* note 18, at 25.

<sup>50</sup> *Id.*, at 10.

<sup>51</sup> 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](http://www.hm-treasury.gov.uk/press_100_08.htm).

<sup>52</sup> 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](http://www.hm-treasury.gov.uk/press_105_08.htm).

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.<sup>53</sup> In exchange, MUFJ received a 21% stake in the company through perpetual preferred shares with a 10% annual dividend.<sup>54</sup>

Warren Buffett announced on September 23, 2008 that he would invest \$5 billion into Goldman Sachs.<sup>55</sup> 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.<sup>56</sup>

In November 2007, the Abu Dhabi Investment Authority invested \$7.5 billion in Citigroup, amounting to 4.9% of Citigroup's equity.<sup>57</sup> 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.<sup>58</sup>

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.<sup>59</sup> 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.<sup>60</sup> The exercise price is the financial institution's market price of common stock on the day it is accepted into the Capital Purchase Program.<sup>61</sup> The exercise price of the common

<sup>53</sup> Aaron Lucchetti, *Propped Up, Morgan Stanley Now Sets Forth to Right Itself*, Wall St. J., Oct. 14, 2008, at C1.

<sup>54</sup> *Id.*

<sup>55</sup> Ben White, *Buffett Deal at Goldman Seen as a Sign of Confidence*, N.Y. Times, Sep. 24, 2008, at A1.

<sup>56</sup> *Id.*

<sup>57</sup> 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>.

<sup>58</sup> *Id.*

<sup>59</sup> TARP Capital Purchase Program, Summary of Senior Preferred Terms available at <http://www.treas.gov/press/releases/reports/document5hp1207.pdf>.

<sup>60</sup> *Id.*

<sup>61</sup> *Id.*

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.<sup>62</sup>

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.<sup>63</sup>

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.<sup>64</sup> Under the plan, Citigroup will take the first \$29 billion in potential losses, plus 10% of any additional losses.<sup>65</sup> Treasury, the FDIC, and the Federal Reserve are responsible for any additional losses, which could be up to nearly \$250 billion.<sup>66</sup> 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.<sup>67</sup>

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 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?

<sup>62</sup> *Id.*, at 21–22.

<sup>63</sup> *See id.*

<sup>64</sup> 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>.

<sup>65</sup> 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](http://news.yahoo.com/s/nm/20081124/bs_nm/us_citigroup).

<sup>66</sup> *Id.*

<sup>67</sup> *Summary of Terms*, Department of Treasury, Nov. 23, 2008, available at [http://www.ustreas.gov/press/releases/reports/cititermsheet\\_112308.pdf](http://www.ustreas.gov/press/releases/reports/cititermsheet_112308.pdf).

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.<sup>68</sup> 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.<sup>69</sup>

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.<sup>70</sup> Total household debt outstanding in the U.S. now exceeds annual national personal income.<sup>71</sup> 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.<sup>72</sup>

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 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.<sup>73</sup> 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

<sup>68</sup> 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>.

<sup>69</sup> Eric Dash, *American Express To Be Bank Holding Company*, N.Y. Times, Nov. 11, 2008, at B2.

<sup>70</sup> Statistical Release, Consumer Credit G.19, Federal Reserve, available at <http://www.federalreserve.gov/releases/g19/current/>.

<sup>71</sup> 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>.

<sup>72</sup> 2004 Survey of Consumer Finances, Federal Reserve, available at [http://www.federalreserve.gov/PUBS/oss/oss2/2004/scf2004home\\_modify.html](http://www.federalreserve.gov/PUBS/oss/oss2/2004/scf2004home_modify.html).

<sup>73</sup> 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>.

than doubled between 1995 and 2005.<sup>74</sup> 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.<sup>75</sup>

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.<sup>76</sup>

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.

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.<sup>77</sup>

<sup>74</sup>*Id.*, at 5, 14, 18.

<sup>75</sup>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](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](http://money.cnn.com/2008/11/25/pf/debt_collections/?postversion=2008112611).

<sup>76</sup>*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>.

<sup>77</sup>Emergency Economic Stabilization Act, *supra* note 15, § 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.")

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.<sup>78</sup> 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.<sup>79</sup> 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.<sup>80</sup>

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.<sup>81</sup> Bank regulators consider bank examination ratings, selected performance ratios, and, in some cases, the intended use of capital injections.<sup>82</sup> 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.<sup>83</sup> Although no bank has been denied, some institutions have withdrawn their applications.<sup>84</sup> As of December 9, Treasury had in-

<sup>78</sup> See GAO Report, *supra* note 18, at 15.

<sup>79</sup> 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.*

<sup>80</sup> Press release, HM Treasury *supra* note 51; 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.

<sup>81</sup> 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>.

<sup>82</sup> *Id.*

<sup>83</sup> *Id.*

<sup>84</sup> *Id.*

vested in 87 institutions.<sup>85</sup> Of these capital infusions, \$115 billion has gone to 8 lenders.<sup>86</sup>

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.<sup>87</sup> 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.<sup>88</sup> Still others have expressed concern that with Treasury intervention, the banks that behaved prudently and whose balance sheets are strong are now losing their comparative advantage in a crisis.<sup>89</sup> 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.

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."<sup>90</sup> 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

<sup>85</sup> Capital Purchase Program Transaction Report, Dec. 9, 2008 available at <http://www.treas.gov/initiatives/eesa/docs/CPPTTransaction%20ReportDec%2009.pdf>.

<sup>86</sup> *Id.*

<sup>87</sup> Mark Landler, *U.S. Is Said To Be Urging New Mergers in Banking*, N.Y. Times, Oct. 21, 2008, at B1.

<sup>88</sup> 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>.

<sup>89</sup> 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>.

<sup>90</sup> Emergency Economic Stabilization Act, *supra* note 15, at § 101(a).

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.<sup>91</sup>

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.”<sup>92</sup> 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.”<sup>93</sup>

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).<sup>94</sup> This program will provide up to \$200 billion on a non-recourse basis to holders of assets backed by new and recent loans.<sup>95</sup> Under the TALF terms, the first \$20 billion comes from TARP and is subordinated to any additional funds provided by FRBNY.<sup>96</sup>

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.<sup>97</sup>

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.

<sup>91</sup> *Id.*, at § 3(9).

<sup>92</sup> *Id.*, at § 3(5) (emphasis added).

<sup>93</sup> 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.

<sup>94</sup> Press Release, Federal Reserve, *supra* note 29.

<sup>95</sup> *Id.*

<sup>96</sup> TALF Terms and Conditions, Federal Reserve, available at <http://www.federalreserve.gov/newsevents/press/monetary/monetary20081125a1.pdf>.

<sup>97</sup> 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.<sup>98</sup> 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.<sup>99</sup>

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.

## 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 ac-

<sup>98</sup> 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>.

<sup>99</sup> See e.g. Charles Feldman, *Alt-A Loans: The Crisis Yet to Come*, BIGGERPOCKETS, available at <http://www.biggerpockets.com/renewblog/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\\_stagdeflation\\_deepens](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_stagdeflation_deepens).

tions 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).