

**FOLLOWING THE MONEY: REPORT OF THE SPECIAL INSPECTOR GENERAL FOR THE TROUBLED ASSET RELIEF PROGRAM [SIGTARP]**

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**HEARING**

BEFORE THE

**COMMITTEE ON OVERSIGHT  
AND GOVERNMENT REFORM**

**HOUSE OF REPRESENTATIVES**

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

JULY 21, 2009

**Serial No. 111-88**

Printed for the use of the Committee on Oversight and Government Reform



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**FOLLOWING THE MONEY: REPORT OF THE  
SPECIAL INSPECTOR GENERAL FOR THE  
TROUBLED ASSET RELIEF PROGRAM  
[SIGTARP]**

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**TUESDAY, JULY 21, 2009**

HOUSE OF REPRESENTATIVES,  
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM,  
*Washington, DC.*

The committee met, pursuant to notice, at 10 a.m., in room 2154, Rayburn House Office Building, Hon. Edolphus Towns (chairman of the committee) presiding.

Present: Representatives Towns, Cummings, Kucinich, Tierney, Clay, Watson, Lynch, Connolly, Quigley, Kaptur, Van Hollen, Cuellar, Speier, Driehaus, Issa, Burton, Mica, Duncan, McHenry, Bilbray, Jordan, Flake, Fortenberry, Chaffetz, and Schock.

Staff present: John Arlington, chief counsel, investigations; Beverly Britton Fraser, counsel; Kwane Drabo and Katherine Graham, investigators; Jean Gosa, clerk; Adam Hodge, deputy press secretary; Carla Hultberg, chief clerk; Phyllis Love and Christopher Sanders, professional staff members; Mike McCarthy, deputy staff director; Jesse McCollum, senior advisor; Leah Perry, senior counsel; Jason Powell, counsel and special policy advisor; Ophelia Rivas, assistant clerk; Jenny Rosenberg, director of communications; Joanne Royce, senior investigative counsel; Ron Stroman, staff director; Lawrence Brady, minority staff director; John Cuaderes, minority deputy staff director; Jennifer Safavian, minority chief counsel for oversight and investigations; Frederick Hill, minority director of communications; Dan Blankenburg, minority director of outreach and senior advisor; Adam Fromm, minority chief clerk and Member liaison; Kurt Bardella, minority press secretary; Christopher Hixon, minority senior counsel; and Brien Beattie and Mark Marin, minority professional staff members.

Chairman TOWNS. We will come to order. Good morning and thank you for being here.

The Troubled Asset Relief Program [TARP], has evolved into a program of unprecedented scope, scale and complexity. TARP funds are being used in connection with 12 separate programs under which the Treasury has already committed \$643 billion and spent \$441 billion.

Today we will hear from the Special Inspector General for TARP, Neil Barofsky, as he presents his quarterly report to Congress. His findings, quite frankly, are astonishing.

According to the IG, "TARP has become a program in which taxpayers are No. 1, not being told what TARP recipients are doing with their money; No. 2, have not been told what their investments are worth; and No. 3, will not be told the full details of how their money is being invested."

He found that even though Treasury receives monthly reports on the value of TARP investments, it will not make that information public. Incredibly, the Treasury Department has taken the position that it will not even ask TARP recipients what they are doing with the taxpayers' money. In short, taxpayers now have a \$700 billion spending program that is being run under the philosophy of don't ask, don't tell.

However, this committee has been asking a lot of questions about last fall's financial meltdown and its consequences. The key question is this: Are these programs being run for the benefit of the American taxpayers who are funding them or for the benefit of Wall Street? That is the question. Without more transparency in these programs, we cannot answer that question for sure. But what we have learned from the IG is not encouraging.

Treasury has hired nine private firms to be asset managers for the Public-Private Investment Program. All of these large firms are engaged in extensive private investment activities. According to the Special IG, this arrangement is vulnerable to conflicts of interest, collusion, and money laundering. Yet Treasury is allowing these firms to share information between employees who make investment decisions on behalf of the Government and those who manage private funds. This arrangement is further indication that Federal financial regulation is a bit too cozy with Wall Street.

Meanwhile, lending to American businesses and consumers remains weak. Some firms claim to have used TARP funds to increase lending but others have used it to acquire other businesses or shore up their own balance sheets and then award bonuses to employees. There is no evidence that Treasury has made any attempt to determine whether TARP funding has resulted in increased lending and whether that has had any effect on reducing unemployment.

I also want to voice my deep concern over recent news that Treasury has requested a legal opinion from the Department of Justice challenging the Special Inspector General's independence. Congress would not have established a Special Inspector General to oversee the TARP if all we wanted was a yes man or yes woman that Treasury could ignore. It is critical that oversight, investigations, and audits of TARP remain unencumbered. Congress may have given Treasury some leeway when it comes to the TARP but we didn't give them a blank check.

The problem is that we can't even say whether the TARP programs are working or not because the information that would allow Congress and the taxpayers to analyze whether they are getting a good return on their investments has not been made available.

I hope today's hearing and the Special IG's report will be a wake-up call to the Treasury and the Federal Reserve that our financial system cannot be run behind closed doors. Again, I want to thank Mr. Barofsky for appearing today. I look forward to his testimony.

At this time, I yield time to the ranking member from the great State of California, Congressman Issa.  
[The prepared statement of Chairman Edolphus Towns follows:]

HOUSE COMMITTEE ON  
OVERSIGHT & GOVERNMENT REFORM

**CHAIRMAN EDOLPHUS TOWNS**

**OPENING STATEMENT**

HEARING

**“FOLLOWING THE MONEY: REPORT OF THE SPECIAL  
INSPECTOR GENERAL FOR THE TROUBLED ASSET  
RELIEF PROGRAM (SIGTARP)”**

JULY 21, 2009

Good morning and thank you for being here.

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According to the IG, “the TARP has become a program in which taxpayers: (1) are not being told what TARP recipients are doing with their money; (2) have not been told what their investments are worth; and (3) will not be told the full details of how their money is being invested.

He found that even though Treasury receives monthly reports on the value of TARP investments, it will not make that information public. Incredibly, the Treasury Department has taken the position that it will not even ask TARP recipients what they are doing with the taxpayers' money.

In short, the taxpayers now have a \$700 billion spending program that's being run under the philosophy of "Don't ask, don't tell."

However, this Committee has been asking a lot of questions about last fall's financial meltdown and its consequences, and the key question is this: are these programs being run for the benefit of the American taxpayers who are funding them, or for the benefit of Wall Street?

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Again, I want to thank Mr. Barofsky for appearing today,  
and I look forward to his testimony.

# # #

Mr. ISSA. Thank you, Mr. Chairman. Thank you again for this vigorous oversight.

As you have said so often, all we ask for is transparency. Today we will hear that all we are not getting is transparency.

Mr. Chairman, because I am going to include them in my opening statement, I would like to ask unanimous consent that three pieces be put in the record. The first, Mr. Chairman, is your letter to Tim Geithner asking that he specifically include the recommendations of the Special IG, something which I am not sure there is an answer to, but it is from February 5th. The second is today's New York Times that says "Big Estimate, Worth Little, on Bailout." I suspect that will be referred to many times today.

The third is because it is related to TARP and to a case recently settled against the Government. I have a letter in response to a letter from myself, on which the chairman has been copied, from Maurice Hank Greenberg concerning his continued willingness to arbitrate rather than to litigate the disputes which so far he has been winning.

Chairman TOWNS. Without objection, so ordered.

Mr. ISSA. Thank you, Mr. Chairman.

Today we are going to hear about a \$23.7 trillion figure related to the TARP. Additionally, we are going to hear that the full transparency, which we asked for and which this President and this administration have promised, is being blocked by the bureaucracy that often seems to say, "just trust us and we will deliver." Now, just trust us and we will deliver, quite frankly, I am not making the comparison except for the purpose of people understanding why we can't trust, Bernie Madoff said, "trust us, we have high returns."

The fact is Treasury is saying, "trust us because you really don't have \$23.7 trillion at risk." As a matter of fact, effectively they are saying that the only thing at risk is a fraction of the \$700 billion that we have committed. Mr. Chairman, nothing could be further from the truth. Over my decades in business, one thing I learned was that insurance policies cost money because the amount insured is, in fact, at risk.

Anyone who thinks that we mark to market assets to half of their original value with some regularity, when they include toxic assets and written-down homes, and then believes that there would be no risk in guaranteeing those, particularly Freddie, Fannie and the other guarantees that are out there, is simply living in a dream world. If we underwrite in various forms over \$23 trillion, we will in fact have losses. There are no gains, for all practical purposes, in these assurances so they are not offset by profits.

In the case of the TARP directly, and I know we are going to hear from the Special IG today, there will be some good news. There already has been some return and some profit on moneys extended in the TARP. That is not so of many of our guarantees. Most of our guarantees are, in fact, insurance without cost to both profit and nonprofit organizations.

Mr. Chairman, I believe that this administration desperately wants the kinds of transparency that will allow us to uncover potential insider trading or cozy relationships between the part of a trading organization which is trading for the Government and the

part which is trading for itself. I believe only through our vigorous oversight will this administration be able to create a kind of sandwich where on one side is the President asking for transparency, on the other side is the Congress demanding it, and in the middle is the IG trying to overcome a bureaucracy that has always been able to outlast administrations and chairmanships.

Mr. Chairman, today we have to make sure that this Special IG goes back with the clear message that Congress will not be outlasted. Our patience is running out for the transparency promised by the administration, promised by the Congress, and not yet delivered by the people who transcend administrations one after another.

Mr. Chairman, I look forward to the testimony of the Special IG and I commend you for continuing this vigorous oversight. I yield back the balance of my time.

[The prepared statement of Hon. Darrell E. Issa follows:]

EDOLPHUS TOWNS, NEW YORK  
CHAIRMAN

DARRELL E. ISSA, CALIFORNIA  
RANKING MINORITY MEMBER

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**Statement of Representative Darrell Issa, Ranking Member**  
**Full Committee Hearing: "Following the Money: Report of the Special Inspector General for the**  
**Troubled Asset Relief Program (SIGTARP)"**  
**July 21, 2009**

Mr. Chairman, thank you for calling today's hearing.

I appreciate Mr. Barofsky's appearance before the committee today. Congress intended SIGTARP to provide oversight of the federal government's bailout efforts, and that's exactly what Mr. Barofsky and his staff are doing. SIGTARP's current report to Congress identifies numerous failures of the Treasury Department to provide transparency and prevent fraud, and these failures are undermining the American people's faith in their government.

When President Obama came to office, he promised to implement TARP "with the highest degree of accountability and transparency possible." As a presidential candidate, Mr. Obama criticized the Bush Administration's "failure to track how the money has been spent." Once again, we've learned that this Administration has abandoned its promise to the American people and is preventing the taxpayers from accessing information about how their money is being spent.

Mr. Chairman, more than four months ago you wrote Secretary Geithner encouraging him to adopt all of SIGTARP's original recommendations prior to awarding any additional TARP funds. Not only has Mr. Geithner ignored your request, but he has spent billions more of taxpayer money without providing the transparency that SIGTARP has repeatedly recommended. For example, Treasury has refused repeated requests from SIGTARP and the Congress to require TARP recipients to report on their use of taxpayer funds, calling such reporting "meaningless." However, we've learned from SIGTARP's first completed audit that almost all banks surveyed by SIGTARP were able to provide meaningful information about how they are utilizing TARP funds.

One interesting result of this audit is that nearly one-third of the banks reported the use of TARP funds to purchase mortgage-backed securities primarily insured by Fannie Mae and Freddie Mac, which are now explicitly backed by the federal government. SIGTARP's audit notes that the banks targeted these securities precisely because of the safety associated with them; if the underlying mortgage borrowers default, the American taxpayers foot the bill.

Treasury's repeated refusal to require TARP recipients to report on their use of taxpayer money is particularly troubling in light of the fact that technology exists and is readily available to follow the money. This Committee has learned through expert testimony that eXtensible Business Reporting Language ("XBRL"), an XML-based technology standard for business information, has the potential to make financial

information disclosure more transparent and more accessible to regulators, investors, and the general public. XBRL is already in place as a reporting standard in approximately 40 countries around the world, including China. Banks in the United States are currently required to disclose information to the FDIC in XBRL format, and the SEC recently approved a final rule mandating the use of XBRL for all public company reporting, with some companies required to comply starting in June of 2009. I am proud, Mr. Chairman, to have your support on H.R. 2392, which would mandate the use of a single data standard for the reporting of financial information and bring real transparency to TARP and financial markets.

SIGTARP's report also sheds light on several problems related to the Administration's plan to provide taxpayer funds to leverage private sector purchases of toxic assets, the so-called "Public-Private Investment Program," or PPIP. Treasury has repeatedly refused to adopt SIGTARP's recommendation that Treasury require the imposition of an informational barrier or "wall" between the private fund managers making decisions about which toxic assets to purchase using taxpayer-funded leverage and those employees of the companies who manage non-PPIP funds. Treasury is effectively insisting that not only must taxpayer money be used to leverage the purchase of toxic assets, but also that the fund managers have the freedom to manipulate inside information about these purchases for their private profit, through insider trading or by inflating the value of other assets on their books. This type of market manipulation should be prevented, not facilitated, by the Treasury Department.

As the Special Inspector General for TARP notes in his written testimony, "TARP has become a program in which taxpayers (i) are not being told what most of the TARP recipients are doing with their money, (ii) have still not been told how much their substantial investments are worth, and (iii) will not be told the full details of how their money is being invested." Treasury's continued unwillingness to provide basic transparency despite numerous recommendations of SIGTARP and the intent of Congress is simply unacceptable and violates one of President Obama's most basic and fundamental promises to the American people.

Mr. Chairman, the ramifications of the Treasury Department's failure to provide transparency could not be more important. **As SIGTARP notes in his written testimony, the total amount of taxpayer money on the line, across all of the federal government's bailout efforts, is \$23.7 trillion.** To put this number in perspective, total annual US GDP is about \$14 trillion. This means that if all of the potential losses of taxpayer money become a reality, the total amount of goods and services produced throughout our economy for almost two years would have to be entirely devoted to paying for these bailouts.

What's even more disturbing than the \$23.7 trillion figure is the reality that Treasury is actively obstructing our ability to determine what the true value of the TARP investment is worth, what TARP recipients are doing with taxpayer dollars and how they are investing it. Until we have full transparency, we will never be able to know how much risk Treasury is assuming on behalf of the taxpayers.

Thank you again, Mr. Chairman, for calling this hearing. I look forward to continuing to work closely with you to hold this Administration accountable for its use of taxpayer money through TARP and other government bailout efforts.

**The New York Times**



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July 21, 2009

## Big Estimate, Worth Little, on Bailout

By **FLOYD NORRIS**

Just how much could the bailout of the financial system end up costing American taxpayers?

Neil M. Barofsky, the special inspector general for the [Troubled Asset Relief Program](#) set up by the [Treasury Department](#), came up with the largest number yet in testimony prepared for delivery Tuesday to a House committee. "The total potential federal government support could reach up to \$23.7 trillion," he stated.

But in the [report](#) accompanying his testimony, Mr. Barofsky conceded the number was vastly overblown. It includes estimates of the maximum cost of programs that have already been canceled or that never got under way.

It also assumes that every home mortgage backed by [Fannie Mae](#) or [Freddie Mac](#) goes into default, and all the homes turn out to be worthless. It assumes that every bank in America fails, with not a single asset worth even a penny. And it assumes that all of the assets held by money market [mutual funds](#), including [Treasury bills](#), turn out to be worthless.

It would also require the Treasury itself to default on securities purchased by the [Federal Reserve](#) system.

The sheer unreality of the number did not stop some members of Congress from taking the estimate seriously.

"The potential financial commitment the American taxpayers could be responsible for is of a size and scope that isn't even imaginable," said Representative Darrell E. Issa of California, the ranking Republican on the House Committee on Oversight and Government Reform, which will hold the hearing. "If you spent a million dollars a day going back to the birth of Christ, that wouldn't even come close to just one trillion dollars -- \$23.7 trillion is a staggering figure."

Mr. Issa's staff distributed a briefing memo for Republicans on the committee that quoted the testimony relating to the \$23.7 trillion number, but did not mention any of the qualifications contained in the report.

In an interview Monday evening, Mr. Barofsky said he did not view his testimony as misleading.

"We're not suggesting that we're looking at a potential loss to the government of \$23 trillion," he said. "Our goal is to bring transparency, to put things in context."

Asked what he thought the maximum total cost could be, he replied that it was not his job to estimate that, and declined to give a figure.

Mr. Barofsky has no authority to investigate most of the programs he discussed. He came up with far smaller numbers for the Troubled Asset Relief Program, known as TARP, that he is charged with monitoring. Of the \$700 billion appropriated by Congress, the Treasury has so far spent \$441 billion, and about \$70 billion of that has been repaid.

"TARP does not operate in a vacuum," Mr. Barofsky said in his prepared testimony. To properly evaluate that spending, "the context of these broader efforts" must be considered.

That \$23.7 trillion figure would amount to about \$77,000 for every person in the United States, and would be almost \$10 trillion more than the country's entire economic output, which is \$14.1 trillion.

To reach that figure, Mr. Barofsky added up all possible Federal Reserve programs, and got a total of \$6.8 trillion. He figured the TARP program could end up costing \$3 trillion, including possible spending by the [Federal Deposit Insurance Corporation](#) and the Fed.

For those totals to be reached, every dollar invested by the government in banks would have to become worthless, and the banks would have to default on securities guaranteed by the F.D.I.C. All the collateral posted by the banks to get loans from the Fed would also have to become worthless.

Added to those figures are \$4.4 trillion in other possible Treasury programs, and \$2.3 trillion in F.D.I.C. guarantees of deposits. The final \$7.2 trillion comes mostly from various mortgage-related programs.

Even if all those numbers somehow turned out to be accurate, the report conceded that the total would be smaller because "there is potential for double-counting of exposures where different federal agencies provide guarantees for the same financial institutions."

The report does not appear to discuss how total government obligations are increased when the Fed either guarantees or purchases Treasury securities. In the interview, Mr. Barofsky declined to address that question.

Andrew Williams, a spokesman for the Treasury Department, called the figures "distorted" because they did not consider the value of the collateral posted for loan programs, as well as the value of securities the Treasury has received from banks.

"These estimates of potential exposures do not provide a useful framework for evaluating the potential cost of these programs," Mr. Williams said, according to Bloomberg News. "This estimate includes programs at their hypothetical maximum size, and it was never likely that the programs would be maxed out at the same time."

He added that the United States had spent less than \$2 trillion so far, and that much of that was backed by valuable assets.

It may be the first time that \$2 trillion appears to be a small number.

Chairman TOWNS. Thank you very much. I thank the gentleman for his statement.

We will now turn to our first and only witness, Mr. Neil Barofsky. It is the long standing policy that we swear all of our witnesses in. Will you please stand and raise your right hand?

[Witness sworn.]

Chairman TOWNS. Let the record reflect that the witness answered in the affirmative.

He is the Special Inspector General for the Troubled Asset Relief Program [SIGTARP]. Prior to assuming this position on December 15, 2008, Mr. Barofsky was a Federal prosecutor in the U.S. Attorney's Office for the Southern District of New York for more than 8 years. In that Office, Mr. Barofsky was a senior trial counselor and headed the Mortgage Fraud Group, which investigated and prosecuted cases of mortgage fraud and securities fraud with respect to collateralized debt obligations. Notably, Mr. Barofsky led the broad investigation into the \$55 trillion credit default swap market and is a recipient of the Attorney General's John Marshall Award for his work.

We welcome you, Mr. Barofsky. You are allowed as much time as you may consume. We generally give people 5 minutes. We thought about giving you 10 minutes but then I thought about the importance of it and so I said as much time as you may consume. But try to stay within 10 minutes.

**STATEMENT OF NEIL BAROFSKY, SPECIAL INSPECTOR  
GENERAL FOR THE TROUBLED ASSET RELIEF PROGRAM**

Mr. BAROFSKY. Thank you, Mr. Chairman. Mr. Chairman, Ranking Member Issa, and members of the committee, it is an honor and privilege to appear before you today and to present to you our quarterly report to Congress. In my testimony I would like to outline what is contained in our quarterly report, section by section, going over some of the highlights.

In Section 2 of our report, we do as we do in each of our quarterly reports to summarize what has happened in the last 3 months in the TARP. This has been a busy quarter for the TARP. We have seen the expansion of several programs; the bankruptcy of General Motors and Chrysler, and the extraordinary Government support of those industries; and the expansion of the Mortgage Modification Program with the selection of servicers and the allocation of approximately \$18 billion in support of that program.

We have seen paybacks of TARP money, more than \$70 billion from Capital Purchase Program recipients, and the launch of the Public-Private Investment Program with the selection of nine asset managers and the commitment to provide up to \$30 billion of taxpayer funds to fund that program. That is all laid out in Section 2.

In Section 3, we have attempted to put the TARP program in context. Originally started as a \$700 billion program to purchase toxic assets from financial institutions, the TARP has expanded to 12 separate programs involving up to \$3 trillion. But it doesn't stand alone in the support of the financial system from the Federal Government. Since 2007, more than 50 different programs from different agencies have been announced, instituted, and implemented.

A lot of what we have seen when hearing about TARP recipients and their participation is that it is not a loan. A bank may have an investment from the TARP but also participate or issue debt with an FDIC guarantee or borrow money from the Federal Reserve.

There are so many numbers flying around that we thought to further the goal of transparency we wanted to put the TARP in the necessary context of these other programs. That is what we have done in Section 3. For each of the 50 programs, we put out three different numbers. One is the amount of money that is currently outstanding on each of those programs, which is about \$3 trillion. Two is the high water mark from their inception until January 30, 2009, which is about \$4.7 trillion. The third number is the total exposure of each of these programs were they fully subscribed to, if each of the insurance contracts were used, all of the different programs were used, and all the support in total, and that number totals \$23.7 trillion.

Now, since we have issued this report, there has been some harsh criticism coming from Treasury. I have seen some public statements that attack the numbers in our report as being inflated. One press comment said that a Treasury spokesman described them as ridiculous. We take offense to that.

I think that if you look at the report, in context it is very clear where these numbers came from. They came from the Government itself. These are all open source, public source information. This is from the Web sites of the Treasury and the Federal Reserve, and submissions to Congress. If the numbers are inflated, then it was the Government itself that inflated them, not us.

Second, as far as the suggestion that we are trying to shock and awe with this number, again, I think that we have made very clear in this report in black and white what this number means. We explain that this number involves programs that, yes, have terminated. We explain that some of these numbers are collateralized and that there is collateral. All that is set forth in black and white.

But one thing is very clear: The number is basically just the accumulation of what these 50 separate programs are and what the total amount of financial support that the Government has committed to is.

Frankly, this attack is a challenge to the basic transparency that we try to provide in this report so that Members of Congress and members of the public understand in total what is going on as part of the Government's support of the financial system in this crisis.

That brings us to our next section, Section 5 of the report, where we talk about our recommendations. One of our primary recommendations brings us to the same issue of transparency. We have now been in existence for 7 months, my Office. Over those 7 months we have been pushing, really from my 8th day in my Office when I made the first recommendation, to push for greater and greater transparency. That recommendation is one that we continue to make today, that Treasury require TARP recipients to report on how they are using the money.

Treasury has repeatedly refused to adopt this recommendation. As a result, in February we sent out letters to each and every financial institution to ask them directly to report to us to prove that

they can provide meaningful information, that there is a purpose to requiring banks to account for their use of funds. Yesterday we issued that audit result and the evidence is as we suspected.

Contrary to Treasury's suggestions, banks can and should be required to report on how they are using funds. Banks reported a variety of different uses aside from just lending, as the chairman noted. They used it to acquire other financial institutions, to make investments in mortgage backed securities, and to pay down debt, all different forms of use of funds that can and should be verified and that can be part of the basic transparency of the TARP program.

As we note in our recommendations, this is not the only recommendation regarding transparency that has not been adopted. We set four different recommendations, including those related to basic concepts so taxpayers can know the value of the assets that they are the chief investors for. Treasury receives monthly reports on those valuation estimates but will not share them with the public. We think that, too, is a failure of transparency.

Similarly, we have recommendations related to the TELF Program and the Public-Private Investment Program. They involve the basic concept of transparency so that one, the taxpayers can know what is going on with their investments; and two, as has been famously quoted, "sunshine is the best disinfectant," and it will discourage and deter bad behavior.

In Section 1 of our report, we talk about what we have been doing for the past 3 months, namely building our Audit and Investigations Divisions. We are concluding six audits this quarter. We have announced or are about to announce five separate audits. We talk about that. Our Investigations Division is continuing. We have 35 open criminal investigations.

We will continue to strive forward with bringing greater transparency to this program. Mr. Chairman, Ranking Member Issa, it is again a privilege to be here today to present this report, which we believe is an essential part of continued transparency. We have had more than 12 million hits to our Web site since we have started and almost 700,000 downloads of our previous reports. I think that we act in deed as in word to bring this necessary transparency.

I thank you for your indulgence on time. I look forward to answering any questions you may have.

[The prepared statement of Mr. Barofsky follows:]



FOR OFFICIAL USE ONLY UNTIL RELEASED BY THE  
HOUSE COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

**STATEMENT OF NEIL BAROFSKY**  
**SPECIAL INSPECTOR GENERAL**  
**TROUBLED ASSET RELIEF PROGRAM**

BEFORE THE  
HOUSE COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

July 21, 2009

Chairman Towns, Ranking Member Issa and Members of the Committee, I am honored to appear before you today to deliver to this Committee my quarterly report to Congress.

In the nine months since the Emergency Economic Stabilization Act of 2008 ("EESA") authorized creation of the Troubled Asset Relief Program ("TARP"), the U.S. Department of the Treasury ("Treasury") has created 12 separate programs involving Government and private funds of up to almost \$3 trillion. From programs involving large capital infusions into hundreds of banks and other financial institutions, to a mortgage modification program designed to modify millions of mortgages, to public-private partnerships using tens of billions of taxpayer dollars to purchase "toxic" assets from banks, TARP has evolved into a program of unprecedented scope, scale, and complexity. Moreover, TARP does not function in a vacuum but is rather part of the broader Government efforts to stabilize the financial system, an effort that includes dozens of inter-related programs operated by multiple Federal agencies. Thus, before the American people and their representatives in Congress can meaningfully evaluate the effectiveness of TARP, not only must the TARP programs themselves be understood, but also TARP's scope and scale must be placed into proper context with the other Government programs designed to support the financial system.

#### **TARP IN FOCUS, AND IN CONTEXT**

TARP, as originally envisioned in the fall of 2008, would have involved the purchase, management, and sale of up to \$700 billion of "toxic" assets, primarily troubled mortgages and mortgage-backed securities ("MBS"). That framework was soon shelved, however, and TARP funds are being used, or have been announced to be used, in connection with 12 separate programs that, as set forth in Table 1 below, involve a total (including TARP funds, loans and guarantees from other agencies, and private money) that could reach nearly \$3 trillion. Through June 30, 2009, Treasury has announced the parameters of how \$643.1 billion of the \$700 billion would be spent through the 12 programs. Of the \$643.1 billion that Treasury has committed, \$441 billion has actually been spent.

As massive and as important as TARP is on its own, it is just one part of a much broader Federal Government effort to stabilize and support the financial system. Since the onset of the financial crisis in 2007, the Federal Government, through many agencies, has implemented dozens of programs that are broadly designed to support the economy and financial system. The total potential Federal Government support could reach up to \$23.7 trillion. Any assessment of the effectiveness or the cost of TARP should be made in the context of these broader efforts.

| TOTAL POTENTIAL FUNDS SUBJECT TO SIGTARP OVERSIGHT, AS OF 6/30/2009 (\$ BILLIONS) |  |                                      |                             |
|---|--|--------------------------------------|-----------------------------|
| Program   | Brief Description or Participant   | Total Projected Funding at Risk (\$) | Projected TARP Funding (\$) |
| Capital Purchase Program ("CPP")  | Investments in 649 banks to date; 8 institutions total \$134 billion; received \$70.1 billion in capital repayments  | \$218.0<br>(\$70.1)                  | \$218.0<br>(\$70.1)         |
| Automotive Industry Financing Program ("AIFP")                                    | GM, Chrysler, GMAC, Chrysler Financial; received \$130.8 million in loan repayments (Chrysler Financial)             | 79.3                                 | 79.3                        |
| Auto Supplier Support Program ("ASSP")  | Government-backed protection for auto parts suppliers  | 5.0                                  | 5.0                         |
| Auto Warranty Commitment Program ("AWCP")   | Government-backed protection for warranties of cars sold during the GM and Chrysler bankruptcy restructuring periods | 0.6                                  | 0.6                         |
| Unlocking Credit for Small Businesses ("UCSB")                                    | Purchase of securities backed by SBA loans   | 15.0                                 | 15.0                        |
| Systemically Significant Failing Institutions ("SSFI")                            | AIG investment   | 69.8                                 | 69.8                        |
| Targeted Investment Program ("TIP")   | Citigroup, Bank of America investments   | 40.0                                 | 40.0                        |
| Asset Guarantee Program ("AGP")   | Citigroup, ring-fence asset guarantee  | 301.0                                | 5.0                         |
| Term Asset-Backed Securities Loan Facility ("TALF")                               | FRBNY non-recourse loans for purchase of asset-backed securities   | 1,000.0                              | 80.0                        |
| Making Home Affordable ("MHA") Program  | Modification of mortgage loans   | 75.0                                 | 50.0                        |
| Public-Private Investment Program ("PPIP")  | Disposition of legacy assets; Legacy Loans Program, Legacy Securities Program (expansion of TALF)                    | 500.0 – 1,000.0                      | 75.0                        |
| Capital Assistance Program ("CAP")  | Capital to qualified financial institutions; includes stress test  | TBD                                  | TBD                         |
| New Programs, or Funds Remaining for Existing Programs                            | Potential additional funding related to CAP; other programs  | 131.4                                | 131.4                       |
| <b>Total</b>  |  | <b>\$2,365.0 – \$2,865.0</b>         | <b>\$699.0</b>              |

Note: See Table 2.1 in Section 2 for notes and sources related to the information contained in this table.

#### OVERSIGHT ACTIVITIES OF SIGTARP

Since its April Quarterly Report, SIGTARP has been actively engaged in fulfilling its vital investigative and audit functions as well as in building its staff and organization.

SIGTARP's Investigations Division has developed rapidly and is quickly becoming a sophisticated white-collar investigative agency. Through June 30, 2009, SIGTARP has 35 ongoing criminal and civil investigations. These investigations include complex issues concerning suspected accounting fraud, securities fraud, insider trading, mortgage servicer misconduct, mortgage fraud, public corruption, false statements, and tax investigations. Two of SIGTARP's investigations have recently become public:

- **Federal Felony Charges Against Gordon Grigg:** On April 23, 2009, Federal felony charges were filed against Gordon B. Grigg in the U.S. District Court for the Middle District of Tennessee, charging him with four counts of mail fraud and four counts of wire fraud. The charges are based on Grigg's role in embezzling approximately \$11 million in client investment funds that he garnered through false claims, including that he had invested \$5 million in pooled client funds toward the purchase of the TARP-guaranteed debt. Grigg pleaded guilty to all charges and is scheduled for sentencing on August 6, 2009.
- **FTC Action Against Misleading Use of "MakingHomeAffordable.gov":** On May 15, 2009, based upon an action brought by the Federal Trade Commission ("FTC"), a Federal district court issued an order to stop an Internet-based operation that pretended to operate "MakingHomeAffordable.gov," the official website of the Federal Making Home Affordable program. According to the FTC's complaint, the defendants purchased sponsored links as advertising on the results pages of Internet search engines, and, when consumers searched for "making home affordable" or similar search terms, the defendants' ads prominently and conspicuously displayed "MakingHomeAffordable.gov." Consumers who clicked on this link were not directed to the official website, but were diverted to sites that solicit applicants for paid loan modification services. The operators of these websites either purport to offer loan modification services themselves or sold the victims' personally identifying information to others. SIGTARP is providing assistance to FTC during the investigation.

More than 50% of SIGTARP's ongoing investigations were developed in whole or in part through tips or leads provided on SIGTARP's Hotline (877-SIG-2009 or accessible at [www.SIGTARP.gov](http://www.SIGTARP.gov)). Over the past quarter, the SIGTARP Hotline received and analyzed more than 3,200 tips, running the gamut from expressions of concern over the economy to serious allegations of fraud.

SIGTARP remains committed to being proactive in dealing with potential fraud in TARP. For example, the previously announced TALF Task Force, which was organized by SIGTARP to get out in front of any efforts to profit criminally from the Term Asset-Backed Securities Loan Facility ("TALF"), has been expanded to cover the Public-Private Investment Program ("PPIP"). In addition to SIGTARP, the TALF-PPIP Task Force consists of the Inspector General of the Board of Governors of the Federal Reserve System, the Federal Bureau of Investigation, Treasury's Financial Crimes Enforcement Network, U.S. Immigration and Customs Enforcement, the Internal Revenue Service Criminal Investigation Division, the Securities and Exchange Commission, and the U.S. Postal Inspection Service.

On the audit side, SIGTARP is in the process of completing its first round of audits. SIGTARP issued yesterday its first formal audit report concerning how recipients of Capital Purchase Program ("CPP") funds reported their use of such funds. In February 2009, SIGTARP sent survey letters to more than 360 financial and other institutions that had completed TARP funding agreements through January 2009. Although most banks reported they did not segregate or track TARP fund usage on a dollar-for-dollar basis, most banks were able to provide insights into their actual or planned future

use of TARP funds. For some respondents the infusion of TARP funds helped to avoid a “managed” reduction of their activities; others reported that their lending activities would have come to a standstill without TARP funds; and others explained that they used TARP funds to acquire other institutions, invest in securities, pay off debts, or that they retained the funds to serve as a cushion against future losses. Many survey responses also highlighted the importance of the TARP funds to the bank’s capital base, and by extension, the impact of the funds on lending. In light of the audit findings, SIGTARP renews its recommendation that the Secretary of the Treasury require all TARP recipients to submit periodic reports to Treasury on their use of TARP funds.

SIGTARP also has audits nearing completion examining the following issues: executive compensation restriction compliance, controls over external influences on the CPP application process, selection of the first nine participants for funds under CPP (with a particular emphasis on Bank of America), AIG bonuses, and AIG counterparty payments. In addition, SIGTARP is undertaking a series of new audits, as follows:

- **CPP Warrant Valuation and Disposition Process:** The audit will seek to determine (i) the extent to which financial institutions have repaid Treasury’s investment under CPP and the extent to which the warrants associated with that process were repurchased or sold; and (ii) what process and procedures Treasury has established to ensure the Government receives fair market value for the warrants and the extent to which Treasury follows a clear, consistent, and objective process in reaching decisions where differing valuations of warrants exist. This audit complements a July 10, 2009, report by the Congressional Oversight Panel examining the warrant valuation process.
- **Follow-up Assessment of Use of Funds by TARP Recipients:** This audit will examine use of funds by recipients receiving extraordinary assistance under the Systemically Significant Failing Institutions program, the Automotive Industry Financing Program, as well as insurance companies receiving assistance under CPP.
- **Governance Issues Where U.S. Holds Large Ownership Interests:** The audit, being conducted at the request of Senator Max Baucus, will examine governance issues when the U.S. Government has obtained a large ownership interest in a particular institution, including: (i) What is the extent of Government involvement in management of companies in which it has made sizeable investments, including direction and control over such elements as governance, compensation, spending, and other corporate decision making? (ii) To what extent are effective risk management, internal controls, and monitoring in place to protect and balance the Government’s interests and corporate needs? (iii) Are there performance measures in place that can be used to track progress against long-term goals and timeframes affecting the Government’s ability to wind down its investments and disengage from these companies? (iv) Is there adequate transparency to support decision making and to provide full disclosure to the Congress and the public?
- **Status of the Government’s Asset Guarantee Program with Citigroup:** The audit examining the Government’s Asset Guarantee Program (“AGP”) with Citigroup, based upon a request by Representative Alan Grayson, will address a series of questions about the Government’s guarantee of certain Citigroup assets through the AGP such as: (i) How was the program for Citigroup developed? (ii) What are the current cash flows from the affected assets? and (iii) What are the potential for losses to Treasury, the Federal Deposit Insurance Corporation, and the Federal Reserve under the program?

- **Making Home Affordable Mortgage Modification Program:** This audit will examine the Making Home Affordable mortgage modification program to assess the status of the program, the effectiveness of outreach efforts, capabilities of loan servicers to provide services to eligible recipients, and challenges confronting the program as it goes forward.

#### **SIGTARP'S RECOMMENDATIONS ON THE OPERATION OF TARP**

One of SIGTARP's oversight responsibilities is to provide recommendations to Treasury so that TARP programs can be designed or modified to facilitate effective oversight and transparency and to prevent fraud, waste, and abuse. SIGTARP details ongoing recommendations concerning PPIP, TALF, and tracking use of funds and provides an update on the implementation of recommendations made in previous reports. Two categories of recommendations are worth highlighting in particular:

##### **Transparency in TARP Programs**

Although Treasury has taken some steps towards improving transparency in TARP programs, it has repeatedly failed to adopt recommendations that SIGTARP believes are essential to providing basic transparency and fulfill Treasury's stated commitment to implement TARP "with the highest degree of accountability and transparency possible." With one new recommendation made in this report, there are at least four such unadopted recommendations:

- **Use of Funds Generally:** One of SIGTARP's first recommendations was that Treasury require all TARP recipients to report on the actual use of TARP funds. Other than in a few agreements (with Citigroup, Bank of America, and AIG), Treasury has declined to adopt this recommendation, calling any such reporting "meaningless" in light of the inherent fungibility of money. SIGTARP continues to believe that banks can provide meaningful information about what they are doing with TARP funds — in particular what activities they would not have been able to do but for the infusion of TARP funds. That belief has been supported by SIGTARP's first audit, in which nearly all banks were able to provide such information.
- **Valuation of the TARP Portfolio:** SIGTARP has recommended that Treasury begin reporting on the values of its TARP portfolio so that taxpayers can get regular updates on the financial performance of their TARP investments. Notwithstanding that Treasury has now retained asset managers and is receiving such valuation data on a monthly basis, Treasury has not committed to providing such information except on the statutorily required annual basis.
- **Disclosure of TALF Borrowers Upon Surrender of Collateral:** In TALF, the loans are non-recourse, that is, the lender (Federal Reserve Bank of New York) will have no recourse against the borrower beyond taking possession of the posted collateral (consisting of asset-backed securities ("ABS")). Under the program, should such a collateral surrender occur, TARP funds will be used to purchase the surrendered collateral. In light of this use of TARP funds, SIGTARP has recommended that Treasury and the Federal Reserve disclose the identity of any TALF borrowers that fail to repay the TALF loan and must surrender the ABS collateral.
- **Regular Disclosure of PPIF Activity, Holdings, and Valuation:** In the PPIP Legacy Securities Program, the taxpayer will be providing a substantial portion of the funds (contributing both equity and lending) that will be used to purchase toxic assets in the Public-Private Investment Funds ("PPIFs"). SIGTARP is recommending that all trading activity, holdings, and valuations of assets of the PPIFs be disclosed on a timely basis. Not only should this disclosure be required as a matter of basic transparency in light of the billions of

taxpayer dollars at stake, but such disclosure would also serve well one of Treasury's stated reasons for the program in the first instance: the promotion of "price discovery" in the illiquid market for MBS. Treasury has indicated that it will not require such disclosure.

Although SIGTARP understands Treasury's need to balance the public's transparency interests, on one hand, with the interests of the participants and the desire to have wide participation in the programs, on the other, Treasury's default position should always be to require more disclosure rather than less and to provide the investors in TARP — the American taxpayers — as much information about what is being done with their money as possible. Unfortunately, in rejecting SIGTARP's basic transparency recommendations, TARP has become a program in which taxpayers (i) are not being told what most of the TARP recipients are doing with their money, (ii) have still not been told how much their substantial investments are worth, and (iii) will not be told the full details of how their money is being invested. In SIGTARP's view, the very credibility of TARP (and thus in large measure its chance of success) depends on whether Treasury will commit, indeed as in word, to operate TARP with the highest degree of transparency possible.

#### **Imposition of Information Barriers, or "Walls," in PPIF**

In the April Quarterly Report, SIGTARP noted that conflicts of interest and collusion vulnerabilities were inherent in the design of PPIF stemming from the fact that the PPIF managers will have significant power to set prices in a largely illiquid market. These vulnerabilities could result in PPIF managers having an incentive to overpay significantly for assets or otherwise using the valuable, proprietary PPIF trading information to benefit not the PPIF, but rather the manager's non-PPIF business interests. As a result, SIGTARP made a series of recommendations in the April Quarterly Report, including that Treasury should impose strict conflicts of interest rules.

Since the April Quarterly Report, Treasury has worked with SIGTARP to address the vulnerabilities in PPIF, and SIGTARP made a series of specific recommendations, suggestions, and comments concerning the design of the program. Treasury adopted many of SIGTARP's suggestions and has developed numerous provisions that make PPIF far better from a compliance and anti-fraud standpoint than when the program was initially announced.

However, Treasury has declined to adopt one of SIGTARP's most fundamental recommendations — that Treasury should require imposition of an informational barrier or "wall" between the PPIF fund managers making investment decisions on behalf of the PPIF and those employees of the fund management company who manage non-PPIF funds. Treasury has decided not to impose such a wall in this instance, despite the fact that such walls have been imposed upon asset managers in similar contexts in other Government bailout-related programs, including by Treasury itself in other TARP-related activities, and despite the fact that three of the nine PPIF managers already must abide by similar walls in their work for those other programs.

If nothing else, the reputational risk that Treasury and the program could face if a PPIF manager should generate massive profits in its non-PPIF funds as a result of an unfair advantage, even if that advantage is not strictly against the rules, justifies the imposition of a wall. Failure to impose a wall, on the other hand, will leave Treasury vulnerable to an accusation that has already been leveled against it — that Treasury is using TARP to pick winners and losers and that, by granting certain firms the PPIF manager status, it is benefitting a chosen few at the expense of the dozens of firms that were rejected, of the market as a whole, and of the American taxpayer. This reputational risk is not one that can be readily measured in dollars and cents, but is rather a risk that could put in jeopardy the fragile trust the American people have in TARP and, by extension, their Government.

In addition to these recommendations, SIGTARP also makes additional recommendations, concerning other aspects of PPIP and concerning the use of ratings agencies in TALF.

Chairman Towns, Ranking Member Issa and Members of the Committee, I want to thank you again for this opportunity to appear before you, and I would be pleased to respond to any questions that you may have.

## SIGTARP Hotline

If you are aware of fraud, waste, abuse, mismanagement or misrepresentations affiliated with the Troubled Asset Relief Program, please contact the SIGTARP Hotline.

By *Online Form*: [www.SIGTARP.gov](http://www.SIGTARP.gov)

By *Phone*: Call toll free: (877) SIG-2009

By *Fax*: (202) 622-4559

By *Mail*:

**Hotline: Office of the Special Inspector General  
For The Troubled Asset Relief Program**  
1801 L Street, NW, Suite 600  
Washington, D.C. 20220

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202-927-8941

## Obtaining Copies of Testimony and Reports

To obtain copies of testimony and reports please log on to our website at [www.sig tarp.gov](http://www.sig tarp.gov)



Chairman TOWNS. Thank you very much. We really appreciate your being here.

I understand that Treasury collects monthly data showing the value of its TARP portfolio. Is there any reason why that should not be made public?

Mr. BAROFSKY. In our view, absent some maybe very limited circumstances, we believe it should be made public. One of the arguments that was offered against doing this was that it may impinge upon Treasury's ability to liquidate some of those assets. But frankly, we think that just like any asset manager or any mutual fund, the investors have a right to know what the value of their assets are. Frankly, the one good example of when you don't know is Ranking Member Issa's example of a Madoff-type hedge fund where investors can't see what is behind the numbers. We think this is an essential part of transparency.

Chairman TOWNS. We are concerned about conflicts of interest. Treasury hired nine private firms to be asset managers for the TARP Public-Private Investment Program, including large companies such as BlackRock, GE Capital Real Estate, Invesco, and others. All of these large firms are engaged in extensive private investment activities. Yet Treasury has refused to require these firms to establish firewalls between their employees who makes investment decisions on behalf of the Government and those who manage private funds. Why does Treasury oppose firewalls at these firms to prevent conflicts of interest and collusion?

Mr. BAROFSKY. We have been pushing this recommendation over the last couple of months. We have consulted with the Federal Reserve Bank of New York, which operates similar programs. They have asset managers both buying and selling assets. Even Treasury itself, we have taken a look at some of their programs. One constant is that when asset managers receive market moving information and have the ability to or know about information to set market prices, a firewall comes attached to that responsibility in every program other than in the PPIP program. We have made this recommendation.

In our quarterly report, Treasury has detailed, I think, in a lengthy letter their explanation as to why they are not requiring this. In short, they say it is not practical in this program for a variety of different reasons.

We strongly disagree. We think that the taxpayer is entitled to the exact same protection that the Federal Reserve requires when it hires an asset manager. We believe the same protections should and must be part of the TARP program.

Chairman TOWNS. Is there a downside to this?

Mr. BAROFSKY. Treasury makes a number of different arguments. One is that it may be more expensive, that there may be a limit as to the firms that are willing to participate with a wall.

All of these may be valid arguments, but from our perspective, tilting the scales are the tremendous dangers that come from not having a wall ranging from being able to take advantage of conflicts of interest to wildly recognized profits in different parts of the firm to the reputational risk. People are going to ask the question, "why does BlackRock operate under a wall when they are managing funds for the Federal Reserve but not when they are managing

for the Treasury?" If there are incredible profits, there is going to be a lot of explaining that needs to get done.

Chairman TOWNS. I find your testimony quite amazing. Do I understand you correctly? Let me put it this way: Does Treasury ask TARP recipients what they are doing with the money? Do they ask them that question?

Mr. BAROFSKY. Overall, no. They have asked Bank of America, CitiGroup, and AIG. They are the only capital recipients that are required to report the use of funds. Some of the other extraordinary assistance recipients also have reporting requirements. But as far as the rest of the recipients, Treasury says no.

They say they won't do it because it won't be meaningful and it won't be reliable information. So of course the question we ask is, if it is a meaningless exercise, why are you doing it with respect to CitiGroup, Bank of America, and very recently AIG? We haven't really gotten an answer to that question.

Chairman TOWNS. I think it is very, very important because in creating this in discussions early on, it was about job creation. I think that we need to have the information in terms of what they are doing with it. When I look at the fact that in the minority community the unemployment rate is 15.5 percent, and of course it is running 9 percent generally, it appears to me that is a legitimate kind of question that should be raised because we feel and recognize that job creation is important.

Mr. BAROFSKY. Of course, Mr. Chairman. I couldn't agree with you more. What Treasury does is it puts out lending survey information. So it is already collecting information from each of the financial institutions reporting on lending. But as our audit demonstrates, that is only part of the story. It doesn't talk about all the other things that banks are doing with TARP funds like investments, retaining capital cushions against future losses, and all these types of things which go right to the heart of the question that you are posing.

Chairman TOWNS. Let me ask you: Did the TARP recipients have any trouble telling you what they were doing with the money?

Mr. BAROFSKY. We had a variety of responses. We had 364 responses. Nearly every single financial institution was able to provide us with meaningful information on this survey.

I have to remind you, this is a voluntary survey. What we are recommending is that Treasury actually require this information. But we just asked and we still got very meaningful responses.

Chairman TOWNS. Is there any reason why the public should not be told what is happening with the TARP money or how it is being used?

Mr. BAROFSKY. I can't think of one. The one argument that was presented to us was that it would be a meaningless endeavor. I think our audit report proves that to be false. I think that banks can and should be required to report on their use of funds.

I think that this Congress can make better policy decisions. Frankly, I think it will assist the Treasury in making better decisions if they have a better understanding of what is being done with funds as we continue in the bailouts and the continuing administration of the TARP.

Chairman TOWNS. Thank you very much, Mr. Barofsky. I yield to the ranking member.

Mr. ISSA. Mr. Chairman, before I begin my questioning, I am not sure that everyone understands that you came here on a day when others probably would have taken the day off. Mr. Chairman, is it actually true that today is your birthday? [Laughter and applause.]

Chairman TOWNS. Thank you very, very much.

Mr. ISSA. That is the power of a chairman if I have ever seen it.

Chairman TOWNS. Thank you so much.

Mr. ISSA. The coffee will be coming, Mr. Chairman.

Chairman TOWNS. Thank you very much. I appreciate that. Thank you.

Mr. ISSA. Mr. Chairman, just in case anyone thinks this isn't a bipartisan committee, Jimmy Duncan has decided to have his birthday today just to make sure there was one on each side. [Laughter and applause.]

Do your part. The chairman blew it out without even showing it. It is much harder as you go down the dais. Thank you, Mr. Chairman. Your coffee is coming.

Mr. Barofsky, I am not sure I can begin to tell you how pleased we are to have you here today. We are pleased for a number of reasons.

I will read from that New York Times article, if I may. "Andrew Williams, a spokesman for the Treasury Department, called the figures "distorted" because they did not consider the value of the collateral posted for loan programs." I would like you to put this into perspective. First of all, did you ever say anywhere in your report or in your findings that we would lose \$23.7 trillion?

Mr. BAROFSKY. Of course not. We explicitly point out in the report the existence of collateral.

Mr. ISSA. So when you talk about \$23.7 trillion—or about 30 times as much money as you would have if you gave away \$1 million a year from the birth of Christ until today, just for somebody to try to figure out if that is true or not—that quantity of money, what you are talking about is the amount other than the \$700 billion that is essentially under assurances and insurance. Is that right?

Mr. BAROFSKY. If every program is maximized to the greatest extent possible, that is what that number is. Coming from a slightly different persuasion, I would say that even if you went back to the time when Moses parted the Red Sea, you would still be in the right numbers.

Mr. ISSA. I think actually Abraham would be sitting here trying to figure it out, too. There is no question, this is an amazing amount of money. When you look at millions over thousands of years and not getting to that number, it is hard for people to understand.

But let us look at it another way. If, in fact, just 5 percent of this \$23 trillion or \$24 trillion under assurances of various sorts were to go bad, isn't that a dramatic amount more than we ever authorized or appropriated from Congress?

Mr. BAROFSKY. It is, of course, a staggering large number. The TARP itself has staggeringly large numbers as it has been expanded through other programs as well.

Mr. ISSA. Now, our previous Neil came before us, Neel Kashkari, and we asked him about how much money the assets were worth. He said he didn't know but he would get it to us in 30 days. Then 30 days later he said he would get it to us in another 30 days. He is gone now so you are the one we have.

Has the Treasury been willing to cooperate and provide the information as to the current value of assets purchased?

Mr. BAROFSKY. This is a recommendation we have made since early February. They have not yet made this information public.

Mr. ISSA. So the assurances made by Neel Kashkari, both in the last Congress and in this Congress, that this was forthcoming in fact were not truthful in the sense that it doesn't appear as though they were ever forthcoming in a, if you will, mark to market value of what the assets are worth?

Particularly I am interested in AIG's assets. Do you have any idea how much money has evaporated permanently from the \$180 billion that AIG has received?

Mr. BAROFSKY. I don't have that information at my fingertips. We are doing a couple of audits on AIG where we are going to have a better sense and be able to report on what is going on in those portfolios, particularly in the context of its counter-party transactions. But I don't have that information.

Mr. ISSA. Do you think that Congress is overdue to find out how many dollars have gone out in a manner that can never be refunded?

Mr. BAROFSKY. I think it is absolutely essential for transparency that Congress and the taxpayers who invested in this program know what Treasury's best estimate is as to the value of their investment, absolutely.

Mr. ISSA. We own AIG and there is litigation against the founder of AIG. You are obviously very familiar with the court decision and apparently follow-on litigation. Do you have any day to day contact or any ability to find out why we continue to spend my understanding is over \$200 million in legal fees trying to recover initially \$4 billion, which the court has said we are not entitled to get back from C.V. Starr and Co.? As a matter of fact, apparently they said it in very short time, essentially that the case never had merit. But we have spent over \$200 million. Is that something that is on your radar screen?

Mr. BAROFSKY. We haven't addressed that situation. We have two ongoing audits of AIG, which are consuming a good chunk of my audit staff. But, of course, we are always going to be continuing to look for followup aspects.

That also, though, maybe included as well in an overall audit that we have just recently announced. We are doing an audit on corporate governance as a whole, including the Government's role in governing and as an 80 percent part owner of AIG. So it may come in that context as well.

Mr. ISSA. Is there any way that we can get an independent assessment of the Federal Government's pursuit of these lawsuits rather than going to binding arbitration, which was offered repeatedly when Mr. Greenberg was before this committee? Is there any way to second guess this as \$1 million a week is being spent on legal fees?

Mr. BAROFSKY. I think what we can bring through our audits is an explanation of what the Federal Government's involvement has been in those decisions. In other words, as an 80 percent owner, how involved is the Federal Government in making those decisions versus AIG's management itself?

Mr. ISSA. I want to go back to the firewall question that you have been working on and that this committee is very concerned about, I am a member of a public board. I own stock. Actually, my foundation owns stock. I am not allowed to trade that during blind periods. Is it any different to say that a Member of Congress who happens to have a foundation which owns stock and who also sits on the board as an individual, would you say that was unwieldy to say you can't trade on behalf of yourself while in fact you have inside information? Is that any more difficult than what you are dealing with, with various firms who are being given huge underwriting and leverage advantages at the Federal Government's expense in return for trading primarily on our behalf?

Mr. BAROFSKY. I think that is exactly the right difference. Here, these fund managers have up to \$3 billion of taxpayer money and the whole design of the program is to encourage them to set prices in an illiquid market. This is a remarkable amount of power. Once they make that decision, it is a remarkable piece of inside information. I think it would be difficult for any Member of Congress to replicate because actually the design of the program is to set prices. So I think it is a far more extreme example in the case of the PPIP.

Mr. ISSA. Thank you. Thank you, Mr. Chairman.

Chairman TOWNS. I now yield 5 minutes to the gentleman from Maryland, a very active member of this committee, Congressman Cummings.

Mr. CUMMINGS. Thank you very much, Mr. Chairman. Mr. Barofsky, it is good to see you again.

Have you had a conversation with Mr. Geithner since you took office?

Mr. BAROFSKY. I spoke to him in late January.

Mr. CUMMINGS. That is it?

Mr. BAROFSKY. That is it.

Mr. CUMMINGS. For how long was that conversation?

Mr. BAROFSKY. It was a couple of minutes before a larger meeting with Mr. Dinero and Ms. Warren from the congressional oversight panel.

Mr. CUMMINGS. The reason why I ask that question is that as I listen to the chairman's questions and our ranking member's, it seems to me that you all should be on the same team, to a degree. I know there is a wall there but I guess a lot of the things that are coming up should concern all of us.

I want to followup on some of the chairman's questions. You said a moment ago that you got 12 million hits. That is a lot of hits to your system. What that means is that apparently the public is very interested in what is going on with regard to this money.

I think the thing that concerns me is something that you had said in the Joint Economic Committee not very long ago regarding your concern about the appearance of some conflicts. Do you still have those concerns?

Mr. BAROFSKY. I think my concerns are greater today than they were a couple of months ago when I spoke to you in the Joint Economic Committee.

Mr. CUMMINGS. Why do you say that?

Mr. BAROFSKY. Because of the absence of walls in this Public-Private Investment Program. I think that the danger here is the perception of picking winners and losers, of giving these nine economic firms out of the 100 that applied the ability to set prices and not put the right type of restrictions in place to make sure that they are not going to otherwise profit unfairly at the expense of the market.

If these firms do start having those types of profits in other aspects of their firms, I think the criticism that has previously been leveled at Treasury, of picking the winners and losers and of the opaqueness in how decisions are being made, could be potentially devastating to the program and potentially devastating to the way the American people view their Government. So it is a very serious concern of mine.

Mr. CUMMINGS. This morning on Morning Joe they had a fellow named McDonald who has written a book. He used to work for Lehman Brothers. He alleged that Mr. Paulson intentionally allowed Lehman to fail. Now, normally I wouldn't pay too much attention to that. But then he laid out the evidence and it sounded pretty logical.

The reason why I mentioned the 12 million hits is that—and I really believe this—in order for us to get past this economic situation that we find ourselves in, the public has to believe that we are doing the right thing. They have to believe. I think one of the things that makes them believe is transparency. I agree with you on that.

One of the things that I am concerned about is that a lot of times when we see a report that doesn't look too favorable, a lot of times we have a tendency to shoot the messenger and not address the report.

But there is one thing that you said here that is quite telling as a former prosecutor. I guess you are still a prosecutor now. You said something about 35 open criminal investigations. I know what it takes to even get to the point to start investigating. Let us assume only five of them have some legs on them. Are you seeing any kind of pattern?

I think my concern is that if there is a pattern, maybe this Congress needs to be doing something. I am trying to figure out whether there is there anything that we need to be doing to give you more power than what you have to accomplish the things that you have to accomplish.

One thing is for sure: If we cannot get to a point of the American people, at 12 million hits, if we can't show them that we are doing the right thing with their money, as the chairman has alluded to, we are going to have problems. I don't see how we can get past this because the American people are not going to buy it.

Mr. BAROFSKY. I couldn't agree with you more about the importance of transparency for all the reasons that you stated, as well as just the fundamental fact that the taxpayers are the investors. I think the reason why we see 12 million hits and more than

700,000 downloads of our reports is because the American people want to know what is going on in their investments. They want to understand these programs.

We serve a role, basically, to translate these programs from the very, very complicated descriptions that the Treasury puts out. We try to translate it into English with tutorials and explanations. So I do agree.

As to your question about the criminal investigations, we haven't seen a major pattern. We have a lot of investigations related to the mortgage modifications. There are a lot of scams out there, people trying to take advantage of struggling home owners. So there are a fair number there. But the rest of the investigations really go across the board. We have some incredibly complex securities and accounting fraud investigations of banks that have either attempted to or actually applied for and received TARP funds that may have lied to the Government in order to get that funding. We have cases of insider trading, trading on inside information they may have learned about the TARP. Really, almost any type of white collar crime you can think of, we are touching on in our investigations. Really, it is what you would expect when you are putting so much money out over such a short period of time and in many instances with very few conditions. They really do cover the board.

Mr. CUMMINGS. Thank you very much.

Chairman TOWNS. Thank you very much. I yield now to the gentleman from Florida, Congressman Mica.

Mr. MICA. Thank you. Thank you, Mr. Barofsky.

Let me followup on Mr. Cummings's questions. Actually, you stated that TARP and these programs have grown into more than 50 different programs?

Mr. BAROFSKY. Not within the TARP. Within the TARP there are 12 programs. In our report, we talk about approximately an additional 50 programs that are across the U.S. Government, everywhere from the FDIC to the Fed and FHFA.

Mr. MICA. So there are about 12 TARP. But the 50, are you keeping sort of a watch over those or just the 12 TARP?

Mr. BAROFSKY. Thankfully, we just have the 12. The rest are being covered by other agencies.

Mr. MICA. Again, some of this seems to have dramatically expanded. Probably the nature of the responsibility required some of that. But to get to the point Mr. Cummings is raising, do you have enough resources to conduct sufficient investigations and oversight?

Mr. BAROFSKY. We are building as an Office. We currently have 70 personnel onboard. We are building to about 160 with a target date of early next year.

Mr. MICA. I read not all of your report but scanned through it. You do have recommendations in here. I notice that only 8 of your 32 major recommendations have been implemented; 5 of 32 have been partially implemented. Is there any way to enforce implementation? Do you have any recommendations as to how we can put some teeth into what you are doing or recommending?

Mr. BAROFSKY. Really, we feel like our statutory role is to make these recommendations.

Mr. MICA. We have to pick up the responsibility. But it appears that a number of your recommendations are not implemented or that some of your recommendations take a while to get implemented. For example, executive compensation, I guess that was finally adopted as a rule on June 15th?

Mr. BAROFSKY. That is correct.

Mr. MICA. So that is why we have seen since June 15th a lot of folks interested in paying back their loans?

Mr. BAROFSKY. I think that is an explanation that has been offered.

Mr. MICA. But it took us, what, 6 months to get that recommendation in place and implemented. Is that correct?

Mr. BAROFSKY. I think it was about 4 months from our February report.

Mr. MICA. I think part of what you said is you are trying to develop and encourage transparency. Many of the things that deal with transparency are recommendations that have not, in fact, been addressed by the various groups that you oversee. That still remains the case?

Mr. BAROFSKY. It does.

Mr. MICA. That is unfortunate. Finally, maybe you could tell me—first, I didn't vote for it—but we started out with about \$700 billion that Members of Congress thought they were going to help bail out financial institutions with. Then you said some of the liability grew to \$3 trillion. Maybe you could explain that?

Then it was \$4.7 trillion, and now the total exposure is \$23 trillion. So how did a little tiny, teeny \$700 billion program balloon into \$23 trillion worth of exposure? Maybe you could tell us about the \$3 trillion level you cited and how far we are at risk at that, followed by the \$4.7 trillion, and \$23 as the ultimate.

Mr. BAROFSKY. Sure. For the TARP, we start off with \$700 billion. We include a chart that gives the precise numbers for each program and where they come from. But then that number got expanded to approximately almost \$3 trillion from other related Federal Government programs.

For example, the Public-Private Investment Program, which we have been discussing, is seeded with about \$100 billion of TARP money. But then the Federal Reserve, and at one point the FDIC, were going to issue nonrecourse loans from the Federal Reserve. Those are loans that don't have to be paid back but are posted with collateral.

Mr. MICA. So that ballooned it?

Mr. BAROFSKY. Right. Then there were also guarantees from the FDIC.

You have the TELF Program, which has been up to a \$1 trillion program, seeded by \$80 billion or \$100 billion of TARP funds. So you have these other Federal Government entities coming in and supplementing these programs. You have an asset guarantee of \$300 billion from CitiGroup, which is done partly by Treasury, partly by FDIC, and partly by the Federal Reserve. So that is how we get to the \$3 trillion.

Those other numbers are actually non-TARP programs. The \$23.7 trillion does actually include the \$3 trillion from the TARP, but it also includes other programs that have nothing to do with

the TARP other than the fact that they are also supporting the financial industry and that the same institutions that can take advantage of the TARP also can take advantage of these other programs. At times they can use one perhaps to pay off another, something we have even coined as “bailout arbitrage.”

Mr. MICA. So \$700 billion seeded a potential of \$23.7 trillion?

Mr. BAROFSKY. I would say the \$700 billion seeded the \$3 trillion and then the other \$20.7 trillion really comes from other Federal Government programs that are non-TARP related.

Mr. MICA. They are riding sort of the same saddle?

Mr. BAROFSKY. They are all for the support of the financial system.

Mr. MICA. Thank you. Thank you, Mr. Chairman.

Ms. KAPTUR. Will the gentleman yield?

Chairman TOWNS. The gentleman’s time has expired.

Ms. KAPTUR. May I just ask, Mr. Chairman—

Chairman TOWNS. The gentleman’s time has expired.

Ms. KAPTUR. Is that in your report, sir? What you just stated to Congressman Mica’s questions, is that summarized, that stair step?

Mr. BAROFSKY. Yes. The \$3 trillion and what is there is featured in the chart in the executive summary.

Ms. KAPTUR. Up to the \$23 trillion?

Mr. BAROFSKY. All of that is set forth in Section 3 of our report with the explanations of what those numbers really mean.

Ms. KAPTUR. Thank you.

Chairman TOWNS. I now yield to the gentleman from Ohio, Mr. Kucinich.

Mr. KUCINICH. Thank you very much.

Mr. Barofsky, I am reading your report about lending where you talk about how banks have been leveraging TARP funds to support lending activities. You say on commercial lending, 20 percent of respondents reported that they used TARP funding for commercial lending activities, 17 percent of respondents deployed TARP funds for other consumer lending, and 13 percent used it for small businesses.

You talk about the capital cushion and how some banks are basically parking their funds to create a cushion against loan losses. I looked at your report and I want to use that report as a backdrop for a news report that came in today.

We went back into the TARP history here. We know that the first intent that Congress had was to purchase toxic assets, which were mortgage-backed securities. We were told that would keep people in their homes. Well, the last administration threw that out the door. Then we were told we are going to switch the TARP funds to help bail out the banks with a direct capital infusion.

But I think something else has happened here. I want to make sure it doesn’t escape this committee. I hope that you can tell me it hasn’t escaped your notice. We are now seeing that we have another switch that has occurred. We actually have the Fed paying banks not to use their “excess capital” to make loans.

I direct your attention to a news report today which says that “banks’ excess reserves at the Fed rose to a record \$877.1 billion daily average in the 2-weeks ended May 20th from \$2 billion a year earlier. Excess reserves, money available for lending that banks

chose to leave with the Fed, instead averaged \$743 billion in the first 2 weeks of this month." Sir, the Fed is paying banks higher interest rates now to keep their funds parked at the Fed instead of loaning the money to the American people. Is that not true?

Mr. BAROFSKY. Yes. The reason I opened up the book is that on page 142 of our report we actually have a chart that depicts exactly what you are saying.

Mr. KUCINICH. Tell me about the chart. Tell this committee about that chart.

Mr. BAROFSKY. It shows the increase in the amount of money that is being parked at the Federal Reserve over time. We link it to one of the Fed programs, a different program. But we do think there is a connection between the Federal programs and the increased reserves that are being held there.

Mr. KUCINICH. If the banks had not received this direct capital injection as a result of the TARP funds, is it conceivable that they would have had, according to this news report, an average of \$743 billion in reserves parked at the Fed? Is it possible that they could have had that?

Mr. BAROFSKY. It may be, but only because of all the other programs that we detail in Section 3 of the report.

Mr. KUCINICH. "All the other programs" meaning Government programs that have helped to sustain the banks, right?

Mr. BAROFSKY. It would certainly appear to be the case.

Mr. KUCINICH. See, members of the committee, first we started out with being told that money was going to mortgage-backed securities. They did a bait and switch on that. Then we were told it is being used to bail out the banks so we can have a loosening of credit through a direct capital infusion. Now, you and I know that there are businesses in our communities who are credit starved. Meanwhile, the Fed is paying banks a premium to keep their money parked at the Fed instead of loosening it up.

This is one fraud after another on the American people. They might use the excuse that they are trying to control inflation. Check it out. Unemployment is skyrocketing. Businesses can't get money so they are laying off more people. We are thinking that somehow we have solved the problem, here.

I want to submit for the record this report out of the Bloomberg News Service.

Chairman TOWNS. Without objection.

Mr. KUCINICH. Thank you. I want to ask Mr. Barofsky, this money is fungible, as we know.

Mr. BAROFSKY. Yes.

Mr. KUCINICH. But, generally speaking, you would agree that there is just no question that a significant part of the money that is being parked at the Fed right now is Government money, money from these Government programs that Congress created?

Mr. BAROFSKY. I think we would have to look institution by institution. But I think if we did so, I wouldn't disagree with what you are saying.

Mr. KUCINICH. Mr. Chairman, I hope that we can get another hearing on this particular matter because this goes to the heart of the entire bailout program. This has been one thing after another, one bait and switch after another.

Mr. BAROFSKY. Congressman Kucinich, in our audit, I think we described that the banks have communicated to us this tension that they feel as well that is really right in line with your comments. On the one hand they are getting pressure to increase lending and get this capital out there, but they are also getting pressure from the regulators to maintain the capital and increase their capital cushions.

Mr. KUCINICH. "Regulators," read the Fed?

Mr. BAROFSKY. The Fed, FDIC, OCC, and OTS. Indeed, that is what a portion of the stress tests were. So I think that is a very real dichotomy.

Mr. KUCINICH. I thank the gentleman. I thank the chairman.

Chairman TOWNS. Thank you very much. I now yield to the gentleman from Tennessee, Mr. Duncan. Happy birthday.

Mr. DUNCAN. Well, thank you, Mr. Chairman. Happy birthday to you, too.

Mr. Barofsky, thank you very much for your report. I read with great interest the story in the Washington Post yesterday where the lead paragraph says, "Many of the banks that got Federal aid to support increased lending have instead used some of the money to make investments, repay debts, or buy other banks." I read at one point that back a few months ago that the Bank of America had taken \$7 billion of the first \$15 billion they got and increased their investment in the Construction Bank of China. I don't think any of us ever intended that this money be spent in that way.

I think a part of the problem was that this legislation was rushed through. We weren't given proper hearings on it or a chance to offer amendments and things like that.

But I can tell you that all of the business people, all of the small business people in Knoxville and east Tennessee have been telling me for months that what is being said at the top is not getting down to that level. The President and the Secretary of the Treasury have been saying under both administrations lend, lend, lend but these examiners on the local level are saying no, no, no. In fact, there was a cartoon to that effect in the Congress Daily publication that we get every day at each of our offices. It shows the President and the Secretary of the Treasury urging the banks to lend and shows the banks with huge piles of money and then these examiners on the local level saying no, no, no. I have heard that from realtors, home builders, other small business people, and bankers from all lines.

But I want to read a portion of the letter I received from Robert S. Talbott, who has been one of the most successful business people in Knoxville. He wrote to me and said, "I'd never seen anything like this in almost 30 years I have been in the business world."

Listen to this: He said, "Holrob Investments"—that is his company—"is the mother company of over 50 partnerships and limited liability companies, all of which are involved in commercial and residential real estate projects. We have been in business for many years and currently own interest in 18 shopping centers and numerous other retail and residential properties. Our loan obligations consistently are in excess of \$100 million and we have multiple lenders with which we do business, large life insurance companies, regional lenders, banks. We are not currently in default with re-

spect to any monetary obligation, nor have we ever been. Our business depends on access to credit and despite public protestations by our Government to the contrary, it has been our experience this year that credit is contracting. We have been told by numerous banks that unsecured lines of credit to developers are being frowned upon by bank regulators. And, consequently, we have been informed by SunTrust, Mountain Commerce Bank, and First Bank that they would not renew personal lines of credit. While Fifth Third did not technically extinguish our line, it was apparent to us that they did not want our business and consequently we are in the process of extinguishing our lines of credit with them.”

This is what I am hearing, except this is a stronger letter. But is this what you have been finding out in your investigation of all of this? Is this true around the country or is my area unusual in this regard? Because I am hearing this from many, many people.

Mr. BAROFSKY. I think this tension does exist. I think we have seen it across the board. On the one hand is the desire for banks to do more and more lending and then on the other hand is the regulators’ desire for banks to buildup capital cushions against further losses. It is a very real tension.

Mr. DUNCAN. I also have heard this from many bankers who say that they can’t speak out publicly because they will receive retribution from the examiners and the situation would grow even worse.

Mr. BAROFSKY. Well, we did see this in response to some of our survey questions. Our source of information for this is the banks themselves, who have come forward and have pointed out this tension. Frankly, it is natural. Part of the results of the stress test was to encourage the financial institutions to raise an additional \$70 something billion. These additions to capital are that. They are additions to capital. Now, capital can be leveraged in certain instances to increase lending but there is a tension there. It is one from conflicting policy concerns.

Mr. DUNCAN. I have written the top banking regulators twice—and those two letters were several months apart—to tell them that this situation is occurring in our area. I hope that other members of the committee who are running into this in their areas will also write these regulators. This money is not being used, I don’t think, in the ways in which the Congress really intended for it to be used.

Thank you very much.

Chairman TOWNS. Thank you. I now yield to the gentleman from Illinois, Congressman Quigley.

Mr. QUIGLEY. Thank you, Mr. Chairman. Good morning.

Sir, you spoke of the extraordinary power placed with the fund managers. But I think you have more faith in the firewall system than others do. Given this extraordinary power, almost life and death over so much money and what can happen to other companies, are firewalls enough? I guess there are firewalls and then there are firewalls, but is there anything else that can be done to protect the trust that is put in them?

Mr. BAROFSKY. A firewall left standing alone would not be enough. There have to be vigorous and strict enforcement and compliance regimes set up over that firewall.

Mr. QUIGLEY. By whom?

Mr. BAROFSKY. It should be both by the company itself within their internal functions and, of course, by Treasury. Our baseline suggestion where we thought the starting point should be—and just as a starting point—should be what the Federal Reserve Bank of New York does with BlackRock and its Maiden Lane facilities and with its four asset managers in its mortgage-backed security buying program. We thought that would be a good starting point because they do have walls and they do have vigorous compliance set up by FRBNY compliance.

That is a starting point but it isn't the ultimate goal. We haven't gotten to that starting point and that is why our recommendations are where they are. But we agree. A wall standing alone isn't going to do it if there is not a vigorous compliance regime in place as well.

Mr. QUIGLEY. Were you aware of whether these conflicts were discussed when Treasury made these decisions choosing the nine out of the over 100?

Mr. BAROFSKY. We were not involved in the formation of this program before it was publicly announced. We learned about it really a couple days before it came out. We became involved during the selection process of the nine managers. One of the members of my audit team actually sat in on some of the interviews. We have been engaged in a dialog with Treasury, a back and forth on this issue, since at least early June.

Mr. QUIGLEY. Did the discussions of the conflicts of interest and protections that were needed, were those discussed after the fact to you?

Mr. BAROFSKY. We have been engaged in an ongoing dialog. There is an amendment to one of the housing bills. It is called the Ensign-Boxer Amendment because of those two sponsors. It actually requires Treasury to consult with us in the formation of these rules. They certainly have abided by that.

Mr. QUIGLEY. Do you have the authority, the desire, and I guess the ability to audit Treasury's decisionmaking process to pick the nine?

Mr. BAROFSKY. We certainly are going to be doing an audit on the conflicts issues and many of the issues associated with the PPIP program. We haven't announced it yet because the program itself hasn't had lift-off but we are going to do that. Frankly, there would be no way for us to do our job without auditing.

Mr. QUIGLEY. Well, given the lack of cooperation that you are facing now, how is that audit process going to work?

Mr. BAROFSKY. I would have to say that when it comes to conducting our audits, Treasury has been cooperative. They have provided the documents that we have asked for. They have made their personnel available to us for interviews. So I see no reason to worry that we are not going to be able to conduct our audits as we have conducted our other audits without interference from Treasury.

Mr. QUIGLEY. Do you suspect that could be completed by the time you do your next quarterly report and repeat all your recommendations again?

Mr. BAROFSKY. Because of the timing of the PPIP program, the final contracts haven't been written. The time the fund managers

are being given to raise the funds is up to 12 weeks, which would take us into the next quarter. I think it is unlikely. We may be able to do something very quickly depending on what the timeframe of the program is. But until sort of all the terms are set and the conditions are set, it is difficult to launch an audit. But we are going to do so.

Mr. QUIGLEY. Very good. Thank you, Mr. Chairman. I yield back.

Chairman TOWNS. Thank you very much. I now yield 5 minutes to Mr. Chaffetz.

Mr. CHAFFETZ. Thank you, Mr. Chairman, I would ask unanimous consent to insert into the record the letter that was referenced in Congressman Duncan's questioning. He would like to have this submitted into the record.

Chairman TOWNS. Without objection, so ordered.

Mr. CHAFFETZ. Thank you.

Thank you for being here. I appreciate your work. This is important work. Taxpayers' money is at hand and we have a role and responsibility in Government to make sure that it is dealt with in a responsible manner.

My understanding is that Treasury has formally asked the Office of Legal Counsel in the Department of Justice to opine on whether SIGTARP is subject to the supervision of the Secretary of the Treasury. Can you give us an update as to where that is at and your understanding of that?

Mr. BAROFSKY. My understanding is that is where it is. Treasury put in their request. We put in our response, giving our opinion that the intent of this Congress was quite clear that we be a strictly independent agency within Treasury. They have submitted their response to our response. The issue is still pending.

Mr. CHAFFETZ. Other than trying to maybe get away from the obligation that SIGTARP puts upon them, have there been any further instances of Treasury attempting to exert control over your Office or investigations?

Mr. BAROFSKY. Nothing even comes to mind. I think that they generally have been cooperative with our investigations and audits.

Mr. CHAFFETZ. What would be the implications if they were to have control over your Office?

Mr. BAROFSKY. I think that in the IG Act and where Treasury suggests that we fit within that scheme, the Secretary of Treasury has the ability to shut down an audit or an investigation of the Treasury IG. We have a great fear. We think that would be a great threat to our independence if the Secretary had that ability over us.

By way of an example, obviously the Treasury has very strongly worded comments about portions of our report that they disagree with. Theoretically, could they use that type of supervision authority to order us to keep that out of the report and keep that information from the American taxpayers and Members of Congress? I am not sure. But we think that those are the types of dangers that we see if we are under the supervision of the Secretary. If that type of authority was asserted, I think that would be a direct threat to really the reason why we were created.

Mr. CHAFFETZ. I concur with that. I would hope that you would let this body know, and me in particular, if there is any instance

or movement toward them trying to exert that control. I think that the natural tension of having an independent auditor come in is a healthy one for the process and for the viability and visibility to the American people.

Let me talk real briefly about the personnel and resources that you have in place. My question is, do you need more resources? My understanding is that at the end of June you had 60 personnel with plans to get to 160 people. You have 35 ongoing criminal and civil investigations and over 3,200 tips that have come in through the hotline and what-not. Help me understand what is happening within your department regarding the stress and workload with the personnel that you do have.

Mr. BAROFSKY. We have been very busy. We have put together really an amazing team of auditors and investigators.

Mr. CHAFFETZ. What are you short? What do you need immediately that you don't have at your fingertips?

Mr. BAROFSKY. I think that right now we are just going through the normal process of hiring and finding the right people. The one thing that we identify in our report is that we are projected to basically run out of money mid-fiscal year 2010. We have a budget amendment request to Treasury to get the necessary money that we would need to keep going through the end of fiscal year 2010. We have been working with them to achieve that, as well as with OMB. Obviously, if that is unsuccessful, we will have to come back to Congress and ask for a direct appropriation. But basically, assuming we get that necessary money, we will be good through fiscal year 2010.

Mr. CHAFFETZ. In my short time that I have left, let me totally shift gears and talk about the value of the TARP portfolio. There is very limited exposure to this. Tell me what you are able to see and not see. What is the value to the public in having that information?

Mr. BAROFSKY. Well, we think it is essential from a basic transparency point of view that members of the public, the investors, know what their investment is worth.

Mr. CHAFFETZ. But how hard would that information be to provide?

Mr. BAROFSKY. Treasury is getting monthly estimates right now.

Mr. CHAFFETZ. So they have the information but we don't?

Mr. BAROFSKY. It would just be a matter of making that information public.

Mr. CHAFFETZ. It is just a matter of flipping the switch? I would urge this committee, I would hope that we would insist that those evaluations be made public so that the taxpayers can understand the valuation of their assets.

Mr. ISSA. Would the gentleman yield?

Mr. CHAFFETZ. Yes.

Mr. ISSA. Is that something that you believe would be appropriate for us to consider subpoenaing under cover so we could at least see what they see once and then maybe reach the same conclusion you have reached?

Mr. BAROFSKY. I don't think it is necessarily my position to suggest what the committee should or should not subpoena. But certainly if the committee wanted that information, the committee cer-

tainly should request it, evaluate it, and make its own determination.

Mr. CHAFFETZ. I see my time is up. Thank you, Mr. Chairman. Thank you.

Chairman TOWNS. Let me just say that is something we are considering as well.

I now yield 5 minutes to the gentleman from Virginia.

Mr. CONNOLLY. Thank you, Mr. Chairman. Let me add my voice to happy birthday and good felicitations. I want to thank you for your leadership of this committee.

Welcome, Mr. Barofsky.

Mr. BAROFSKY. Thank you.

Mr. CONNOLLY. Let me ask a question. Is the TARP program working? Has it in fact achieved the ends for which it was designed?

Mr. BAROFSKY. I think that really depends on what your definition of working is. I think that the goals of the TARP have changed over time. Different folks have different definitions of what is working and what is not working. I think if the goal was to remove \$700 billion of toxic assets off the books of financial institutions, that clearly has not happened. If the goal was to increase lending, I think that, too, unfortunately has not happened. If the goal was to avoid a complete systematic collapse of the financial industry, that may very well have happened.

I think that it is impossible to look in the crystal ball and know exactly what would have happened absent the TARP. But from what we have seen from what financial institutions have told us, we were on the precipice of a potential total collapse. Shoring up the capital may have indeed achieved that goal if that was a goal.

Mr. CONNOLLY. I haven't been a big fan of TARP either but I think you have to give credit where credit is due. I voted against the release of the second tranche, which was the only vote I got to have as a new Member of Congress on TARP, because I didn't feel that the accountability and transparency standards were in place. The House, in fact, had a statutory framework to allow that but the Senate didn't agree to it.

But having said that, we were facing a systematic financial meltdown last September, were we not?

Mr. BAROFSKY. In the conducting of our audits and gathering of information, that is certainly an opinion we have heard many times from the top regulators as well as members of the industry.

Mr. CONNOLLY. While the flow of credit may still be impeded, the fact of the matter is that stability in the financial system, the stress tests on 19 banks, for example, would seem to suggest that some stability has returned in the system that was lacking as recently as last fall.

Mr. BAROFSKY. I think we are certainly in a much different situation than we were last fall. It may very well be that the TARP is responsible for that, or responsible in part. Again, part of the reason why we do Section 3 and talk about all these programs is so that you can have in one place all the different supports that were out there and that have been in place, of which the TARP is only a small part. I think GAO has pointed this out. It is hard to

say specifically whether the effect is from the TARP or from a different program.

Mr. CONNOLLY. But it might be fair to say that had we not had some intervention of some magnitude such as TARP, we might have actually faced a much more serious situation?

Mr. BAROFSKY. That is certainly the opinion of the people that we have spoken to who were there at the time, including Chairman Bernanke and former Secretary Paulson.

Mr. CONNOLLY. Let me ask about the \$300 billion in TARP funding was invested directly in systematically important firms through the Capital Purchase Program, the Target Investment Program, and the Systematically Significant Failing Institutions Program. The Bush administration pretty much opposed giving the Federal Government a voting stake in banks in which the Federal Government made equity injections. Do you think oversight and accountability capabilities might have been improved if we had not resisted that?

Mr. BAROFSKY. I am sorry. I just missed the last part of your question.

Mr. CONNOLLY. I said the Bush administration, in making those funds available through those programs, opposed giving the Federal Government a voting stake in banks in which it made equity injections. Did we make a mistake in that respect? Could oversight and accountability have been improved if we had a voting stake in those banks?

Mr. BAROFSKY. I think oversight and accountability certainly would have been improved if there were more conditions that were in place and if there were oversight triggering mechanisms that accompanied those conditions. There were very, very few conditions put on the initial output of funds.

I think it is a policy decision that increased transparency, as we look and see what has happened and as we report, hopefully, and convince Treasury to give us an accounting on the use of funds, I think we can be in a better position to make that evaluation by looking at exactly what has happened.

That is why we push for transparency, so that the Members of Congress could make those determinations. You will have all the information available to look back and say, the next time that we are in a bailout, what worked, what didn't work, and what was the impact of the various decisions.

Mr. CONNOLLY. Let me give an example. The Bank of America is now attempting to back out of the Federal Reserve's ring fencing arrangement. If we had insisted as part of the \$118 billion we pumped into BOA that one of the tools would be to have a voting stake in BOA in return for that, would that be helpful from an oversight and accountability point of view from your perspective today?

Mr. BAROFSKY. It certainly would have an impact on the decisionmaking process and that. I am not sure if voting in particular, from our perspective in SIGTARP, what difference that would make. Although it certainly would make a difference from Treasury's perspective on their ability to control the actions of these financial institutions.

Mr. CONNOLLY. Thank you. My time is up. Thank you, Mr. Chairman.

Chairman TOWNS. Thank you very much. Now I yield 5 minutes to the former chairman of this committee, the gentleman from Indiana, Mr. Burton.

Mr. BURTON. Thank you, Mr. Chairman.

I don't want to be redundant because I got here late so I apologize if I ask questions that you have already answered. But why do you think the Treasury Department is dismissive of your calculations?

Mr. BAROFSKY. I don't know. I hate to try to crawl into the minds of some of the comments that have been made. I think that if they had read the report in total and had read some of the charts and pages they couldn't be saying some of the things they are saying with their dismissiveness and their description of numbers that are inflated when all the numbers came from them. So I am not sure.

Mr. BURTON. You haven't had a chance yet. I have been told that you have only been able to spend maybe 1 or 2 minutes with Mr. Geithner since he took over. Is that right?

Mr. BAROFSKY. I had a several minute meeting with him in January. It was followed by a larger meeting that probably went about 45 minutes that included a number of members of Treasury, GAO, and the congressional oversight panel. That was all in one occurrence in late January.

Mr. BURTON. Did he take into consideration your comments and your positions?

Mr. BAROFSKY. We didn't really have that much time in that one meeting.

Mr. BURTON. Did you make some suggestions to him?

Mr. BAROFSKY. I think we conveyed where we were in late January. At that meeting he actually announced to the press his adoption of one of our recommendations, which was posting TARP agreements on the Internet. So that was some progress that we saw at that time.

Mr. BURTON. Well, do you think he wants to keep any information from the people? Do you think there is a deliberate attempt to do that?

Mr. BAROFSKY. I am not sure, again, of what the intent is. The effect is that information that the taxpayers and Members of Congress we believe should have as part of transparency is not being provided.

Mr. BURTON. You said here, and you probably answered this already, that the total potential Federal Government support could reach up to \$23.7 trillion. Obviously, there is some speculation there but the liability could reach that amount?

Mr. BAROFSKY. I think the speculation is if every one of these programs was fully subscribed to, that is the total commitment in guarantees. But I don't think there is a speculation as to what the numbers are. These are numbers that have been provided to us by the Federal Government. Frankly, every one of these numbers any member of the public could go find. It is all publicly available information.

Mr. BURTON. Well, if even half of that is correct, we have a big problem.

Mr. BAROFSKY. I think the important caveat which we set forth in the report is that we don't have \$23.7 trillion outstanding right now. Right now the number outstanding is closer to \$3 trillion. Since the inception of the crisis, again as we put out in the report, the total maximum amount has been about \$4.7 trillion. But when you add up all of the different programs, including programs that have been paid back, ones that may have been canceled, and collateralized programs, the total amount of support, which is what we are trying to capture here, does total \$23.7 trillion.

Mr. BURTON. We are concerned about the terrorist problem. That is one of the top issues that the American people are concerned about. I understand SIGTARP has recommended that Treasury require its private fund managers to collect information on whether any of their investors are involved in organized crime, terrorism, or fraud in order to prevent such groups from using PPIP to launder money.

As currently designed, are you confident that the Obama administration has taken steps to prevent organized crime syndicates and terrorist groups from using PPIP money to launder?

Mr. BAROFSKY. I think they are most of the way there but I think there is a little bit more that needs to be done. They are requiring these fund managers to use the normal procedures like KYC and different procedures to screen for that information. What we have recommended and what they have not adopted is that Treasury not only receive all the information about all the different investors in these programs but also have the unilateral right to kick one out.

To use an example, let us say that a fund manager does all the right diligence but doesn't know that a particular investor has a pending FBI investigation into them being involved in drug trafficking, organized crime, or even terrorism. They would accept that person, that individual, or that institution into the program but wouldn't know any better. But we, Treasury, or our law enforcement partners could run those names in a data base, kick something out, and then reject that investor. We wouldn't necessarily want to tell the PPIP fund manager that we have a pending criminal investigation into one of their clients because it might be pending.

But I still think it is important that Treasury have the ability to unilaterally knock those types of folks out of it. That is a recommendation that we have made and that has not been adopted.

Mr. BURTON. Well, let me just end up by asking this question: The TARP funds that have been allocated by Congress do not reach the \$3 trillion level. What do you think is going to happen? Do you think they are going to ask for another bailout?

Mr. BAROFSKY. Congressman, I don't have that crystal ball.

Mr. BURTON. Do you think it is going to be needed? Do you think additional funds will be required to meet their obligations or their requirements?

Mr. BAROFSKY. I really can't answer that question. I don't know. I think there is a lot in question about what is going to happen in the economy in the next 3, 4, 5, or 6 months or in the next year. I am just not in a position to really answer that.

Mr. BURTON. What would your recommendation be?

Mr. BAROFSKY. I think right now Treasury has stated that they don't need additional funds. So at this point I assume that is where we are.

Chairman TOWNS. The gentleman's time has expired. Now I yield to a senior Member of Congress, not in age but in years of service, Marcy Kaptur.

Ms. KAPTUR. Thank you. Thank you, Mr. Chairman, very much. Happy birthday. This is just the beginning of your life.

Mr. Barofsky, thank you so very much. You have a really important job on behalf of the American people and your staff. We thank you for that.

My first question is what more can we do to help you do your job?

Mr. BAROFSKY. Congress has been amazingly supportive of our agency since we have begun. We really have, I think, all the necessary tools in place right now.

Ms. KAPTUR. All right. Your report came out today. Most Members of Congress have not had a chance to digest it and take it apart. Would you or your staff be willing to come back and help us ferret out some of the information we feel we still need in its interpretation? Would you be willing to do that?

Mr. BAROFSKY. Of course. At any time my staff will be available to brief your staff. Any time this committee or any of the subcommittees want to hear our testimony, we will always be available. We are a creation of Congress and part of our job is to inform the American people through its representatives of everything that is going on. So of course.

Ms. KAPTUR. Now, you have a hotline, 877-SIG-2009. Your report states that you received over 3,200 tips from the American people. That hotline is available to the American people if they work for one of these hotshot companies and they were involved in activity that they have now reflected might not have been cricket and above board. They can report that to you, can't they?

Mr. BAROFSKY. Yes. They can and should also go to our Web site if they don't want to use the phone, [www.sig tarp.gov](http://www.sig tarp.gov). This has been a crucially important aspect of what we do. More than half of our criminal investigations have been initiated by tips from the hotline. So people are using it and we really strongly encourage it.

Ms. KAPTUR. So some of those tips are good?

Mr. BAROFSKY. Some of the tips are very good.

Ms. KAPTUR. So the American people have to muscle up here as well. I think the fact it is a free phone number, 877-SIG-2009, means people ought to use it. This was networked across the country. There is knowledge all across America and we need to pull it together.

I can tell you, in my region of northern Ohio, mortgage foreclosures are going up. Unemployment is going up. Four businesses told me this weekend that they can't get credit, and these are excellent businesses. The system is not working at the grassroots level in Ohio.

I voted against the TARP and I voted against the bailout because I thought that they weren't the right means to resolve a crisis inside the mortgage system. We had done that before back in the 1980's when we used mark to market accounting. We actually went

into the books of troubled institutions using FDIC examiners and SEC accountants. So you had accountants plus bank examiners in there. The burden was not put on the American people. This was back when Continental Bank failed in Illinois and when all the banks in Texas went down but for one.

When they came up with this concoction of these particular means, investing all this power in Treasury, and ramrodded it through Congress 6 weeks before an election, I have to tell you I became very, very suspicious. I still am.

One of my questions to you is this: You have had background in your own life in mortgage fraud. Have you ever had a background in control fraud and systemic fraud?

Mr. BAROFSKY. I don't know how much control fraud or systemic fraud as sort of cases are concerned. I have certainly been involved in securities fraud of what would probably today be considered some systematically significant institutions. I looked at some of the accounting frauds and frauds that those companies have committed.

Ms. KAPTUR. I would urge you very much to look at, of course, the Enron situation. Because this goes to the very highest levels of finance and of institutional structures in our country. Ultimately, it had international repercussions. But I would urge you to look at the Enron situation and to think about the kind of staff that you might hire up and the additional authorities that you have been given.

Mr. BAROFSKY. Well, it is funny that you mention that because we just recently brought on, I prosecuted the Refco matter and we just recently brought on as one of our attorney advisors one of the prosecutors on the WorldCom matter. So we are gearing up with that in mind.

Ms. KAPTUR. Very good. One of the most insightful people I have read on this is Mr. Bill Black out of I think the University of Missouri, Kansas City. He had worked for the Commodity Futures Trading Commission back in the early 1990's. I don't believe he is for hire. But I am just saying his way of thinking about what went on is very, very useful. I wish to share that with you.

I also want to put two issues out there. One is warrants and my deep concern about, for instance, Goldman Sachs and their warrants. It is my understanding that the American people have the right to 12.2 million shares of Goldman Sachs, according to the numbers that I have. Goldman Sachs actually has the privilege under the agreement of determining when our taxpayers have to sell those warrants and exercise their rights. So they control the price and they control the timing.

I think it is really important on the warrant issue that you examine these warrant potentials, sales prices, and the timing of this for the American people. The other day the price was \$1.60 per share and apparently Goldman was saying they will sell it to us for \$1.229. That difference yields \$450 million if we were to sell today. What if we held it for 9 years? Nobody is asking those questions, as far as I know.

I am very concerned for the American people if Goldman and all these other companies get their money back plus.

Mr. BAROFSKY. We have an ongoing audit into exactly these issues on the warrant repurchase process. So that is something that is pending that we are looking at.

Ms. KAPTUR. Mr. Chairman, I just wanted to say for the record—I don't have time to ask on the PPIP program—but what troubles me, Mr. Barofsky is some of the individuals. Forget the company names like BlackRock. I am concerned about the people who were involved in inventing the mortgage sub-prime instruments, then moving it to market, changing it from a bond to a security, and then creating the derivative instruments. They are changing the companies they were in so now they are the same people who have gone to the Fed and have gotten these contracts.

I really think you need to look at people, where they were in the system over the last 20 years; what impact that has had now on our economy; and who is in place, in my mind, with the potential power to cover over some of their own very bad mistakes. I would urge you to look at those firms closely.

Thank you.

Chairman TOWNS. The gentlewoman's time has expired. I now yield to the gentleman from North Carolina, Mr. McHenry.

Mr. MCHENRY. Thank you, Mr. Chairman. The tune of \$23.7 trillion worth of taxpayer exposure for the bailouts is quite striking and frightening.

I appreciate your testimony and your frankness. I am grateful that the President has not fired you like he has fired two other Inspectors General.

Mr. BAROFSKY. Me, too.

Mr. MCHENRY. But I do think it is a big concern that the administration is choosing to remove Inspectors General. You, as well as your colleagues within the various Inspector General Offices across the Government, do a yeoman's task of making sure the Government is accountable to the taxpayer.

With that, I would like to yield to the ranking member the remainder of my time.

Mr. ISSA. I thank the gentleman.

In following up on that line, I will bring to your attention that according to the Wall Street Journal, some of the private fund managers selected to participate in the PPIP may have consulted informally to the Obama administration in writing the PPIP itself. In other words, they wrote what they now participate on, which is not surprising.

Additionally, the New York Times reports that BlackRock CEO Laurence Fink, who has been chosen as one of the PPIP fund managers, is a member of Larry Summers's inner circle. The program lets him select fund managers that use 75 percent of the taxpayers' money and assets.

My question to you is if, in fact, these and other activities begin to look like a cordial relationship where information is being passed and positions are being given because of friendships of people that go in and out of Government, are you in a position to investigate that?

Mr. BAROFSKY. I think that certainly any type of corruption is squarely within our mandate. But the points that you raise go so importantly to what we were discussing earlier as far as the

reputational risk to Treasury. If, in fact, these individuals had a hand in writing these programs, it becomes all the more important that from a perception area alone we have the tightest and most significant ethical and informational barriers and walls to prevent them from taking advantage of a program that they may have had a hand in creating.

Mr. ISSA. Mr. Barofsky, you have been criticized a little bit for this \$23.7 trillion, as we entered in the record earlier, partially because these are assurances and partially because it is outside of the TARP itself. How many IGs would have to be at your table if we were to cover all the guarantees, assurances, promises, and underwriting that the Government is doing? How many different parts of Government would we be dealing with here?

Mr. BAROFSKY. If you go through our chart and count up the institutions, I don't have the number at hand, but certainly the FDIC, Federal Reserve, Pension Guarantee, and the National Credit Union. It would be basically the financial services roundtable of IGs.

Mr. ISSA. So if we can't fit them all at the present table, and the chairman has not yet said we are going to increase the size of the witness table, then is it fair for us to consider here the fact that when we created your position we were thinking in terms of \$700 billion in TARP and today we are thinking in terms of the financial recovery and oversight process that now has a dozen or more IGs loosely associated who are not able to coordinate their activities, at least by design?

Do you believe that either your position or another position should be created that would be the IG for financial oversight to bridge all these various IGs so that our systemic risk, which is \$23.7 trillion of risk, could in fact be overseen in a coordinated way?

Mr. BAROFSKY. I think the most vital thing that I have as an Inspector General, being obviously brand new to the Inspector General system, coming here last December—

Mr. ISSA. But not to the Inspector part of it?

Mr. BAROFSKY. The most vital thing is my independence. The independence is the most vital thing for an Inspector General.

I think it is very important for us to coordinate with one another. In the TARP, I formed an IG council so all the different IGs that touch on TARP programs meet monthly and we talk about audits and investigations. We have subcommittees. I think that type of coordination is very good. In fact, I will be going on Thursday, there is a monthly lunch for regulatory IGs. So we are coordinating with each other.

I think putting an umbrella over other Inspectors General, I think that almost invariably will impinge on their independence. I think we are coordinating and will continue to do so.

Mr. ISSA. But in fairness, since we are seeing you, it is important that you be able to give us, if you will, the results of that coordination so that we are looking at the entire financial oversight as we are here today.

Let me just ask you one closing question. In the case of Chrysler, it has been reported, and I believe this to be true, that we have given up \$3.8 billion worth of DIP financing, meaning we gave

them the money out of TARP in order to go through a process. We then sold them and took back nothing in return. Is that something that needs to be investigated, whether or not it was necessary to write off nearly \$4 billion of the last money into Chrysler?

Mr. BAROFSKY. Yes. In our report we detail those numbers of what has been waived, both in Chrysler and in General Motors, and what has been received on the other side, including equity interest. I think that sort of the facts are what they are on that and are certainly open to any fair inquiry as to how we got to that situation.

Mr. ISSA. So perhaps it is for us to decide whether it is worth investigating now that you have given us the facts?

Mr. BAROFSKY. Yes. It is certainly something that we can look into potentially, or one of our oversight partners, as part of an audit as to what that decisionmaking process was.

Mr. ISSA. Thank you. Thank you, Mr. Chairman.

Chairman TOWNS. The gentleman from North Carolina's time has expired. I now yield to the gentlewoman from California, Congresswoman Watson.

Ms. WATSON. Mr. Chairman, I want to say to you on your birthday that yesterday is the past, tomorrow is the future, but today is a gift from God. That is why it is called the present. Happy birthday, Mr. Chairman.

Chairman TOWNS. Thank you very much. I appreciate your kind words.

Ms. WATSON. Thank you so much, Mr. Barofsky, for being here and being so open with us. I want to get back to the Bank of America. According to recent reports, Bank of America is now trying to avoid paying billions of dollars in fees to the U.S. taxpayers in return for the \$118 billion in guarantees they received from the Federal Government. According to the Bank of America, the agreement was never signed but the guarantees have been announced as part of the assistance they received to complete the acquisition of Merrill Lynch.

Do you believe that the Bank of America benefited from increased investor confidence because of the perception that they had Federal ring fencing of their toxic assets?

Mr. BAROFSKY. I really am reluctant to comment as Inspector General on an ongoing negotiation between Treasury and Bank of America. I think that the events are what they are on that. But I think we may be crossing a line as an agency if we start publicly commenting on something that is an ongoing investigation. So respectfully I would ask for your permission not to answer that question.

Ms. WATSON. We had the former Secretary of the Treasury, Mr. Paulson, in here for 5 hours last week. It was like trying to unscramble rotten eggs. It is very frustrating to us.

Has the Treasury Department provided an explanation for why they did not require Bank of America to join the Asset Guarantee Program agreement? Do you know?

Mr. BAROFSKY. We haven't gotten that explanation. We have been monitoring the program since its announcement. We have a little bit of information basically that there has been ongoing discussions.

We have an audit coming out I think that tracks a lot of the fine work of this committee on the Bank of America and its participation in the various TARP programs. We will be presenting that in September. I would be happy at that time to come back to the committee and discuss the findings if the committee would think that would be helpful.

Ms. WATSON. Yes. I would ask the Chair to hold a followup meeting in due time so that we can followup on some of this.

You lead right into my next question I wanted to ask. Have you discovered any other large scale agreements which the Federal Government has entered into with financial institutes without valid contracts to enforce the proper repayment of the taxpayers' investments? This is a question that you can keep in mind for our followup meeting. I do hope we can set that sometime in the very near future.

In your April quarterly report, you noticed the risk of conflicts of interest and collusion vulnerabilities inherent in the design of the Public-Private Investment Program [PPIP]. However, the Treasury Department has declined to adopt your recommendation to impose an informational barrier between the employees who do or do not handle PPIP funds at the nine PPIP fund managers. Can you comment on that or should we wait for a subsequent meeting?

Mr. BAROFSKY. Absolutely. We think that this is a fundamental deficiency in the current structure of the PPIP program. We think that it is absolutely essential that there be an informational barrier or ethical wall that prevents the fund managers' firm from taking advantage of confidential market moving information that the fund managers are going to have. We think it is a problem and we think it is a deficiency in the program.

Ms. WATSON. Thank you. Why do you believe that the Treasury Department is unwilling to impose the measure despite having placed similar restrictions on asset managers in comparable Federal bailout-related programs?

Mr. BAROFSKY. Treasury has provided to us and we have included in our report a very detailed written description of their justifications and reasoning. In our report, we address each of those and show why we disagree with them.

One of them is that it is impractical, that the design of the program doesn't make it susceptible to such walls. It may very well be that the program is fundamentally flawed in its design in such a way that in its current structure it may be impractical. Our response is that, because this is such an important issue for such a variety of reasons, if it is impractical with the current nine fund managers then before selecting these nine fund managers Treasury should have changed its criteria or did what was necessary to put in the necessary walls to protect the taxpayers.

Ms. WATSON. My time is up. Mr. Chairman, I would hope that in our subsequent hearing with Mr. Barofsky that we can get these recommendations and get some ideas about how you would assess the standard functions of such a department. So thank you.

Are we going to recess?

Chairman TOWNS. No, we are going to continue all the way through. Just to give you an update, the House is in recess, which

makes it good for us. We can continue. We are not in recess. When the House is in recess, that is when we really do our work.

Ms. WATSON. Thank you, Mr. Chairman.

Chairman TOWNS. I now yield to the gentleman from California, Mr. Bilbray.

Mr. BILBRAY. Thank you, Mr. Chairman. I would like to join the committee in congratulating you on your birthday. All of us were witnesses to how quickly you blew out that candle so maybe we can negotiate with Mr. Waxman for a carbon credit for you on that item, OK? [Laughter.]

First of all, I watched this morning, Mr. Barofsky, the way you were attacked for releasing this report. I would just like to say to you as one member of this committee, thank you for giving us the hard, cold facts. I just hope that you remember that when you get attacked like that, basically because you brought a message a lot of people didn't want to hear in this town, that contrary to public belief the ancient Egyptian tradition was to always send your best people to give bad news. The guys who were sent with the good news were sacrificed to thank the gods for the good news.

So it should be a credit to you to understand that you are attacked because you are bringing this up. I want to thank you very much for that. I am sure that not just this committee but the public at large is going to thank you for your report. The hard, cold facts do get into trouble.

Speaking of footprints, I want to talk about the whole concept of looking at BlackRock and some of these others, the nine players here, looking at the footprint of the Federal Government picking winners in this whole game. Do you have any idea, or if you don't and you need to have time I understand because you can get back to us in writing, how did these nine major players get chosen as the winners in this game to be blessed not just by the bureaucracy of the Federal Government but by all the taxpayers in the Federal Government? How did these nine players become the winners in this game as opposed to the other losers that were pointed out by the former Mayor of Cleveland, Mr. Kucinich?

Mr. BAROFSKY. Treasury's explanation is that they put out applications. They received about 140 applications. The next step was to remove duplicative or incomplete applications. That came down to 102. They then applied the criteria, which they have put out on their Web site, of what they were looking for in the ideal asset managers. Basically, those that didn't meet that cut, I think they narrowed the number down to 13. They then did a series of interviews and ended up with the final nine.

I think those are the numbers. I think the exact numbers are likely reflected in our report. That is essentially how Treasury has described their process.

Mr. BILBRAY. Thank you, Mr. Chairman. I just think this report, again, really reinforces the fact that we have ventured into a very, very scary territory. It is a brave new world where Washington decides what happens on Wall Street and Main Street. Hopefully, we can somewhere in the future find a way to have an exit strategy and remove ourselves from imposing our footprint over the rest of American society. I thank you very much for this report because I think it is a dose of reality to make all of us work together here.

I yield back, Mr. Chairman.

Chairman TOWNS. Thank you very much. I now yield 5 minutes to the gentlewoman from California, Ms. Speier.

Ms. SPEIER. Thank you, Mr. Chairman. Thank you, Inspector General. It is a pleasure to have you before us. In your short time you have done an extraordinary job. We thank you on behalf of the American people.

Let me first ask this question: Did any bank you surveyed not participate by returning the survey?

Mr. BAROFSKY. No, we had 100 percent participation.

Ms. SPEIER. Very good. Should we pass legislation to require the tracking of TARP funds since evidently it was not required in the actual providing of the TARP moneys?

Mr. BAROFSKY. We believe that requiring recipients to account for their use of funds is a fundamentally important part of transparency. It is why we make this recommendation and continue to make this recommendation.

As a policy, we tend not to cross into the policy recommendations as to what Congress should do or what Treasury should do. We do say what Treasury should do but we don't suggest legislation for Congress just as a policy matter and to maintain our independence. We certainly do feel it is our obligation to present to you why we think it is such an important factor of transparency.

Ms. SPEIER. Did the contracts that the Treasury devised with the banks for the distribution of the TARP funds prohibit the use of the money for any purpose?

Mr. BAROFSKY. There are different contracts and different programs. There are some restrictions on stock buybacks in the Capital Purchase Program and certain restrictions on increasing the level of dividends. So there are some restrictions, although not many.

Ms. SPEIER. So the fact that they would use the money to make investments, pay debts, or buy other banks was all legal under the granting of the TARP funds?

Mr. BAROFSKY. Absolutely.

Ms. SPEIER. Should we change that?

Mr. BAROFSKY. As I said, that is a real policy decision that needs to get made. I think in making that decision, we should take a look at both sides of these arguments. Part of the role of transparency, as the Special Inspector General we think that these debates are best informed by bringing transparency so we can see what happened. But I can give you arguments that I have heard on both sides of any one of these issues. I think one of the more controversial is acquisitions. I have heard some very powerful, strong arguments that is actually good for the banking system and arguments on the other side that it would be an inappropriate use of TARP funds.

Ms. SPEIER. Let us talk about acquisitions. Which banks actually took the TARP money and made acquisitions?

Mr. BAROFSKY. We are going to be publishing, necessarily in some redacted form, each of the responses that we received. The reason why I say redacted is that there is some confidential business information that we would be prohibited by law from making public. Since we are still in the process of that, I am reluctant to

comment on any specific response that we had. We will be making that information public hopefully within the next 30 days.

Ms. SPEIER. In terms of alarms that go off in your head because of what you have been able to ascertain through your surveys, what are those alarms that we should be particularly focused on?

Mr. BAROFSKY. I don't think that there are any alarms. I think when we did this survey we were taking great care not to make any judgments for all the reasons that I have stated.

The most alarming thing to me is that Treasury continues to refuse to adopt this recommendation even in light of the proof that we now have in this audit. They continue to tell us that it is a meaningless survey even though no one from Treasury has taken us up on our offer to come look at these survey responses in unredacted form. We said, "come over, take a look at them, and see if you think that these are meaningless responses that can't provide transparency." So I think the most alarming thing to me is this steadfast refusal, this willful refusal to adopt a recommendation that we think is so important to provide transparency.

Ms. SPEIER. So you are saying that even though you now have over 360 surveys that provide information on how the TARP funds have been used, no one from the Treasury Department has come over to look at this information?

Mr. BAROFSKY. No. Their refusal to adopt our recommendation was made purely off of our audit report. They have not come over.

Ms. SPEIER. I think that is astonishing. I yield back.

Chairman TOWNS. Thank you very much. I now yield to Congressman Schock from Illinois.

Mr. SCHOCK. Thank you, Mr. Chairman. Likewise, happy birthday on your special day. I am just noticing your election to office in 1983. As someone who is 28 years old in Congress, that is a lifetime.

Chairman TOWNS. I feel it, too.

Mr. SCHOCK. So thank you for your service this Congress and your country. Happy birthday.

Mr. Barofsky, I am specifically interested in the change in purpose that has occurred under the new administration with the use of TARP funds and how that might change your role or add additional responsibilities. How does your responsibility as the Special Inspector General for TARP interface with our Federal Government's decision to bail out the automakers? Could you speak to that?

Mr. BAROFSKY. Sure. I think that in the near term we are addressing that through our audit function. We have announced an audit of corporate governance, which of course oversees the fact that we do have a controlling equity interest in General Motors now and a minority interest in Chrysler Financial. My team is going to be heading out to Detroit next week, some of my audit team, to start that process.

We are also going to be sending representatives of our Investigative Division as well to make the necessary contacts and make sure that the word is out, including the word about our hotline if anyone within these companies knows of any misrepresentations. There is a whole bunch of reporting that is required as a condition of the

Federal funds. So we are going to keep a very close eye and dedicate the necessary resources to fulfill our oversight role.

Mr. SCHOCK. So you feel you are being given the latitude you need in terms of allowing your personnel into GM and Chrysler to oversee the use of those TARP funds?

Mr. BAROFSKY. I will let you know next week. But I don't anticipate that we are going to have a problem.

Mr. SCHOCK. OK. The next question is your opinion. When this bill was sold to Congress last fall, it was predicated on the idea that this money, in the words of former Treasury Secretary Hank Paulson, would be if not all paid back, most of it. And there was a slim likelihood that we might actually make money on the TARP money for the taxpayers. Do you believe that the majority of this money will be paid back?

Mr. BAROFSKY. I think if you look at the way the program has evolved, I think it is extremely unlikely that we are going to get \$700 billion back. The Mortgage Modification Program alone is \$50 billion. There is no anticipation that any of that money will come back. That money is being directly given to mortgage servicers to help convince them to lower mortgage payments and payments they will make on behalf of home owners. So I think it is very unlikely that TARP will turn a profit significant enough on other activities to generate a profit to cover that \$50 billion.

In addition, on some of the other programs, as the ranking member noted, the money has been written off from Chrysler. We still have to see what happens with our equity interest in those companies.

So it is certainly possible that more may be retained or earned back over time than maybe we even suspect right now. But I think the idea of getting a dollar for dollar return would be extremely unlikely.

Mr. SCHOCK. Then I wonder specifically about your statements earlier about asking Treasury to detail or to basically collect information from TARP recipients and also the use of the taxpayer funds from those TARP recipients. Treasury kind of gives this response that would be meaningless and really is not necessary. What is your view of that?

Mr. BAROFSKY. First of all, if it were meaningless, I don't understand why Treasury does this with respect to Bank of America, Citigroup, and AIG. Recently with AIG, are they including conditions in their contracts that they believe are meaningless? I certainly hope not.

My view is that sure, money is fungible. That is a true concept. But just to use a simple example from my own life, I get direct deposit of my Federal paycheck. Normally I couldn't tell you if I buy some groceries whether it is from 1 week or a different week because money is fungible it all goes into my checking account. A couple of years ago when I won the John Marshall Award for my work on the Refco case, there is a small cash component. I knew that was going to be direct deposited into my checking account. Before I got that check, I knew what I was going to do with that money. I was going to pay off a piece of my student loan. Sure enough, the money came into my account and then went out to pay off the student loan. So sure, money is fungible but I could tell you with a

great deal of certainty what I did with that bonus money, that extra money that came in.

What we see is that the financial institutions have been able to do the exact same thing. The TARP was an extraordinary amount of money and an extraordinary investment. Banks can tell what they did with that money. If they are responsible companies, they are budgeting for the fact that they are increasing the capital by these amounts. This is all money that can be verified and tested.

So much of Treasury's compliance system is based on similar types of self reporting where financial institutions report their compliance and then Treasury comes back and hopefully one day will test through its compliance function. This is no different. If a bank says, I used the money to acquire another financial institution which I wouldn't have been able to do otherwise because I wouldn't have had enough money, that is certainly a verifiable fact. If they go buy agency mortgage-backed securities and say this is what we did with the money, we can look at what their total volume of securities were before the TARP money and afterwards and test that money.

So we do believe that this is an important part of transparency. It is important for the Members of Congress, for the American people, and for Treasury as well to know what is going on with the taxpayer funds.

Mr. SCHOCK. I agree. Thank you very much for your testimony. I hope you will continue to press on. Thank you, Mr. Chairman.

Chairman TOWNS. Congressman Schock's time has expired. I now yield 5 minutes to the gentleman from Massachusetts, Congressman Lynch.

Mr. LYNCH. Thank you, Mr. Chairman. Mr. Barofsky, thank you for your great work. I appreciate the work being done by Mr. Dodaro and Elizabeth Warren as well. The work that you do obviously allows us on the Oversight Committee to do a lot of our work.

Let me ask you: One of the programs that Treasury has set up was this Asset Guarantee Program where Treasury will guarantee certain toxic assets held by qualifying financial institutions. They have focused mainly on toxic assets held by Bank of America and Citigroup. I think those are the two big outfits that they focused on. Have you been able to get information on the specific assets that Treasury has acquired from Citigroup and Bank of America?

Mr. BAROFSKY. We are in the process of putting together an audit that is going to address exactly that question. We received a letter request from Congress to look into that. We are right now in the process of putting together the audit structure that is going to address exactly that issue of what is in there, what the cash-flows are, and how it came to be. It will be really a thorough audit on the entire process and what is going on at Citigroup.

For Bank of America, Ken Lewis, the CEO of Bank of America, indicated that they are withdrawing from that program. The contract was never signed and therefore it is not actually going to be imposed. We do have a pending audit that we expect to complete in September that addresses Bank of America and its participation in the TARP programs. So we will touch on that there but we won't be doing a similar study of the assets given the change in status of that program.

Mr. LYNCH. I know this was instituted in November 2008 and I am just wondering what actually was purchased. My question really focuses on our potential exposure. If we are providing a guarantee behind a credit default swap or some complex derivative, our exposure may be greater than what your monetary assessment has been, even at \$3 trillion. I am just worried about our exposure there.

Let me just shift. I certainly anticipate your report in September. That will be great.

Let me ask you about your own position here. We originally set up the Special Inspector General for TARP in connection with the \$700 billion that was allocated. I did not vote for that but it went through anyway. A lot of us didn't. Originally you were set up to oversee and to safeguard the taxpayers' money. However, recently I understand that Treasury has challenged your authority as an independent oversight body. Reportedly, Treasury has requested an opinion from the Justice Department Office of Legal Counsel questioning whether your Office in fact falls under Treasury's authority.

Can you comment on Treasury's challenge to your independence, which you talked about earlier as being so important, integral to your operation there?

Mr. BAROFSKY. Yes. We do think this is potentially an issue that could impair our independence. Treasury has sought this legal advice from LLC. We have submitted our own submission detailing our position. We think it is crystal clear what Congress's intent was, for us to be an independent agency operating within the Treasury Department. We are going to wait and see. But we think that there is a danger that Treasury could try to assert, depending upon what the LLC opinion is, the authority to shut down investigations or audits that we may seek to initiate. We think that would obviously be contrary to the intent of Congress. Certainly we will let Congress know if we do get an adverse opinion.

I am pretty confident, though. I think the statute is so clear and the intent of Congress is so clear. I am hopeful that LLC will see it the right way, I think really the only way that makes sense based on how the statute is written and what the statements of Congress have been both at the time of enactment and since then. Hopefully this issue goes away. I always thought this was an unnecessary thing for Treasury to do. I continue to think so.

Mr. LYNCH. Obviously if this challenge is diverting the energies of your staff to defend itself, perhaps we in this committee can, there are some vehicles that are going through Congress right now, we could simply amend one of those just to clarify that our intent was that you would be independent and that you conduct oversight over the operations of Treasury in connection with this TARP program.

I also heard that Treasury's decision to challenge this came immediately in response to some of your questions regarding the bonus payouts at AIG. Is that correct?

Mr. BAROFSKY. That was the timing. I wouldn't go so far as to do a causal relationship between the two because I don't know for sure. It did come up, the issue, on the eve of an interview that we were going to have with a member of Treasury's General Counsel's

Office who was involved in the executive compensation issue at AIG. So it certainly was at that time.

Mr. LYNCH. I only speak for myself and I know my time has expired. I just want to say that I think it would be a terrible miscarriage of what Congress's intent was to have you hamstrung by being put under Treasury. We established your Office to oversee and to protect taxpayer money. We do not expect you to be answering to Treasury. We expect you to be investigating them and conducting your oversight.

Thank you. I yield back, Mr. Chairman. Happy birthday.

Chairman TOWNS. You can't yield back. You don't have any time. [Laughter.]

Congressman Fortenberry.

Mr. FORTENBERRY. Thank you, Mr. Chairman. Mr. Barofsky, welcome. Thank you for your testimony today.

You have made the news with your \$23.7 trillion pronouncement in your report. I would like ask you to unpack that further. That obviously is the fullness of potential taxpayer liability, the potential exposure to taxpayer liability. Many of us have been operating off of a working assumption that total taxpayer liability was about \$12 trillion, that between the Fed and the FDIC as well as the Treasury Department that totaled about \$12 trillion. Now, the other number that I thought was significant that you said was about \$4 trillion of actual realized expenditures.

So I have two questions. Let us just try to break this down into categories that are manageable. Tell the American people where that taxpayer liability is located. To whom has it has been gifted, basically? Then, again, under the \$4 trillion actual realized expenditures, to whom is that going and in what form, direct expenditures, loans, guarantees? By whom, to whom?

Mr. BAROFSKY. Your question actually encapsulates why I made this an entire section of our report. It is obvious there are some very complicated issues here. In Section 3 of this report, we do that breakdown. We talk about each of the numbers that we are talking about.

The \$3 trillion that is currently outstanding, the \$4.7 trillion that has been expended or guaranteed in total including money that has been paid back and canceled programs from the initiation of the crisis through June 30th, and then the \$23.7 trillion number, which is the maximum number if every one of these programs was subscribed to to the highest amount, every guarantee was done.

The purpose of this really wasn't to make the news or to make a splash. What we did here is we took the 50 programs because we thought it was important to show what the 50 programs were in addition to TARP that address the Government's support of the financial system. Really, the \$23.7 trillion which has generated so much controversy and so much comment from the Treasury Department is just adding up the number of what the total high water mark is for each of those 50 programs. That is what is reflected in here.

So it is not that the taxpayer is on the hook right now for \$23.7 trillion. We do not say that and we do not suggest it. But that is the maximum if you take all of the programs that have been initiated since the inception of the financial crisis.

Mr. FORTENBERRY. That is the total potential exposure. But again, let us get back, let us try to frame that a little bit more concisely. This is 250 pages, the particular section you are referring to I do not know how many pages is that, I do not know if you have a particular chart that categorizes this in broad terms so that we can all have a working framework that is useable so that we can understand the total liability that exists and actually where it is going.

Mr. BAROFSKY. Table 3.4 on page 138. I would say that any taxpayer or anyone interested, this report is at our Web site [www.sig tarp.gov](http://www.sig tarp.gov), anyone can download this and see all the facts. But if you look at page 138, that has a table which is entitled Incremental Financial Systems Support. What we have done here is some existing programs were increased, so we have not included the total program but only the increase that is attributable to the financial crisis.

What we have here is it lists the different sources of where the guarantees or support are coming from and lists what the current balance is, the maximum balance from inception, and what the total potential support is. And that is the phrase that I think is the right one, it is total potential support. Now each of these entries in here, and we list the Federal Reserve, the FDIC, Treasury TARP, Treasury non-TARP, and then others, is supported subsequently in the report by other charts.

So, for example, if you wanted to see what the Federal Reserve portion of this is, you just turn the next page and in Table 3.5 we list each of the Federal Reserve programs that is described again with this same information, the current balance, the maximum balance, and the total support related to the crisis. What you do when you add up each of these charts and the total support, that is where the \$23.7 trillion number comes from.

Mr. FORTENBERRY. Now, out of this comes about \$16 trillion between the Federal Reserve, Treasury, and the FDIC. Again, the operating assumption that we have been working off of for basically the balance of this year because there were no numbers available, easily available, was \$12 trillion. So that is a very significant increase.

Mr. BAROFSKY. That is one of the reasons why we have done this. We have come under some criticism for having done this. But every time that we would look at a different article or a different newspaper there would be a different number there. We thought it was important to put the TARP in context to collect what the major numbers were, and that is what we have tried to do here.

Mr. FORTENBERRY. What level of detail does it go into in terms of actual recipients of these various funds between FDIC, Treasury, as well as the Federal Reserve?

Mr. BAROFSKY. We had a page limit. Ultimately, this is TARP in context and given the number of these programs, what we have done is really a one or two paragraph summary of each program. Also, everything that is in here is based on publicly available information. This is all stuff that we got off the Web sites or congressional testimony of the different agencies. Getting into the recipients would be I think in a large part in many cases beyond what

is publicly available and, frankly, beyond our jurisdiction or authority because these are non-TARP related.

Chairman TOWNS. The gentleman's time has expired. Thank you.

I now yield 5 minutes to the gentleman from Massachusetts, Mr. Tierney.

Mr. TIERNEY. Thank you very much, Mr. Chairman. Thank you, Mr. Barofsky, for the work that you are doing and for being here today. I just have two lines of questions, should not take too long. One concerns the term asset backed securities loan facility, the so-called TELF. This is an idea where they need a AAA rating from two of the rating firms and a not less than AAA rating from the third firm. But we continue to have these rating agencies paid by the issuers, by the people whose product they are rating.

You made mention of that in your report. You said essentially they are "paid by the issuers of the very securities that they are rating. As a result, the agency has an incentive to issue a high rating to attract future business from that issuer." That is one of the problems that got us to where we are today in this whole financial crisis. It should boggle our minds that we are continuing down that path and in relying on those as part of this program. So you would agree, obviously, that we should be concerned about this. Moreover, what would you suggest that we do as a different methodology for the TELF program and others?

Mr. BAROFSKY. This is something that we have been pushing for since our initial report to Congress in February. We have some suggestions. One of our concerns is a race to the bottom. Moody's actually came out, one of the three rating agencies, and has said basically that they are losing business because they have been more strict than the other two and, as a result, they have not been getting enough business.

We have not investigated that. We think that the Federal Reserve and Treasury needs to investigate that further. But it sort of raises the ultimate issue of a potential race to the bottom. And then it was expanded when the TELF went into commercial mortgage-backed securities they added more rating agencies but kept the number at two that are required to get approval. That only exacerbates the issue of more rating agencies for that race to the bottom to occur.

I think what they need to do is what the Federal Reserve, to their credit, has started to do, which is, stop relying on rating agencies to do the work, the diligence, the underwriting that stands behind these asset-backed securities. The Federal Reserve has hired a collateral monitor for commercial mortgage-backed securities to come up with its own evaluations as to what these things might be worth in a stressed environment. We think that it is important to keep pushing in that direction, away from reliance or the importance of rating agencies in this process to make sure when we are dealing with taxpayer money that the level of protection is a little bit higher than what has, as you correctly state, got us into this soup in the first place.

Mr. TIERNEY. What can Congress do to help you push that point? Obviously, if we are not going to have somebody other than the issuer pay, then we should do exactly what the Fed is doing with this program.

Mr. BAROFSKY. It is not really our policy to advise Congress on specific legislation on these policy issues.

Mr. TIERNEY. But saying that legislation would be the only thing we could do or one of the things we could do or whatever, it would be helpful, generally.

Mr. BAROFSKY. I think it also is sort of worth noting that in the regulatory reform that this Congress is considering, taking a good hard look at what the reforms are for the rating agencies and whether the reforms truly and squarely address these conflicts of interest that had such disastrous consequences leading into the financial crisis.

Mr. TIERNEY. Thank you. My other line of questioning has to deal with the credit derivative contracts that AIG held with third party counter-parties. The financial situation when it occurred obviously created a situation where the counter-parties claimed that the contract terms had been violated. They demanded either payment or additional collateral from AIG. AIG's lack of liquidity obviously made that difficult to come up with, and there was a contest between AIG and those third party people as to whether or not there was money owed, if so, how much should it be, and there was a negotiation that was going on on that.

When Mr. Liddy from the AIG was before the committee we asked him why it was they paid 100 percent on the claim. He said he did not believe they necessarily should have, that in fact there was contention amongst that, and he had been somewhat surprised because he and the people at AIG had not done it, that in fact it had been the Fed and the New York branch, in particular, that had done it. Are you looking at that at all? Are you able to tell us what happened that all of a sudden in contested claims they just up and forked over 100 percent?

Mr. BAROFSKY. We are. We are looking at that. We have a pending audit into that very specific issue, the credit party payments, the payment of 100 cents on the dollar, and who made that decision. I expect that audit will be finalized by September.

Mr. TIERNEY. Thank you very much. I yield back.

Mr. ISSA. Would the gentleman yield?

Mr. TIERNEY. Yes, I will.

Mr. ISSA. I have just one quick followup. Are you familiar with the XBRL and are you in a position to help get this kind of transparency data base access available to agencies that currently are not reporting in a transparent fashion?

Mr. BAROFSKY. We are familiar with the XBRL product. I heard some testimony about it. Actually, my office received a presentation on it. It does appear to be a useful type of product to track these types of funds.

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

Chairman TOWNS. I yield to the gentleman from Indiana, Mr. Burton.

Mr. BURTON. Thank you very much. I want to thank Congressman Issa for the letter that he gave to me.

We had Mr. Paulson and Mr. Bernanke before the committee just in the last couple of weeks. They had an epidemic of memory loss on a number of issues. Mr. Paulson was working of course very closely with Mr. Geithner, the now Secretary of Treasury, on a

number of issues, as well as Mr. Bernanke. This whole pattern really kind of bothers me about how they have appeared to keep things from the Congress of the United States because they can't remember who did what on the Merrill Lynch deal with Bank of America and now Geithner's work with Paulson.

Now they are in effect threatening you. I don't see how anybody can get anything out of this letter that we received other than they were putting the hammer to you to back off.

You say here that on April 15th, Mr. Knight wrote to the OLC over at the Justice Department attaching a copy of SIGTARP's April 7th memorandum regarding the presented issues. They were asking whether or not you should fall under the jurisdiction or control of the Treasury Department. It is pretty clear I think to everybody on this committee that you should be independent because that is what your job is.

But then there was some kind of correspondence between you and the Department of Justice. They asked you to redact a portion of the email exchange from OLC. That was to you, right?

Mr. BAROFSKY. I think all of the information that our correspondence that we—oh, yes. I am sorry, yes. The response from OLC to us, which then generated an additional response from Treasury, yes. We were asked to redact that.

Mr. BURTON. I wonder why they asked you to redact that. Did they give you a reason?

Mr. BAROFSKY. The stated reason from OLC is that the information was indicative of their current thinking on an uncompleted matter. Therefore, it was privileged information. Until they came to a final resolution, they didn't want—

Mr. BURTON. I was chairman of this committee for 6 years and I worked with the Justice Department on a number of occasions, a lot of occasions, as a matter of fact. They didn't give any information out or send any correspondence whatsoever that would have to be redacted. The reason they didn't is because until they made a final determination, they didn't want any information out there in the hinterlands.

When they sent you this information, and then they tell you that it has to be redacted, it seems to me that is once again working with the Treasury Department to kind of keep the hammer on you and hold things in abeyance so that you will walk the chalk. Do you have any comment on that?

Mr. BAROFSKY. I really can't, unfortunately.

Mr. BURTON. I didn't think you could. I think this is such a blatant attempt to intimidate you. I am so happy that you contacted Ranking Member Issa and Senator Grassley. What it has done is it has illuminated this issue so that these people that are trying to slow you down and not let this information get out in the public domain, they are going to be threatened by this right now.

The only thing I would admonish you to do is to watch your back. You, as I understand it, are subject to the President. You serve at his pleasure. So I think there could be some reason they could come up with down the road that would get you replaced.

But in the meantime, I want to congratulate you for having the intestinal fortitude—and I would use some other terminology if I weren't in public—to stand up for what you believe in. I think it

is really great and I am glad you sent this letter to Mr. Issa. Thank you.

Mr. BAROFSKY. Well, thank you very much. I can assure you and I can assure this committee that I will not spend a single moment worrying about my job security or my future. I am just going to continue to do the job that I have been hired to do, which is bring as complete transparency as possible and to continue to audit and investigate to the best of my abilities.

Mr. BURTON. I have not met you before but I like you, man.

Mr. BAROFSKY. I have had a tough couple of days so I appreciate that.

Mr. ISSA. Would the gentleman yield?

Mr. BURTON. I would be happy to yield.

Mr. ISSA. I have one followup question. Much has been said of this \$23.7 trillion plus or minus a trillion here or there. But because constitutionally we must authorize and appropriate moneys, wouldn't it be fair to say that we need to have the transparency so we can anticipate in each fiscal year the likely outlays of additional money where risk is beginning to become recognized? Wouldn't that be something that this committee has to be able to access if we are going to allow the appropriators to make those funds available, presumably because additional losses may still occur in a number of markets like the housing market?

Mr. BAROFSKY. I have to confess that I don't have an intimate knowledge of the emergency authorities that have been invoked by the Federal Reserve and to a certain extent by the FDIC in authorizing these maximum amounts and what Congress's role is for authorizing them. So I am not really sure what the constitutional structure is.

Mr. ISSA. Assuming that we believe that, currently, in your opinion, are we getting that information assuming that we believe that we should appropriate moneys in the years in which the loss occurs?

Mr. BAROFSKY. I think from a looking back perspective, we have done our best to bring that information to your attention to the best that we can based on publicly available information.

Mr. ISSA. Thank you, Mr. Chairman.

Chairman TOWNS. Let me just say before I yield to the gentleman from Missouri that I like you, too. Let me just say that you also serve at the pleasure of the Congress as well. I don't think you have a problem because the President has said that he is for transparency. Every conversation I have ever had with him, he talked about the importance of transparency. So to me, you should be in good shape.

Mr. BAROFSKY. Thank you, Mr. Chairman. Happy birthday.

Chairman TOWNS. Thank you very much. I yield to the gentleman from Missouri, Congressman Clay.

Mr. CLAY. Thank you, Mr. Chairman. Happy birthday also.

Chairman TOWNS. I am afraid this is making me even older. [Laughter.]

Mr. CLAY. Mr. Barofsky, thank you for being here. I look forward to your insight on questions that are asked frequently in Missouri's First Congressional District. I did not agree with the original thrust of TARP and am still troubled by some results that I see.

One of the most important reasons for the legislation was to provide liquidity for businesses and home owners as the ultimate benefit of shoring up the banks and investment houses. We are seeing large banks and investment houses experiencing exorbitant profits but no relaxation of credit and no significant increase in liquidity. Why has liquidity not been restored to small businesses and individual consumers as a result of stabilizing these lenders? Do you find that too much of the moneys and profits are invested in Treasury bonds rather than in moneys made available for lending?

Mr. BAROFSKY. I think that the lack of transparency and the failure to adopt our recommendations regarding requiring the recipients to report on their use of funds makes answering that question almost impossible. Until we know with some degree of precision exactly how the financial institutions are using the money, it is hard to answer the question of why they are not using it to increase lending. We do not know what they are doing.

In our survey, our audit report, which was just their responses to our survey, we have a lot of answers that could lead to some conclusions. But that survey, of course, was from a certain point in time, basically March of this year. The banks that responded to the survey, 75 percent of them, said that they had not yet allocated or spent all of their TARP funds.

Since the time of this survey, another 200 institutions received TARP money, including insurance companies, which, frankly, I do not think anyone expects is going to be using the money as part of their banking subsidiaries that entitle them to receive TARP funds.

So it is very difficult to answer the question of why are they not increasing lending if we do not know what they are actually doing with the money. The only way we can get that on a more timely and regular basis is if Treasury adopts our recommendation and commits itself in deed as well as in word to maximum transparency.

Mr. CLAY. In your crystal ball, do you suspect that they are perhaps paying out lucrative bonuses or paying off debt? What do you think is happening?

Mr. BAROFSKY. Based on what we saw from our snapshot back in March, a certain number are using it to pay off debt, different types of debt. Some are paying down lines of credit with the Federal Reserve with TARP funds.

One smaller institution reported to us that, in substance, they were planning on using the TARP money for one purpose. I think it was to increase lending but right around the time that they got their TARP funds they got a line of credit that they had with another financial institution called in and they ended up using substantially all of the TARP funds to make good on this money that they had borrowed from another financial institution that they may have had real trouble paying back but for the TARP funds. So we get glimpses, at least from the dates of our survey, as to what happened.

Mr. CLAY. On another subject, how do you see the private program of AIG, the Systemically Significant Failing Institution Program, as having worked to the advantage of the taxpayers? AIG is the only company to receive funds under this program. We own 80

percent of the company yet allow fire sales of the most valuable assets, which are on the insurance side of the company. Why do we do this?

Mr. BAROFSKY. That is a question I think is better addressed to Treasury than to myself. It is very hard to go back into the old way back machine and know exactly what would have happened if we had not bailed out AIG through the Federal Reserve or through Treasury and what the implications and ramifications would have been. Certainly from some folks' perspective, those who were responsible for the bailout and those at AIG warned that the consequences would have been disastrous. But it is hard to really know, to go back and know exactly what would have happened. What we have to do and will continue to do in our audits of AIG is to try to bring transparency to that decisionmaking process and transparency to what is happening over there. We are going to continue to do so.

Mr. CLAY. Who do you think are the recipients of these below dollar deals?

Mr. BAROFSKY. For AIG to sell the AIG assets?

Chairman TOWNS. Yes.

Mr. BAROFSKY. I think AIG has disclosed some of their sale of assets and, to the extent that they have, those are included in our report.

Mr. CLAY. Thank you so much for your answers.

Mr. BAROFSKY. Thank you.

Chairman TOWNS. I now yield to Congressman Driehaus.

Mr. DRIEHAUS. Thank you very much, Mr. Chairman. Let me echo my colleagues in wishing you a happy birthday as well.

Mr. Barofsky, thank you very much for your testimony. I share the opinion of many of the members of the committee that you should, in fact, be independent. If there are challenges with Treasury, we should certainly be addressing those because we value your independence. We certainly value the information that you have provided us here today.

I, too, like many of my colleagues, am astonished by the potential exposure that you have identified. I guess I take a little different view. I go back to how this may have been prevented and am astonished that so few people are willing to look at the inaction and the failure of regulation to work properly to prevent the almost collapse of our financial markets. I was not serving in Congress last fall when the markets nearly collapsed but I said at the time that I would have reluctantly supported the TARP if only to stabilize the financial institutions. I subsequently voted against the second round TARP because it did not include many of the conditions on transparency that so many of my colleagues have talked about here today.

But I go back to the failure of Congress and the failure of previous administrations to regulate mortgage-backed securities, CDOs, and CLOs while at the same time the banking industry was suggesting that they are the most regulated industry in the country and there was not any need for us to move forward. Many of these same folks that are complaining about the exposure are also working against regulatory reform in financial services. So I am

struck by some of the comments that have been made by some of my colleagues.

Specifically, I would like to pursue a line of questioning regarding some of these toxic assets and the valuation of the toxic assets. There was an article in the Wall Street Journal yesterday that I think was very interesting when they talked about collateralized debt obligation and the fact that this was related to the mortgage-backed securities which allowed the predatory lending to happen. But trying to pull all of these assets apart and value them in any real way is a Herculean task. There is so little in terms of collateral, in terms of capital that is actually behind them. From your perspective, when looking at these toxic assets, how do you believe we can best value them?

Mr. BAROFSKY. I, too, read the Wall Street Journal article on the pulling apart of one of these CDOs. I think it was a great illustration of the problem of these unbelievably complex securities and the challenge that Congress has in creating the right type of regulatory reform that will ensure oversight so that these types of products do not reek the damage that they did.

I think the valuation issue is a very challenging one and I think it is one that at first instance has to be done by the Treasury itself, to the extent that they have these assets on their books, whether it is through an asset guarantee of Citigroup or whether it is in its own collection of assets. It is a very complicated structure that needs a great degree of expertise and I think a great degree of skepticism.

We also have to see what happens with the other programs, whether these complex derivative products start coming across in the actual purchase programs or other subsequent TARP programs where I think that issue will come more to the front.

Mr. DRIEHAUS. I realize your function is in evaluating the way in which the TARP moneys are being spent. But as you look at it and as you look at the causes of this financial collapse, can you offer advice as to moving forward, the type of regulation and the type of products that we should be looking to regulate as we move forward?

Mr. BAROFSKY. I think that one is a little bit outside of my lane. I think I would be uncomfortable offering opinion on that. I think when it gets to the core issues of regulatory reform it is fair for us to identify some areas like the role of credit rating agencies because we are seeing that. But when you get into the nuts and bolts of regulatory reform, I would be uncomfortable offering my opinion.

Mr. DRIEHAUS. Is it fair to say that much of the exposure that you have identified is due to a failure to regulate appropriately certain products?

Mr. BAROFSKY. I do not think that, short of an audit product or short of a more thorough examination of these causes, I would feel comfortable offering that opinion.

Mr. DRIEHAUS. Thank you, Mr. Chairman.

Chairman TOWNS. Thank you very much. I now yield to the ranking member from California, Congressman Issa.

Mr. ISSA. Thank you, Mr. Chairman. I am just going to close. I realize there is a second round but our side will not be asking for it. We thank Mr. Barofsky. The fact is that you have been very

generous with your time and you have given us a lot of food for thought.

I just want to close, first of all, by thanking the chairman, and second, by asking the chairman if would he consider bringing the Treasury Secretary here next to help close the loop on a lot of these areas of transparency. I think Treasury deserves an opportunity to tell us from their perspective why they have not yet implemented these.

Chairman TOWNS. The gentleman makes a good point. We will definitely look into it.

Mr. ISSA. Finally, in closing, I want to echo your words when you said, "in deed as well as in word." President Obama promised us an unparalleled level of transparency and it is very clear that the bureaucracy that stands between President Obama and what he has told both the chairman and myself and all of us is in the way. So in closing, and we look forward to having you back here again in a quarter, I want to thank you for doing everything you can do to bring about that level of transparency.

For myself, and the chairman has already said for himself, we want to promise that we will be your partners in bridging that bureaucratic nightmare that always exists between a President, like President Obama who has promised us transparency; the Congress who begs for transparency; the IGs who help produce it; and the bureaucracy that stands in the way. So you have our support on a bipartisan basis. You will continue to have our support because we agree with you that transparency, this light is the only form of disinfectant that is going to prevent Government waste.

With that, Mr. Chairman, I thank you again for this series of very good oversight hearings. I thank our witness and look forward to seeing you in about 90 days. I yield back.

Chairman TOWNS. Thank you very much. I now recognize the gentlewoman from Ohio.

Ms. KAPTUR. Thank you, Mr. Chairman. We appreciate this and we appreciate your endurance, Mr. Barofsky. I wanted to just state for the record that at least this Member and many of the people she represents believe that this is the largest transfer of wealth in American history that we have ever seen from those whose equity has been moved to Wall Street institutions that now have become even more concentrated as a result of what has occurred with the meltdown in the financial sector. I just wanted to again share information.

It is interesting to me that some of the companies like BlackRock that are involved in the resolution are headed by individuals who were heavily involved formerly when they headed other companies in inventing the sub-prime instrument itself. We do not know where they did all of their handiwork necessarily, but I find it very interesting that the Federal Government now rewards them in very non-transparent processes. I said to myself, could they well be handling paper that they invented and trafficked 10 years ago or 15 years ago? The derivative instrument itself, I understand, was heavily influenced by a gentleman who is now the vice chair of PNC.

At our home in Ohio, I have just received a notice that our certificate of deposit that has been with National City Bank is going

to be transferred to PNC come this November. I do not want PNC owning our meager assets. That is not my choice and yet I see this having an impact. Ohio is now left with only three money center banks. National City is disappearing. I see this power gravitating elsewhere to the very people who caused this problem in the first place.

One of my questions really has to do with Freddie Mac, and I could concentrate on Fannie Mae and FHA, because basically what has happened is all the bad paper is being dumped on the taxpayer, as you have well noted in your report, in different ways, putting it here, here, and every place else in the Federal Government so it is not easily traceable.

But if one looks at Freddie Mac, which is central in terms of being a dumpster as well as an enabler during the 1990's, let me just ask you why, and when I looked at your report I could not find the word Freddie Mac, but why have Freddie Mac and Fannie Mae's paper been hidden behind the walls of Oz over at the Federal Reserve? Do you have any role at all in unwinding the role of Freddie Mac in all of this going back into the 1990's?

Mr. BAROFSKY. We do not have jurisdiction over Freddie Mac in any aspect other than the fact that Treasury has hired them as a financial agent to help do compliance for the mortgage modification program. But other than that, since Freddie Mac is not involved in TARP specifically, we do not have jurisdiction over them.

Ms. KAPTUR. I do not know if you are aware of this or if the public is aware of this, but Freddie Mac had over \$500 million of fines placed on it already for fraudulent activities. The fact is that during the heyday of their nefarious activity they had blown up profits over 30 percent on their books, they underestimated risk, and they have begun to pay a heavy price for that.

I am very interested in your opinion as an auditor, do you find it rather interesting that we cannot get at that paper even though the American people are the recipient of all the mistakes? Our mortgages are not being worked out at the local level. J.P. Morgan Chase is the worst forecloser in my district, including through one of its affiliates called Plymouth. Yet they can dump their paper, and theoretically a lot of it moves through Freddie and Fannie, and behind these walls of the Federal Reserve we cannot get at that.

As I look at a capable individual like yourself and your staff, I am saying to myself, you are never going to get at the truth because they divided up the turf in such a way that you can never tell us the whole. How do you respond to that concern of mine? How do we get the whole truth?

Mr. BAROFSKY. I think it should be no surprise at this point that I agree wholeheartedly that more transparency is better than less, that the more information that is out there for policymakers and the American people is better. Because it is not related to a TARP, it is outside of our scope and our jurisdiction.

Ms. KAPTUR. You are saying it is unrelated yet the Fed has just hired I believe Black Rock to help to resolve, whatever that means, the Freddie Mac and Fannie Mae paper. Let me just quote from the Washington Post: "Freddie Mac's alleged manipulation and accounting errors caused it to understate profit by 30.5 percent in 2000 and 42.9 percent in 2002 and to overstate profit by 23.9 per-

cent in 2001. These manipulations include transactions that shifted windfall earnings into later periods or it might have been hard for the company to meet Wall Street expectations.”

My point is I do not see how we can know the whole truth and this troubles me, Mr. Chairman, because even the secret TARP report today, there are so many agencies, it is like they have divided up into a thousand pieces just like they did the derivatives so we can never know the truth. How do we get our arms around the whole? How do we do that? Can you think about that?

Mr. BAROFSKY. I think the question is best addressed to the Inspector General for the Federal Reserve as well as the Inspector General for FHFA who oversees the conservatorship of Fannie and Freddie. They would be in a better position since these things are under their jurisdiction to help you find the answers.

Ms. KAPTUR. From a Federal Government standpoint, are you disallowed from working together?

Mr. BAROFSKY. Oh, no, no, no. We do coordinate together. Those Inspector Generals are both on part of my TARP IG council because they do have actions that impact the TARP, and I am part of the Financial Regulatory IG Council and we do talk and do coordinate with one another where our interests intersect. Here, this is sort of apart from the TARP program so I do not really have an ability to go in and look at that information.

Chairman TOWNS. The gentlewoman's time has expired. But I think she makes a great case as to why the Inspectors General should have independence. I agree, when there is \$23.7 trillion at stake it is important that we make certain that they are independent.

Let me thank you, Mr. Barofsky, for your testimony. I appreciate the interest of the Members who attended today's hearing.

Earnings at the largest banks and the bank holding companies, such as J.P. Morgan, Goldman Sachs, are up yet lending remains down. It is unacceptable that profits go up while lending goes down. The taxpayers have invested very large amounts of money in these banks, but what have we gotten in return? It remains unclear. The taxpayers deserve to know how their tax dollars are being spent. The Treasury Department needs to publish full and detailed information on the use of TARP funds and publish the value of TARP portfolio on a monthly basis. They have that information and they should make it public.

Moreover, Treasury also requires the largest banks to file monthly reports showing the dollar value of their new lending. That should be made public also. If Treasury does not put this information up on its Web site, this committee will. And if Treasury does not turn over this information voluntarily, Secretary Geithner will be brought before the committee to explain why not.

What we have heard today convinces me that one of the best things Congress did when it created the TARP was to also create the Special Inspector General to oversee TARP spending. I can now understand why the Treasury Department would like to reign in SIG TARP. But we are not going to let that happen. You heard from the members on this committee today in terms of their commitment.

Again, I thank our witness, Mr. Barofsky. We thank you for your time and information that you shared with us.

Finally, let the record demonstrate my submission of a binder with documents relating to this hearing. Without objection, I enter this binder into the committee record.

Without objection, the committee stands adjourned.

[Whereupon, at 2:40 p.m., the committee was adjourned.]

[The prepared statements of Hon. Gerald E. Connolly, Hon. Diane E. Watson, and additional information submitted for the hearing record follows:]

Opening Statement of Congressman Gerald E. Connolly

Committee on Oversight and Government Reform

“Report of the Special Inspector General for the Troubled Asset Relief Program”

July 21<sup>st</sup>, 2009

Thank you, Chairman Towns for holding this hearing, in a time that many seem to be suffering from a severe case of amnesia. At this Committee’s last meeting the minority lambasted the “Bush-Obama” TARP plan that we are discussing again today. This hearing should serve to remind us that aggressive intervention was necessary to prevent economic collapse in the fall of 2008, and that only the rigid anti-government ideology of the Bush administration prevented this rescue from being executed more effectively. It is ironic that the minority would tag the President with the TARP slur when in fact it was the Democratic Congress that demanded changes to the administration’s original TARP proposal that have allowed the Treasury to wage a more effective economic stabilization campaign, and that it was the minority’s opposition to a voting stake in banks that now makes TARP investments less transparent and accountable. Although I voted against the second tranche of TARP funding, it is worth remembering that Democratic intervention greatly improved the initial TARP legislation.

As so many members reminded Mr. Paulson at the last meeting, the Bush administration presented Congress with a three page bill authorizing the Treasury to purchase “toxic assets,” removing subprime mortgages and other liabilities from banks’ balance sheets. Upon receiving this ill-conceived bill, many members of Congress (and economists) noted that it would be a more effective and accountable use of taxpayer money to make direct equity investments in banks. As Nobel Prize-winning economist Paul Krugman wrote in October of 2008:

What he [Paulson] should have proposed instead, many economists agree, was direct injection of capital into financial firms: The U.S. government would provide financial institutions with the capital they need to do business, thereby halting the downward spiral, in return for partial ownership. When Congress modified the Paulson plan, it introduced provisions that made such a capital injection possible, but not mandatory. And until two days ago, Mr. Paulson remained resolutely opposed to doing the right thing.

Fortunately, Congress insisted on allowing Treasury to make these direct equity injections in banks, in addition to granting authority to purchase toxic assets, and former Secretary Paulson ended up using that authority more frequently than he had originally planned. A week ago many in the minority party expressed dismay that former Secretary Paulson used equity purchases as the primary means of economic stabilization through TARP. This view suggests a profound lack of understanding about economic policy.

Surely the minority party will recall that the Bush administration categorically rejected many members' efforts to allow equity injections with voting representation for the Federal government. Obviously a voting stake in the banks receiving equity injections would give Congress and the American people more oversight and control of funds invested through TARP. The same individuals who decried equity investments in banks were of the party that explicitly rejected the very mechanism—a voting stake in banks—that would provide far greater accountability and oversight of taxpayer investments.

Today it is quite easy to look back and claim that TARP was unnecessary, because the catastrophe it helped avert has indeed been averted. With no disaster, the nihilists say, what was the need for TARP? Recognizing the difficulty of conveying a nuanced view, I will attempt to propound one anyway: The TARP represented a necessary economic intervention to prevent economic collapse. It was more effective because economists and members of Congress ensured that the Treasury could make direct investments in banks rather than just buy toxic assets, but it was less effective than it could have been because anti-government ideology of the Bush administration precluded the kind of oversight and accountability that would have allowed taxpayers to monitor and recoup their investment more quickly.

Questions for Neil Barofsky, Special Inspector General for the TARP:

Q: I am one of many members who represent people who have lost hundreds of thousands of dollars on their homes. Although there were certainly speculators who lost money when the housing bubble burst, many homeowners also lost money simply because they happened to buy a house at the wrong time. How many homeowners have been helped by the \$50 billion invested through the Making Home Affordable program in TARP, and what lessons can we learn about the application of this funding to inform policy decisions that could both assist stressed homeowners today and avoid housing bubbles in the future?

Q: It seems that over \$300 billion in TARP funding has been invested directly in systemically important firms through the Capital Purchase Program, Targeted Investment Program, and Systemically Significant Failing Institutions program. If the Bush administration had not adamantly opposed giving the Federal government a voting stake in banks in which it makes equity injections, what kind of oversight and accountability capabilities might we have had that we do not have today?

Q: Bank of America is now attempting to back out of the Federal Reserve's ring fencing arrangement that involved an investment of \$118 billion without paying the Federal government anything for the financial benefits of having its assets backed by this ring fencing arrangement. If the Federal government had acquired a voting stake in Bank of America, what other tools would we have had to force BoA to return taxpayer funds on order with the benefits it received from ring fencing?

*Opening Statement  
Of  
Congresswoman Diane E. Watson  
Oversight and Government Reform Committee*

*Tuesday, July 21, 2009  
2154 Rayburn HOB  
10:00 A.M.*

*“Following the Money: Report of the Special Inspector  
General for the Troubled Asset Relief Program (SIGTARP)”*

**Thank you Mr. Chairman for holding today’s important hearing on the release of the Special Inspector General for the Troubled Asset Relief Program, or SIGTARP’s third quarterly report and first audit report on how recipients have used their TARP funds. The Emergency Economic Stabilization Act of 2008 (EESA) authorized the TARP program for the dispersal of approximately \$700 billion of federal money to attempt to restore liquidity and stability to the financial system.**

**Section 121 of the EESA established SIGTARP to provide stringent oversight of the TARP program in conjunction with the Congressional Oversight Panel, the Government Accountability Office, and Congress. In this capacity SIGTARP is responsible for reviewing the TARP-related activities of Treasury and relevant Federal agencies, for overseeing recipient compliance with their obligations under various TARP programs, and for collecting information to present quarterly reports to Congress.**

**While I am encouraged by the oversight efforts put forth, troubling practices have been revealed. For instance, after receiving \$150 billion in direct assistance and guarantees from the federal government it was revealed that AIG used that money to pay**

**counterparties to the derivatives trades that decimated the insurance company at 100 cents on the dollar.**

**While in contrast the first bank, Old National, to buy back the warrants attached to their federal loans negotiated a deal with the Treasury to purchase them at only 8% of their value, paying the taxpayers back at what analysts estimate to be at least two to three times less than the market value of such warrants which represent the only upside for taxpayers on their risky low-yielding investments in the financial sector.**

**With the unemployment rate at 9.5% nationally and 11.4% in my district in Los Angeles it is crucial that today's hearing gives us an honest perspective into the use of TARP funds. If the American people, who are suffering profoundly in this economy, are to accept**

**investing in the banking sector they deserve to know how their money is being used, and when it will be returned to them.**

**I would like to thank today's witness for his testimony and for the work his office has done overseeing and scrutinizing the TARP program on behalf of American taxpayers.**

**Thank you Mr. Chairman and I yield back my time.**

**“Following the Money: Report of the Special  
Investigator General for the Troubled Asset Relief  
Program (SIGTARP)”**

**EXHIBIT BOOK**

**“Following the Money: Report of the Special Inspector  
General for the Troubled Asset Relief Program (SIGTARP)”**

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**SIGTARP**

OFFICE OF THE SPECIAL INSPECTOR GENERAL  
FOR THE TROUBLED ASSET RELIEF PROGRAM

ADVANCING ECONOMIC STABILITY THROUGH TRANSPARENCY, COORDINATED OVERSIGHT AND ROBUST ENFORCEMENT

Quarterly Report to Congress  
July 21, 2009

## MISSION

SIGTARP's mission is to advance economic stability by promoting the efficiency and effectiveness of TARP management, through transparency, through coordinated oversight, and through robust enforcement against those, whether inside or outside of government, who waste, steal or abuse TARP funds.

## STATUTORY AUTHORITY

SIGTARP was established by Section 121 of the Emergency Economic Stabilization Act of 2008 (EESA). Under EESA, the Special Inspector General has the duty, among other things, to conduct, supervise and coordinate audits and investigations of the purchase, management and sale of assets under the Troubled Asset Relief Program (TARP). In carrying out those duties, SIGTARP has the authority set forth in Section 6 of the Inspector General Act of 1978, including the power to issue subpoenas.

**Office of the Special Inspector General  
for the Troubled Asset Relief Program**  
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\*Visit [www.sig tarp.gov](http://www.sig tarp.gov) to view Appendix A: Glossary, Appendix B: Acronyms and Abbreviations, Appendix E: Public Announcement of Audits, Appendix F: Key Oversight Reports and Testimonies, and for further reference material.

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EXECUTIVE SUMMARY

## EXECUTIVE SUMMARY

In the nine months since the Emergency Economic Stabilization Act of 2008 ("EESA") authorized creation of the Troubled Asset Relief Program ("TARP"), the U.S. Department of the Treasury ("Treasury") has created 12 separate programs involving Government and private funds of up to almost \$3 trillion. From programs involving large capital infusions into hundreds of banks and other financial institutions, to a mortgage modification program designed to modify millions of mortgages, to public-private partnerships using tens of billions of taxpayer dollars to purchase "toxic" assets from banks, TARP has evolved into a program of unprecedented scope, scale, and complexity. Moreover, TARP does not function in a vacuum but is rather part of the broader Government efforts to stabilize the financial system, an effort that includes dozens of inter-related programs operated by multiple Federal agencies. Thus, before the American people and their representatives in Congress can meaningfully evaluate the effectiveness of TARP, not only must the TARP programs themselves be understood, but also TARP's scope and scale must be placed into proper context with the other Government programs designed to support the financial system. That is one of the ambitious goals of this report.

In this report, the Office of the Special Inspector General for the Troubled Asset Relief Program ("SIGTARP") endeavors to (i) explain the various TARP programs and how Treasury has used those programs through June 30, 2009, (ii) provide a brief explanation of the numerous other Government programs that have been implemented by Treasury and other Federal agencies to support the financial and mortgage markets; (iii) describe what SIGTARP has done to oversee the various TARP programs since its April Quarterly Report to Congress, dated April 21, 2009 (the "April Quarterly Report"), and (iv) set forth a series of recommendations for the operation of TARP.

### TARP IN FOCUS, AND IN CONTEXT

TARP, as originally envisioned in the fall of 2008, would have involved the purchase, management, and sale of up to \$700 billion of "toxic" assets, primarily troubled mortgages and mortgage-backed securities ("MBS"). That framework was soon shelved, however, and TARP funds are being used, or have been announced to be used, in connection with 12 separate programs that, as set forth in Table 1 on the next page, involve a total (including TARP funds, loans and guarantees from other agencies, and private money) that could reach nearly \$3 trillion. Through June 30, 2009, Treasury has announced the parameters of how \$643.1 billion of the \$700 billion would be spent through the 12 programs. Of the \$643.1 billion that Treasury has committed, \$441 billion has actually been spent.

As massive and as important as TARP is on its own, it is just one part of a much broader Federal Government effort to stabilize and support the financial system. Since the onset of the financial crisis in 2007, the Federal Government, through

many agencies, has implemented dozens of programs that are broadly designed to support the economy and financial system. As detailed in Section 3 of this report, the total potential Federal Government support could reach up to \$23.7 trillion. Any assessment of the effectiveness or the cost of TARP should be made in the context of these broader efforts. Section 3 also provides a tutorial on the Federal Reserve System, which administers many of the non-TARP credit and liquidity facilities that are providing support to the financial system.

TABLE 1

| TOTAL POTENTIAL FUNDS SUBJECT TO SIGTARP OVERSIGHT, AS OF 6/30/2009 (\$ BILLIONS) |  |                                      |                             |
|---|--|--------------------------------------|-----------------------------|
| Program   | Brief Description or Participant   | Total Projected Funding at Risk (\$) | Projected TARP Funding (\$) |
| Capital Purchase Program ("CPP")  | Investments in 649 banks to date; 8 institutions total \$134 billion; received \$70.1 billion in capital repayments  | \$218.0<br>(\$70.1)                  | \$218.0<br>(\$70.1)         |
| Automotive Industry Financing Program ("AIFP")                                    | GM, Chrysler, GMAC, Chrysler Financial; received \$130.8 million in loan repayments (Chrysler Financial)             | 79.3                                 | 79.3                        |
| Auto Supplier Support Program ("ASSP")  | Government-backed protection for auto parts suppliers  | 5.0                                  | 5.0                         |
| Auto Warranty Commitment Program ("AWCP")   | Government-backed protection for warranties of cars sold during the GM and Chrysler bankruptcy restructuring periods | 0.6                                  | 0.6                         |
| Unlocking Credit for Small Businesses ("UCSB")                                    | Purchase of securities backed by SBA loans   | 15.0                                 | 15.0                        |
| Systemically Significant Failing Institutions ("SSFI")                            | AIG investment   | 69.8                                 | 69.8                        |
| Targeted Investment Program ("TIP")   | Citigroup, Bank of America investments   | 40.0                                 | 40.0                        |
| Asset Guarantee Program ("AGP")   | Citigroup, ring-fence asset guarantee  | 301.0                                | 5.0                         |
| Term Asset-Backed Securities Loan Facility ("TALF")                               | FRBNY non-recourse loans for purchase of asset-backed securities   | 1,000.0                              | 80.0                        |
| Making Home Affordable ("MHA") Program  | Modification of mortgage loans   | 75.0                                 | 50.0                        |
| Public-Private Investment Program ("PPIP")  | Disposition of legacy assets; Legacy Loans Program, Legacy Securities Program (expansion of TALF)                    | 500.0 – 1,000.0                      | 75.0                        |
| Capital Assistance Program ("CAP")  | Capital to qualified financial institutions; includes stress test  | TBD                                  | TBD                         |
| New Programs, or Funds Remaining for Existing Programs                            | Potential additional funding related to CAP; other programs  | 131.4                                | 131.4                       |
| <b>Total</b>  |  | <b>\$2,365.0 – \$2,865.0</b>         | <b>\$699.0</b>              |

Note: See Table 2.1 in Section 2 for notes and sources related to the information contained in this table.

## OVERSIGHT ACTIVITIES OF SIGTARP

Since the April Quarterly Report, SIGTARP has been actively engaged in fulfilling its vital investigative and audit functions as well as in building its staff and organization.

SIGTARP's Investigations Division has developed rapidly and is quickly becoming a sophisticated white-collar investigative agency. Through June 30, 2009, SIGTARP has 35 ongoing criminal and civil investigations. These investigations include complex issues concerning suspected accounting fraud, securities fraud, insider trading, mortgage servicer misconduct, mortgage fraud, public corruption, false statements, and tax investigations. Two of SIGTARP's investigations have recently become public:

- **Federal Felony Charges Against Gordon Grigg:** On April 23, 2009, Federal felony charges were filed against Gordon B. Grigg in the U.S. District Court for the Middle District of Tennessee, charging him with four counts of mail fraud and four counts of wire fraud. The charges are based on Grigg's role in embezzling approximately \$11 million in client investment funds that he garnered through false claims, including that he had invested \$5 million in pooled client funds toward the purchase of the TARP-guaranteed debt. Grigg pleaded guilty to all charges and is scheduled for sentencing on August 6, 2009.
- **FTC Action Against Misleading Use of "MakingHomeAffordable.gov":** On May 15, 2009, based upon an action brought by the Federal Trade Commission ("FTC"), a Federal district court issued an order to stop an Internet-based operation that pretended to operate "MakingHomeAffordable.gov," the official website of the Federal Making Home Affordable program. According to the FTC's complaint, the defendants purchased sponsored links as advertising on the results pages of Internet search engines, and, when consumers searched for "making home affordable" or similar search terms, the defendants' ads prominently and conspicuously displayed "MakingHomeAffordable.gov." Consumers who clicked on this link were not directed to the official website, but were diverted to sites that solicit applicants for paid loan modification services. The operators of these websites either purport to offer loan modification services themselves or sold the victims' personally identifying information to others. SIGTARP is providing assistance to FTC during the investigation.

More than 50% of SIGTARP's ongoing investigations were developed in whole or in part through tips or leads provided on SIGTARP's Hotline (877-SIG-2009 or accessible at [www.SIGTARP.gov](http://www.SIGTARP.gov)). Over the past quarter, the SIGTARP Hotline received and analyzed more than 3,200 tips, running the gamut from expressions of concern over the economy to serious allegations of fraud.

SIGTARP remains committed to being proactive in dealing with potential fraud in TARP. For example, the previously announced TALF Task Force, which was

organized by SIGTARP to get out in front of any efforts to profit criminally from the Term Asset-Backed Securities Loan Facility ("TALF"), has been expanded to cover the Public-Private Investment Program ("PPIP"). In addition to SIGTARP, the TALF-PPIP Task Force consists of the Inspector General of the Board of Governors of the Federal Reserve System, the Federal Bureau of Investigation, Treasury's Financial Crimes Enforcement Network, U.S. Immigration and Customs Enforcement, the Internal Revenue Service Criminal Investigation Division, the Securities and Exchange Commission, and the U.S. Postal Inspection Service.

On the audit side, SIGTARP is in the process of completing its first round of audits. SIGTARP will be issuing, at about the time of this report, its first formal audit report concerning how recipients of Capital Purchase Program ("CPP") funds reported their use of such funds. In February 2009, SIGTARP sent survey letters to more than 360 financial and other institutions that had completed TARP funding agreements through January 2009. Although most banks reported they did not segregate or track TARP fund usage on a dollar-for-dollar basis, most banks were able to provide insights into their actual or planned future use of TARP funds. For some respondents the infusion of TARP funds helped to avoid a "managed" reduction of their activities; others reported that their lending activities would have come to a standstill without TARP funds; and others explained that they used TARP funds to acquire other institutions, invest in securities, pay off debts, or that they retained the funds to serve as a cushion against future losses. Many survey responses also highlighted the importance of the TARP funds to the bank's capital base, and by extension, the impact of the funds on lending. In light of the audit findings, SIGTARP renews its recommendation that the Secretary of the Treasury require all TARP recipients to submit periodic reports to Treasury on their use of TARP funds.

SIGTARP also has audits nearing completion examining the following issues: executive compensation restriction compliance, controls over external influences on the CPP application process, selection of the first nine participants for funds under CPP (with a particular emphasis on Bank of America), AIG bonuses, and AIG counterparty payments. In addition, SIGTARP is undertaking a series of new audits, as follows:

- **CPP Warrant Valuation and Disposition Process:** The audit will seek to determine (i) the extent to which financial institutions have repaid Treasury's investment under CPP and the extent to which the warrants associated with that process were repurchased or sold; and (ii) what process and procedures Treasury has established to ensure the Government receives fair market value for the warrants and the extent to which Treasury follows a clear, consistent, and objective process in reaching decisions where differing valuations of warrants exist. This audit complements a July 10, 2009, report by the Congressional Oversight Panel examining the warrant valuation process.
- **Follow-up Assessment of Use of Funds by TARP Recipients:** This audit will examine use of funds by recipients receiving extraordinary assistance under the

Systemically Significant Failing Institutions program, the Automotive Industry Financing Program, as well as insurance companies receiving assistance under CPP.

- **Governance Issues Where U.S. Holds Large Ownership Interests:** The audit, being conducted at the request of Senator Max Baucus, will examine governance issues when the U.S. Government has obtained a large ownership interest in a particular institution, including: (i) What is the extent of Government involvement in management of companies in which it has made sizeable investments, including direction and control over such elements as governance, compensation, spending, and other corporate decision making? (ii) To what extent are effective risk management, internal controls, and monitoring in place to protect and balance the Government's interests and corporate needs? (iii) Are there performance measures in place that can be used to track progress against long-term goals and timeframes affecting the Government's ability to wind down its investments and disengage from these companies? (iv) Is there adequate transparency to support decision making and to provide full disclosure to the Congress and the public?
- **Status of the Government's Asset Guarantee Program with Citigroup:** The audit examining the Government's Asset Guarantee Program ("AGP") with Citigroup, based upon a request by Representative Alan Grayson, will address a series of questions about the Government's guarantee of certain Citigroup assets through the AGP such as: (i) How was the program for Citigroup developed? (ii) What are the current cash flows from the affected assets? and (iii) What are the potential for losses to Treasury, the Federal Deposit Insurance Corporation, and the Federal Reserve under the program?
- **Making Home Affordable Mortgage Modification Program:** This audit will examine the Making Home Affordable mortgage modification program to assess the status of the program, the effectiveness of outreach efforts, capabilities of loan servicers to provide services to eligible recipients, and challenges confronting the program as it goes forward.

#### SIGTARP'S RECOMMENDATIONS ON THE OPERATION OF TARP

One of SIGTARP's oversight responsibilities is to provide recommendations to Treasury so that TARP programs can be designed or modified to facilitate effective oversight and transparency and to prevent fraud, waste, and abuse. In Section 5 of this report, SIGTARP details ongoing recommendations concerning PPIP, TALF, and tracking use of funds and provides an update on the implementation of recommendations made in previous reports. Two categories of recommendation are worth highlighting at the outset:

##### Transparency in TARP Programs

Although Treasury has taken some steps towards improving transparency in TARP programs, it has repeatedly failed to adopt recommendations that SIGTARP

believes are essential to providing basic transparency and fulfill Treasury's stated commitment to implement TARP "with the highest degree of accountability and transparency possible." With one new recommendation made in this report, there are at least four such unadopted recommendations:

- **Use of Funds Generally:** One of SIGTARP's first recommendations was that Treasury require all TARP recipients to report on the actual use of TARP funds. Other than in a few agreements (with Citigroup, Bank of America, and AIG), Treasury has declined to adopt this recommendation, calling any such reporting "meaningless" in light of the inherent fungibility of money. SIGTARP continues to believe that banks can provide meaningful information about what they are doing with TARP funds — in particular what activities they would not have been able to do but for the infusion of TARP funds. That belief has been supported by SIGTARP's first audit, in which nearly all banks were able to provide such information.
- **Valuation of the TARP Portfolio:** SIGTARP has recommended that Treasury begin reporting on the values of its TARP portfolio so that taxpayers can get regular updates on the financial performance of their TARP investments. Notwithstanding that Treasury has now retained asset managers and is receiving such valuation data on a monthly basis, Treasury has not committed to providing such information except on the statutorily required annual basis.
- **Disclosure of TALF Borrowers Upon Surrender of Collateral:** In TALF, the loans are non-recourse, that is, the lender (Federal Reserve Bank of New York) will have no recourse against the borrower beyond taking possession of the posted collateral (consisting of asset-backed securities ("ABS")). Under the program, should such a collateral surrender occur, TARP funds will be used to purchase the surrendered collateral. In light of this use of TARP funds, SIGTARP has recommended that Treasury and the Federal Reserve disclose the identity of any TALF borrowers that fail to repay the TALF loan and must surrender the ABS collateral.
- **Regular Disclosure of PPIF Activity, Holdings, and Valuation:** In the PPIP Legacy Securities Program, the taxpayer will be providing a substantial portion of the funds (contributing both equity and lending) that will be used to purchase toxic assets in the Public-Private Investment Funds ("PPIFs"). SIGTARP is recommending that all trading activity, holdings, and valuations of assets of the PPIFs be disclosed on a timely basis. Not only should this disclosure be required as a matter of basic transparency in light of the billions of taxpayer dollars at stake, but such disclosure would also serve well one of Treasury's stated reasons for the program in the first instance: the promotion of "price discovery" in the illiquid market for MBS. Treasury has indicated that it will not require such disclosure.

Although SIGTARP understands Treasury's need to balance the public's transparency interests, on one hand, with the interests of the participants and the desire to have wide participation in the programs, on the other, Treasury's default position should always be to require more disclosure rather than less and to provide the investors in TARP — the American taxpayers — as much information about what is being done with their money as possible. Unfortunately, in rejecting SIGTARP's basic transparency recommendations, TARP has become a program in which taxpayers (i) are not being told what most of the TARP recipients are doing with their money, (ii) have still not been told how much their substantial investments are worth, and (iii) will not be told the full details of how their money is being invested. In SIGTARP's view, the very credibility of TARP (and thus in large measure its chance of success) depends on whether Treasury will commit, in deed as in word, to operate TARP with the highest degree of transparency possible.

#### **Imposition of Information Barriers, or "Walls," in PPIF**

In the April Quarterly Report, SIGTARP noted that conflicts of interest and collusion vulnerabilities were inherent in the design of PPIF stemming from the fact that the PPIF managers will have significant power to set prices in a largely illiquid market. These vulnerabilities could result in PPIF managers having an incentive to overpay significantly for assets or otherwise using the valuable, proprietary PPIF trading information to benefit not the PPIF, but rather the manager's non-PPIF business interests. As a result, SIGTARP made a series of recommendations in the April Quarterly Report, including that Treasury should impose strict conflicts of interest rules.

Since the April Quarterly Report, Treasury has worked with SIGTARP to address the vulnerabilities in PPIF, and SIGTARP made a series of specific recommendations, suggestions, and comments concerning the design of the program. Treasury adopted many of SIGTARP's suggestions and has developed numerous provisions that make PPIF far better from a compliance and anti-fraud standpoint than when the program was initially announced.

However, Treasury has declined to adopt one of SIGTARP's most fundamental recommendations — that Treasury should require imposition of an informational barrier or "wall" between the PPIF fund managers making investment decisions on behalf of the PPIF and those employees of the fund management company who manage non-PPIF funds. Treasury has decided not to impose such a wall in this instance, despite the fact that such walls have been imposed upon asset managers in similar contexts in other Government bailout-related programs, including by Treasury itself in other TARP-related activities, and despite the fact that three of the nine PPIF managers already must abide by similar walls in their work for those other programs.

If nothing else, the reputational risk that Treasury and the program could face if a PPIF manager should generate massive profits in its non-PPIF funds as a result

of an unfair advantage, even if that advantage is not strictly against the rules, justifies the imposition of a wall. Failure to impose a wall, on the other hand, will leave Treasury vulnerable to an accusation that has already been leveled against it — that Treasury is using TARP to pick winners and losers and that, by granting certain firms the PPIF manager status, it is benefitting a chosen few at the expense of the dozens of firms that were rejected, of the market as a whole, and of the American taxpayer. This reputational risk is not one that can be readily measured in dollars and cents, but is rather a risk that could put in jeopardy the fragile trust the American people have in TARP and, by extension, their Government.

In addition to these recommendations, SIGTARP also makes additional recommendations, described in more detail in Section 5, concerning other aspects of PPIF and concerning the use of ratings agencies in TALF.

#### REPORT ORGANIZATION

The report is organized as follows:

- **Section 1** describes the activities of SIGTARP.
- **Section 2** describes how Treasury has spent TARP funds thus far and contains an explanation or update of each program, both implemented and recently announced.
- **Section 3** places TARP in the context of the broader bailout efforts by summarizing multiple other Government programs that support the financial system and the economy.
- **Section 4** describes the operations and administration of the Office of Financial Stability (“OFS”), the office within Treasury that manages TARP.
- **Section 5** lays out SIGTARP’s recommendations to Treasury with respect to the operation of TARP.
- The report also includes numerous appendices containing, among other things, figures and tables detailing all TARP investments through June 30, 2009.

The goal is to make this report a ready reference on what TARP is and how it has been used to date. In the interest of making this report as understandable as possible, and thereby furthering general transparency of the program itself, certain technical terms are highlighted in the text and defined in the adjacent margin. In addition, portions of Sections 2 and 3 are devoted to tutorials explaining the financial terms and concepts necessary to obtain a basic understanding of the programs’ operations.

**SECTION 1** THE OFFICE OF THE SPECIAL  
INSPECTOR GENERAL FOR THE  
TROUBLED ASSET RELIEF PROGRAM



## SIGTARP'S CREATION AND STATUTORY AUTHORITY

### Emergency Economic Stabilization Act

The Office of the Special Inspector General for the Troubled Asset Relief Program ("SIGTARP") was created by Section 121 of the Emergency Economic Stabilization Act of 2008 ("EESA"). Under EESA, SIGTARP has the responsibility, among other things, to conduct, supervise, and coordinate audits and investigations of the purchase, management, and sale of assets under the Troubled Asset Relief Program ("TARP"). SIGTARP is required to report quarterly to Congress to describe SIGTARP's activities and to provide certain information about TARP over that preceding quarter. EESA gives SIGTARP the authorities listed in Section 6 of the Inspector General Act of 1978, including the power to obtain documents and other information from Federal agencies and to subpoena reports, documents, and other information from persons or entities outside of Government. EESA provided SIGTARP with an initial allocation of \$50 million to fund its operations.

The Special Inspector General, Neil M. Barofsky, was confirmed by the Senate on December 8, 2008, and sworn into office on December 15, 2008.

### SIGTARP Act

On April 24, 2009, the President signed into law the Special Inspector General for the Troubled Asset Relief Program Act of 2009 (the "SIGTARP Act" or the "Act"), which amends EESA as follows:

- provides SIGTARP the authority, with limited exceptions, to conduct, supervise, and coordinate audits and investigations into any actions taken under EESA
- makes clear that SIGTARP can undertake law enforcement functions without first obtaining Attorney General approval
- gives SIGTARP the responsibility to coordinate and cooperate with other inspectors general on oversight of TARP-related activities
- clarifies that SIGTARP's quarterly reports are due 30 days after the end of a fiscal quarter
- provides SIGTARP with the ability to hire up to 25 Federal retirees, without offset of their pension, and, for six months, the authority to hire Federal employees under 5 U.S.C. § 3161, which gives employees a right to return to their original agencies once SIGTARP no longer exists
- requires the Treasury Secretary to take steps to address deficiencies identified by SIGTARP or certify to Congress that no action is necessary or appropriate
- mandates that SIGTARP shall provide a report to Congress, by September 1, 2009, on how TARP recipients have used TARP funds
- releases SIGTARP's \$50 million allocation for immediate use

SIGTARP believes that the Act makes clear that it has the authorities it needs to fulfill its mission and will significantly improve its ability to attract and hire experienced Government auditors and investigators.

#### **Ensign-Boxer Amendment**

On May 20, 2009, the President signed into law the Helping Families Save Their Homes Act of 2009, Public Law No. 111-22. Section 402 of this legislation (the "Ensign-Boxer Amendment") is named after two of its co-sponsors, Senators John Ensign and Barbara Boxer. The Ensign-Boxer Amendment, consistent with recommendations made in SIGTARP's Quarterly Report to Congress, dated April 21, 2009 (the "April Quarterly Report"), requires the U.S. Department of the Treasury ("Treasury"), in implementing its Public-Private Investment Program ("PPIP"), to:

- impose, in consultation with SIGTARP, strict conflicts-of-interest rules on Public-Private Investment Fund ("PPIF") managers to ensure arm's-length transactions, compliance with fiduciary duties, and full disclosure of relevant facts and financial interests
- require PPIF managers to file quarterly reports, disclosing the 10 largest positions of the fund
- provide for SIGTARP access to PPIF manager books and records
- compel PPIF managers to retain all of their books and records
- require PPIF managers to acknowledge, in writing, that they owe fiduciary duties to the public and private investors in the fund
- provide that PPIF managers must develop robust ethics policies and ensure compliance with the same
- compel PPIF managers to develop and implement strict investor screening procedures
- require PPIF managers periodically to identify each investor that directly or indirectly owns 10% or more of the fund
- consult with SIGTARP and issue regulations governing the interaction of PPIP with the Term Asset-Backed Securities Loan Facility ("TALF") and other similar public-private investment programs

As discussed later in this section and in detail in Section 5 of this report, SIGTARP has, consistent with this statute, engaged in a series of discussions with Treasury concerning the design of PPIP. For more detail on PPIP operations, see the "Public-Private Investment Program" discussion in Section 2: "TARP Overview."

The Ensign-Boxer Amendment also made available to SIGTARP an additional \$15 million, but directed that SIGTARP, in expending such funds, prioritize performance audits and investigations of recipients of non-recourse loans made under any program that is funded by EESA. SIGTARP believes that the Ensign-Boxer

Amendment will assist SIGTARP to fulfill its mission under EESA and that it will substantially improve the controls of PPIP and make it less susceptible to fraud, waste, and abuse.

#### **Fraud Enforcement Recovery Act**

Also on May 20, 2009, the President signed into law the Fraud Enforcement Recovery Act of 2009, Public Law No. 111-21 ("FERA"). Section 2(d) of FERA amends 18 U.S.C. § 1031, entitled "Major Fraud Against the United States," by clarifying that any fraud related to efforts to obtain Federal financial assistance or economic stimulus made available pursuant to EESA invokes the application of criminal remedies under that section. SIGTARP believes that section 2(d) of FERA will thus enhance deterrence and assist in the prosecution of persons who are inclined or attempt to defraud the programs implemented under EESA.

### **SIGTARP'S OVERSIGHT ACTIVITIES SINCE THE APRIL QUARTERLY REPORT**

SIGTARP has continued to fulfill its oversight role in multiple parallel tracks: from making recommendations relating to preventing fraud and abuse prospectively; to auditing aspects of TARP both inside and outside of Government; to investigating allegations of fraud, waste, and abuse in TARP programs; to coordinating closely with other oversight bodies; all the while trying to promote transparency in TARP programs.

#### **Providing Advice on Compliance and Fraud Prevention**

To further its goal of improving prospectively the compliance and fraud prevention aspects of TARP programs, SIGTARP has attempted to establish and maintain regular lines of communications with the personnel primarily responsible for running TARP, including those working within Treasury's Office of Financial Stability ("OFS") and within other agencies who manage TARP-related programs or activities, including the bank regulators, the Federal Reserve Board, and the Federal Reserve Bank of New York ("FRBNY"), as follows:

- SIGTARP personnel generally receive briefings concerning each new TARP initiative and new developments in implemented programs when necessary.
- The Special Inspector General and Deputy Special Inspector General typically meet weekly with the head of OFS, OFS's Chief Compliance Officer, and OFS's General Counsel to discuss ongoing issues and new developments.
- SIGTARP has established regular communication with officials from the Federal Reserve System (staff from the Federal Reserve Board of Governors and FRBNY) in connection with the Federal Reserve TARP-related programs.

Fraud Enforcement Recovery Act of 2009, Public Law No. 111-21 ("FERA")  
A law enacted to expand the Department of Justice's authority to prosecute crimes related to mortgage fraud, commodities fraud, and fraud associated with Government assistance related to the economic crisis.

**Mortgage-Backed Securities ("MBS")**  
A pool of mortgages bundled together by a financial institution and sold as securities — a type of asset-backed security.

Generally, Treasury and the other agencies have been cooperative in making their personnel available to SIGTARP and have responded to SIGTARP's requests for documents and information.

SIGTARP has endeavored, to the extent it has had an opportunity, to examine the planned framework for TARP initiatives before their terms are finalized and to make recommendations designed to advance oversight and internal controls and prevent fraud, waste, and abuse within the programs. Since the April Quarterly Report, SIGTARP has made such recommendations with regard to PPIP's Legacy Securities Program, among others.

#### **Recommendations Regarding the Legacy Securities Program**

As discussed more fully in Section 2 of this report, in PPIP's Legacy Securities Program, private fund managers will buy and manage portfolios of legacy mortgage-backed securities ("MBS") with equity consisting of both private capital and TARP funds. In the April Quarterly Report, SIGTARP identified several potential vulnerabilities in the basic structure of PPIP and made a series of recommendations addressing such vulnerabilities in the areas, among others, of conflicts of interest, collusion, money laundering, and how PPIP would interact with TALE. Consistent with the Ensign-Boxer Amendment, SIGTARP and Treasury have engaged in an active dialogue concerning the compliance and anti-fraud provisions of the Legacy Securities Program. In light of those discussions, and after SIGTARP consulted extensively with the Federal Reserve and FRBNY (which administers several programs in which asset managers are retained in similar circumstances), SIGTARP made a series of additional recommendations in two letters to Treasury. As discussed in more detail in Section 5 of this report, Treasury has adopted many of SIGTARP's recommendations, making the program far better from a compliance and fraud-prevention standpoint. However, Treasury has not adopted several fundamentally important recommendations, including the need for an information barrier, or "wall," between those managing the PPIP funds and those managing portfolios of similar assets at each fund management company.

#### **SIGTARP Audit Activity**

To fulfill SIGTARP's mandate to promote the economy, efficiency, and effectiveness of TARP programs and operations, SIGTARP's Audit Division has identified several aspects of TARP — some internal to Treasury and some external — that will be the

general focus of its work. SIGTARP's audits generally will be designed to accomplish these objectives:

- ensure transparency in TARP programs to the fullest reasonable extent to foster accountability in use of funds and program results
- examine whether Treasury managers have developed sufficient internal controls and procedures to manage TARP programs and the vendors hired to assist in such management
- ensure a fair, equitable, and consistent application and review process for individuals and entities seeking relief under the various TARP programs
- test compliance with the policies, procedures, regulations, terms, and conditions that are imposed on TARP participants
- coordinate with other relevant audit and oversight entities to maximize audit coverage while minimizing overlap and duplication of efforts

#### **SIGTARP's First Completed Audit: Use of Funds**

SIGTARP's first audit report, which is being released at or about the time of this report, concerns how recipients of Capital Purchase Program ("CPP") funds reported their use of such funds. In February 2009, SIGTARP sent survey letters to more than 360 financial and other institutions that had completed TARP funding agreements through January 2009. In response to those surveys, although most banks reported that they did not segregate or track TARP fund usage on a dollar-for-dollar basis, they were able to provide insights into their actual or planned future use of TARP funds. Over 98% of survey recipients reported their actual uses of TARP funds. Highlights of the audit include:

- More than 80% of respondents cited the use of funds for lending; some reported how it helped them avoid reduced lending. Many banks reported that lending would have been lower without TARP funds or would have come to a standstill.
- More than 40% of respondents reported that they used some TARP funds to help maintain the capital cushions and reserves required by their banking regulators to be able to absorb unanticipated losses.
- Nearly a third of the respondents reported that they used some TARP funds to invest in MBS, such as those backed by Ginnie Mae, Fannie Mae, and Freddie Mac. These actions provided immediate support of the lending and borrowing activities of other banks and positioned the banks for increased lending later.
- A smaller number reported using some TARP funds to repay outstanding loans — some because the TARP funds were a more cost-effective source of funds

than their outstanding debt and some because of pressure from a creditor to use the funds for that purpose.

- Several banks reported using some TARP funds to buy other banks. One reported that this was a cost-effective way to acquire additional deposits that, in turn, would facilitate an even greater amount of lending.
- Some banks reported that they had not yet allocated funds for lending and other activities due to the short time elapsed since the receipt of funds, the weak demand for credit, and the uncertain economic environment.

As discussed further in Section 5 of this report, in light of the audit findings, SIGTARP renews its recommendation that the Secretary of the Treasury ("Treasury Secretary") require all CPP recipients to submit periodic reports to Treasury on their use of TARP funds, including reports on their lending, investments, acquisitions, and other activities that were supported by or resulted from their receipt of TARP funds, as well as a description of what actions they were able to take as a result of TARP funding.

#### Audits Nearing Completion

Several additional audits are nearing completion, and SIGTARP plans to issue reports on the following audits over the next quarter:

- **Executive Compensation Compliance:** This audit, also based on SIGTARP's survey of TARP recipients, examines evolving executive compensation requirements during the first nine months of TARP and efforts of CPP recipients to comply with the requirements as known at the time. This report is expected to be issued in August 2009.
- **External Influences:** This audit examines whether, or to what extent, external parties may have influenced decision making by Treasury or bank regulators in approving bank applications for funding under CPP. This report is also expected to be issued in August 2009.
- **Funding of the First Nine TARP Recipients, with a Special Focus on Bank of America:** This audit examines the review and approval process associated with TARP assistance to the first nine CPP recipients, with emphasis on additional assistance to Bank of America subsequently authorized under the Targeted Investment and the Asset Guarantee Programs ("TIP" and "AGP"). The audit also examines selected issues and interactions among Treasury, Federal Reserve, and Bank of America officials in connection with Bank of America's acquisition of Merrill Lynch and the timing of Government assistance under the latter two programs following the acquisition. This report is expected to be issued in September 2009.
- **Executive Compensation Oversight (AIG Bonuses):** This audit examines payouts of large bonus payments to American International Group ("AIG")

employees in March 2009, including the extent of knowledge and oversight of AIG compensation issues by Treasury and FRBNY in light of their respective programs involving AIG. This report is expected to be issued in September 2009.

- **AIG Counterparty Payments:** This audit examines payments made to AIG counterparties, AIG, which has received the largest amount of financial assistance from the Government during the current financial crisis, reportedly made counterparty payments at 100% of face value to other financial institutions, including some foreign institutions and other financial institutions that had received financial assistance under TARP. Questions exist whether any efforts were made to negotiate any reduction in those payments. This report is expected to be issued in September 2009.

#### **New Audits Underway or Planned**

SIGTARP has a number of recently announced audits and several others are planned. Recently announced audits include:

- **CPP Warrant Valuation and Disposition Process:** This audit seeks to determine (i) the extent to which financial institutions have repaid Treasury's investment under CPP and the extent to which the warrants associated with that process were repurchased or sold; and (ii) what process and procedures Treasury has established to ensure that the Government receives fair market value for the warrants, and the extent to which Treasury follows a clear, consistent, and objective process in reaching decisions where differing valuations of warrants exist. This audit complements a Congressional Oversight Panel ("COP") report released on July 10, 2009, that examines the warrant valuation process.
- **Follow-up Assessments of Use of Funds by TARP Recipients:** This audit follows up on SIGTARP's earlier use of funds audit. It focuses on use of funds by recipients receiving extraordinary assistance under the Systemically Significant Failing Institutions ("SSFI") program, the Automotive Industry Financing Program ("AIFP"), as well as insurance companies receiving assistance under CPP. This review seeks to provide a more complete picture of use of funds across a broader category of recipients to meet a Congressional mandate for a SIGTARP report on use of funds by TARP recipients.
- **Governance Issues Where U.S. Holds Large Ownership Interests:** SIGTARP recently received a request from Senator Max Baucus, Chairman of the Senate Committee on Finance, to undertake a body of work examining the following issues: (i) What is the extent of Government involvement in management of companies in which it has made sizeable investments, including direction and control over such elements as governance, compensation, spending, and other corporate decision making? (ii) To what extent are effective risk management, internal controls, and monitoring in place to protect and balance

the Government's interests and corporate needs? (iii) Are there performance measures in place that can be used to track progress against long-term goals and timeframes affecting the Government's ability to wind down its investments and disengage from these companies? (iv) Is there adequate transparency to support decision making and to provide full disclosure to Congress and the public? SIGTARP is currently engaged in discussions and planning with the Government Accountability Office ("GAO") directed toward a potential joint or complementary effort in addressing this request.

- **Status of the Government's Asset Guarantee Program with Citigroup:** This review, recently requested by Representative Alan Grayson, addresses a series of questions about the Government's guarantee of certain Citigroup assets through the AGP such as: (i) How was the program for Citigroup developed? (ii) What are the current cash flows from the affected assets? (iii) What is the potential for losses to Treasury, the Federal Deposit Insurance Corporation ("FDIC"), and the Federal Reserve under the program? SIGTARP expects to launch a review of this program during this coming quarter.
- **Making Home Affordable Mortgage Modification Program:** According to Treasury, approximately three to four million homeowners could benefit from the Making Home Affordable ("MHA") mortgage modification program. SIGTARP plans to launch a broad review during this coming quarter to assess the status of the program, the effectiveness of outreach efforts, capabilities of loan servicers to provide services to eligible recipients, and challenges confronting the program as it goes forward.

#### **SIGTARP Investigations Activity**

SIGTARP's Investigations Division has developed rapidly and is quickly becoming a sophisticated white-collar investigative agency. Through June 30, 2009, SIGTARP has opened 37 and has 35 ongoing criminal and civil investigations. These investigations include complex issues concerning suspected accounting fraud, securities fraud, insider trading, mortgage servicer misconduct, mortgage fraud, public corruption, false statements, and tax investigations. Two of SIGTARP's investigations have recently become public.

#### **Felony Charges Against Gordon Grigg**

On April 23, 2009, Federal felony charges were brought against Gordon B. Grigg in the U.S. District Court for the Middle District of Tennessee, charging Grigg with four counts of mail fraud and four counts of wire fraud. The charges are based on Grigg's role in embezzling approximately \$11 million in client investment funds. Grigg pled guilty to all charges and is scheduled for sentencing on August 6, 2009.

According to public documents, Grigg solicited approximately 60 investors to invest funds totaling approximately \$11 million. Grigg never purchased securities

or managed accounts for clients who invested funds with him; instead, he used the investor funds for his personal benefit and expenses and to disburse “fictitious” earnings and return of deposits to clients who cashed out or closed their accounts. As an inducement for clients to invest, Grigg promised that he would generate and sustain high rates of annualized returns on investment, and, as part of his solicitation, he falsely claimed that he had the ability to invest client funds in Government-guaranteed commercial paper and bank debt as part of TARP. SIGTARP investigators provided assistance in the case in coordination with the United States Attorney’s Office for the Middle District of Tennessee, the Securities and Exchange Commission (“SEC”), the Federal Bureau of Investigation (“FBI”), the United States Postal Inspection Service (“USPIS”), the Tennessee Department of Commerce and Insurance, and the Franklin, Tennessee, Police Department.

#### **Supporting FTC’s Action Enjoining Improper Use of “MakingHomeAffordable.gov”**

On Friday, May 15, 2009, at the request of the Federal Trade Commission (“FTC”), a Federal district court issued an order to stop an Internet-based operation that pretended to operate “MakingHomeAffordable.gov,” the official website of the Federal MHA program for mortgage loan assistance. The FTC alleged that the defendants deceptively diverted consumers who searched online for the free Government-assistance program to commercial websites that offer loan modification services for a fee.

According to the FTC’s complaint, the defendants purchased sponsored links for their advertising on the results pages of Internet search engines, including yahoo.com, msn.com, altavista.com, and alltheweb.com. When consumers searched for “making home affordable” or similar search terms, the defendants’ ads prominently and conspicuously displayed the website address “makinghomeaffordable.gov.” Consumers who clicked on this advertised hyperlink were not directed to the official website for the MHA program, but rather were diverted to websites that solicit applicants for paid loan modification services. These commercial websites, which are not part of or affiliated with the U.S. Government, require consumers to enter personally identifying and confidential financial information. The operators of these websites either purport to offer loan modification services themselves or sell the personally identifying information to others.

The FTC filed an emergency request for a temporary restraining order in the U.S. District Court for the District of Columbia, Civil Case No. 1:09-cv-00894 (CKK). Judge Colleen Kollar-Kotelly entered a temporary restraining order, barring the defendants from using the “MakingHomeAffordable.gov” hyperlink or representing that they are affiliated with the U.S. Government. The order also requires the four search engine providers to identify those who paid them to place the ads and to refuse to place paid ads that contain active hyperlinks that are labeled

"MakingHomeAffordable.gov" or any other domain name containing ".gov."

SIGTARP is providing assistance and support to the FTC during the investigation.

#### **SIGTARP Hotline**

One of SIGTARP's primary investigative priorities is to operate the SIGTARP Hotline and thus provide an interface with the American public to facilitate the reporting of concerns, allegations, information, and evidence of violations of criminal and civil laws in connection with TARP. Over the past quarter alone, the SIGTARP Hotline has received and analyzed more than 3,200 contacts on the Hotline. These contacts run the gamut from expressions of concern over the economy to serious allegations of fraud involving TARP, and more than half of SIGTARP's investigations were generated in connection with Hotline tips. The SIGTARP Hotline is capable of receiving information anonymously, and confidentiality can and will be provided to the fullest extent possible. The American public can provide information by telephone, mail, fax, or online. SIGTARP has established a Hotline connection on its website at [www.SIGTARP.gov](http://www.SIGTARP.gov). SIGTARP honors all whistleblower protections.

#### **TALF-PPIP Task Force**

In a proactive initiative to get out in front of any efforts to profit criminally from the up to \$1 trillion TALF program, SIGTARP organized a multi-agency task force to deter, detect, and investigate any instances of fraud or abuse in TALF. In connection with the announcement of the Financial Stability Plan ("FSP"), Treasury announced the outlines of PPIP to deal with the problems posed by "toxic" legacy mortgages and MBS. The PPIFs set up through PPIP will be able to use TALF to obtain Federal Reserve financing to purchase such assets. Because of the expected use of TALF by PPIP and the significant subject-matter overlap, SIGTARP and its partners have expanded the TALF Task Force to also address the law enforcement challenges posed by PPIP.

The TALF-PPIP Task Force, comprising both civil and criminal law enforcement agencies, with both investigative and analytical resources, demonstrates that the agencies involved are meeting that challenge proactively and before the bulk of the money has been expended. In addition to SIGTARP, the TALF-PPIP Task Force consists of the Inspector General of the Board of Governors of the Federal Reserve System, FBI, Treasury's Financial Crimes Enforcement Network ("FinCEN"), U.S. Immigration and Customs Enforcement ("ICE"), Internal Revenue Service Criminal Investigation Division ("IRS-CI"), SEC, and the USPS. The members of the TALF-PPIP Task Force combine their shared expertise in securities fraud investigations and maximize their resources to deter potential criminals, to identify and stop fraud schemes before they can fully develop, and to

bring to justice those who seek to commit fraud through TALF or PPIP. Although participants of these programs who play by the rules have nothing to fear from this Task Force, Federal law enforcement is ready now to detect, investigate, and bring to justice any who would try to steal from these important programs.

Representatives from each agency participate in regular briefings about TALF and PPIP, collectively identify areas of fraud vulnerability, engage in the training of agents and analysts with respect to the complex issues surrounding the program, and serve as points of contact within each agency for leads relating to TALF and any resulting cases that are generated. The TALF-PPIP Task Force has already received substantive briefings from FRBNY, Treasury, and SEC and has further training sessions scheduled.

The TALF-PPIP Task Force represents a historic law enforcement effort with an ambitious goal: to redefine the policing of complex Federal Government programs by proactively arranging a coordinated law enforcement response before fraud occurs.

#### **Coordination with Law Enforcement Agencies**

As part of its coordination role, SIGTARP has been active in forging partnerships with other criminal and civil law enforcement agencies. These relationships are designed to benefit both investigations originated by other agencies, when SIGTARP expertise can be brought to bear, and SIGTARP's own investigations, which can be improved by tapping into additional resources. In this regard:

- SIGTARP has continued to develop close working relationships with the FBI, IRS-CI, USPIS, ICE, SEC, and the FTC, both with each agency's headquarters and various field offices.
- SIGTARP has brought on a full-time detailee from the FBI's Washington Field Office ("WFO") to work on SIGTARP investigations and to serve as a liaison with the FBI-WFO.
- The Special Inspector General and Deputy Special Inspector General recently met with SEC's new Chief of the Enforcement Division and SIGTARP has several ongoing investigations with SEC.
- SIGTARP is in the process of bringing on board a detailee from SEC to assist in SIGTARP investigations and to serve as a liaison with SEC.
- SIGTARP has continued to develop relationships with the Department of Justice ("DOJ"), both at Main Justice and with U.S. Attorney's Offices across the country, concerning both criminal and civil enforcement, and is currently working with various DOJ components on many of its open investigations. The Special Inspector General recently gave the keynote address at DOJ/FDIC's annual conference on bank fraud.

- SIGTARP continues to coordinate with more than a dozen States Attorneys General.
- SIGTARP's Deputy Special Inspector General for Investigations established the Assistant Inspector General for Investigations ("AIGI") TARP Interagency Working Group. Its objective is to provide an active forum for heads of investigative divisions within the Inspector General ("IG") community and other law enforcement agencies whose agency mission is in some way affiliated with TARP, to coordinate and share relevant investigative information at the national level.
- SIGTARP continues to work closely with the New York High Intensity Financial Crime Area ("NY HIFCA"). NY HIFCA provides SIGTARP with two dedicated financial analysts, supervised by a Senior Special Agent from ICE, to provide database search and analytical support, and the Special Inspector General recently gave the keynote address at the NY HIFCA's annual conference. This relationship has already generated several complex ongoing investigations.
- SIGTARP obtains access to Bank Secrecy Act (31 U.S.C. § 5311 *et seq.*) database services through FinCEN. SIGTARP is working with FinCEN to develop an advisory regarding TARP programs that will be sent to thousands of financial institutions, and SIGTARP's Deputy Special Inspector General gave a presentation at FinCEN's Bank Secrecy Act Working Group annual meeting.

#### **Coordination with Other EESA Oversight Bodies**

EESA, as amended, is explicit in mandating that SIGTARP coordinate audits and investigations into TARP with the other primary oversight bodies: the Financial Stability Oversight Board ("FSOB"), COP, and GAO. Numerous other agencies, both in the IG community and among criminal and civil law enforcement agencies, potentially have responsibilities that touch on TARP as well. SIGTARP takes seriously its mandate to coordinate these overlapping oversight responsibilities, both to ensure maximum coverage and to minimize duplicative requests of TARP managers. SIGTARP and its partners have continued to have significant success on this front since the April Quarterly Report. These coordination efforts include:

- bi-weekly conference calls with staff from FSOB
- regular meetings with staff from COP and the launching of a complementary effort to address Treasury's repurchase of warrants from TARP recipients
- frequent interactions with GAO to coordinate ongoing and planned work to avoid any unnecessary duplication of efforts and to better facilitate their individual responsibilities

### TARP-IG Council

Due to the scope of the various programs under TARP, numerous Federal agencies have some role in administering or overseeing TARP programs. To further facilitate SIGTARP's coordination role, the Special Inspector General founded and chairs the TARP Inspector General Council ("TARP-IG Council"), made up of the Comptroller General and those IGs whose oversight functions are most likely to touch on TARP issues. The Council meets monthly to discuss developments in TARP and to coordinate overlapping audit and investigative issues. The TARP-IG Council currently comprises:

- The Special Inspector General
- Inspector General of the Department of the Treasury
- Inspector General of the Board of Governors of the Federal Reserve System
- Inspector General of the Federal Deposit Insurance Corporation
- Inspector General of the Securities and Exchange Commission
- Inspector General of the Federal Housing Finance Agency
- Inspector General of the Department of Housing and Urban Development
- Treasury Inspector General for Tax Administration
- Inspector General for the Small Business Administration
- Comptroller General of the United States (head of GAO) or designee

### Communications with Congress

One of SIGTARP's primary functions is to ensure that Members of Congress are kept informed of developments in TARP programs and SIGTARP's oversight activities. To fulfill that role, the Special Inspector General and SIGTARP staff regularly brief Members and staff. More formally, over the past quarter, the Special Inspector General testified before the Joint Economic Committee ("JEC") on April 23, 2009; entitled "Following the Money: A Quarterly Report by the Special Inspector General for the TARP," the testimony focused on the findings and recommendations of SIGTARP's April Quarterly Report. Copies of all of the Special Inspector General's written testimony, hearing transcripts, and a variety of other materials associated with Congressional hearings since SIGTARP's inception are posted at [www.SIGTARP.gov/reports](http://www.SIGTARP.gov/reports).

### BUILDING SIGTARP'S ORGANIZATION

From the day that the Special Inspector General was confirmed by the Senate, SIGTARP has worked to build its organization through various complementary strategies, including hiring experienced senior executives who can play multiple

roles during the early stages of the organization, leveraging the resources of other agencies, and, where appropriate and cost-effective, obtaining services through SIGTARP's authority to contract. Since the April Quarterly Report, SIGTARP has continued to make substantial progress in building its operation.

**Hiring**

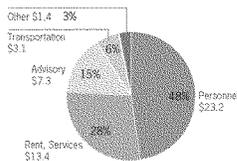
Each of SIGTARP's divisions has continued the process of filling out its ranks. As of June 30, 2009, SIGTARP had approximately 60 personnel, including detailees from other agencies, with several new hires to begin over the coming weeks. SIGTARP's employees hail from many Federal agencies, including DOJ, FBI, IRS-CI, Air Force Office of Special Investigations, GAO, Department of Transportation, Department of Energy, SEC, DOJ, U.S. Secret Service, United States Postal Service, U.S. Army Criminal Investigation Command, Naval Criminal Investigative Service, Treasury-Office of the Inspector General, Department of Energy-Office of the Inspector General, Department of Transportation-Office of the Inspector General, Department of Homeland Security-Office of the Inspector General, FDIC-Office of the Inspector General, Office of the Special Inspector General for Iraq Reconstruction, and the Department of Housing and Urban Development Office of the Inspector General. Hiring is actively ongoing, building to SIGTARP's current goal of approximately 160 full-time employees. The SIGTARP organizational chart, as of June 30, 2009, is included in Appendix H.

**SIGTARP Budget**

Section 121(j) of EESA provided \$50 million in initial operating funds to SIGTARP. When SIGTARP was established and its initial operating resources were allocated, TARP was envisioned as a \$700 billion asset-purchase and -guarantee program. In the months that followed, however, TARP evolved into 12 separate programs that have been estimated to involve up to approximately \$3 trillion, significantly expanding the necessary scope of SIGTARP's oversight operations and resource needs. SIGTARP anticipates that its total budget for FY 2010 will be \$48.4 million, based on the assumption that it will reach its target of 160 staff by early 2010. Approximately 50% of SIGTARP's non-personnel costs will be payments to other Government agencies for services provided. For a detailed breakdown of SIGTARP's FY 2010 budget, see Figure 1.1.

SIGTARP estimates that its initial operating funds will be expended by approximately the second quarter of FY 2010 and that an additional \$28.3 million will be needed to fully fund operations through the fiscal year. Taking into account a portion of the \$15 million in additional funds made available by the Ensign-Boxer Amendment, which SIGTARP expects to spend over three years (i.e., \$5 million per year), SIGTARP has submitted a request to Treasury for a \$23.3 million amendment to the FY 2010 budget submission.

FIGURE 1.1  
SIGTARP FY2010 PROPOSED BUDGET  
\$ Millions, % of \$48.4 Million



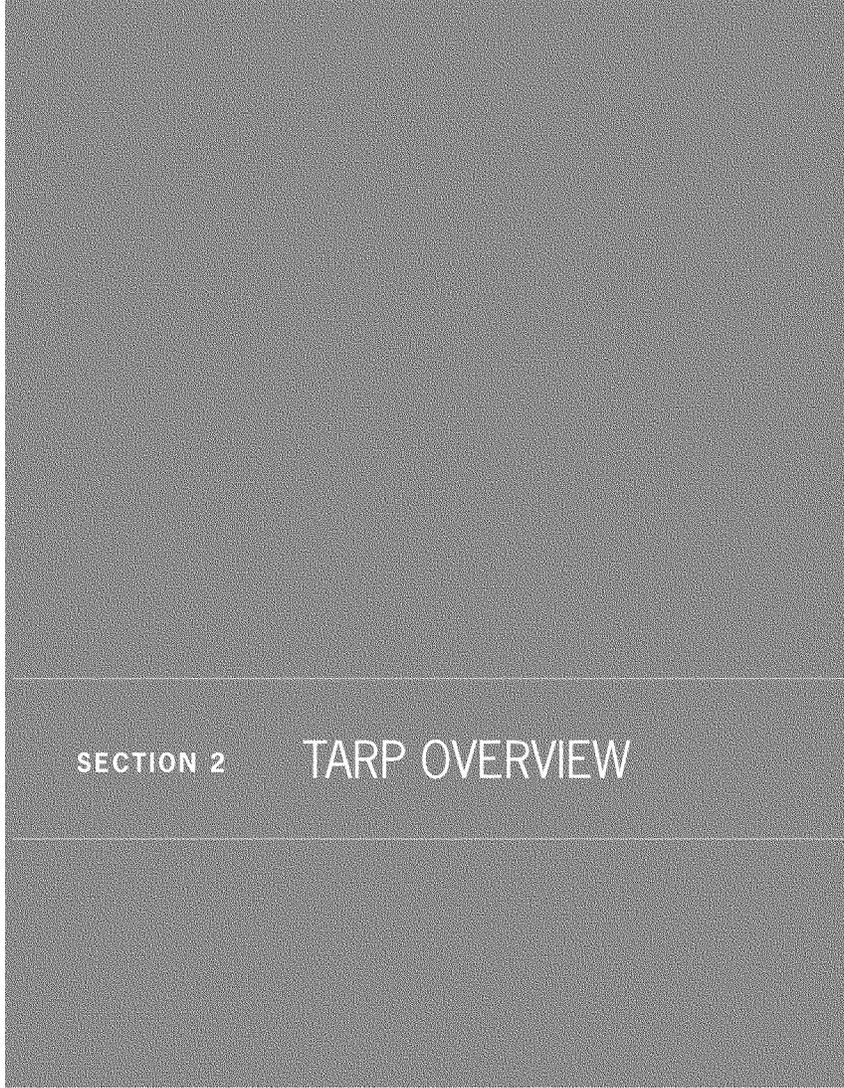
**SIGTARP's Physical and Technical Infrastructure**

SIGTARP has begun the process of moving into office space at 1801 L Street, NW, in Washington, D.C., the same office building in which the Treasury officials managing TARP are located. SIGTARP is already occupying temporary quarters in that building while its two permanent floors are being renovated. SIGTARP anticipates occupying its permanent space by early 2010.

SIGTARP operates a website, [www.SIGTARP.gov](http://www.SIGTARP.gov), on which it posts all of its reports, testimony, audits, investigations (once such investigations are made public), contracts, and more. The website prominently features SIGTARP's Hotline, which can also be accessed by phone at 877-SIG-2009 (877-744-2009).

From the website's inception through June 30, 2009, more than 12 million visitors have accessed SIGTARP's website, and SIGTARP's first two reports have been downloaded more than 670,000 times.





SECTION 2

TARP OVERVIEW



This section summarizes the activities of the U.S. Department of the Treasury ("Treasury") in its management of the Troubled Asset Relief Program ("TARP"). It includes a financial overview and provides updates on established TARP programs, including the status of TARP executive compensation restrictions.

## FINANCIAL OVERVIEW OF TARP

As of June 30, 2009, Treasury had announced commitments to spend \$643.1 billion of the \$700 billion authorized by Congress in the Emergency Economic Stabilization Act of 2008 ("EESA").<sup>1</sup> Of this amount, approximately \$441 billion had been expended through nine implemented programs to provide support for U.S. financial institutions, companies, and individual borrowers.<sup>2</sup> On May 6, 2009, Congress passed the Helping Families Save Their Home Act of 2009 (Public Law No. 111-22),<sup>3</sup> which amended EESA and reduced TARP's authorized \$700 billion by \$1.2 billion.<sup>4</sup> Therefore, the Secretary of the Treasury ("Treasury Secretary") now "has the authority to purchase and hold up to roughly \$699 billion in assets at one time."<sup>5</sup>

Treasury interprets the \$699 billion maximum funding for TARP, as authorized in EESA, as a cap on the amount that can be "outstanding" at any one time. Therefore, as funds are repaid, they become available for other EESA-authorized purposes.<sup>6</sup> As of June 30, 2009, \$70.3 billion in TARP funds had been repaid to the Government. In total, 46.9% of TARP's available \$699 billion was outstanding.<sup>8</sup> Any interest or dividends received from Treasury's investments, as well as revenues from the sale, exercise, or surrender of the warrants, are deposited into Treasury's general fund for the reduction of public debt and are not available to be re-used by Treasury.<sup>9</sup> As of June 30, 2009, \$6.9 billion in interest and dividends had been received by the Government, and \$20.3 million in profits had been received from the sale of warrants and preferred stock (received as a result of exercised warrants).<sup>10</sup>

The 12 announced programs within TARP can be categorized in 4 general groups depending on the type of support they were designed to provide:

- **Financial Institution Support Programs** — These programs share a common, stated goal of stabilizing the financial market to avoid disruption and provide for a healthy economy.
- **Asset Support Programs** — These programs attempt to support asset values and liquidity in the market by providing funding to purchase securities.
- **Automotive Industry Support Programs** — These programs all have a universal goal to stabilize the American automotive industry, promoting market stability and a vigorous economy.
- **Homeowner Support Programs** — These programs encourage homeowner affordability by providing loan modification and refinancing assistance.

Warrant: The right, but not the obligation, to purchase a certain number of shares of common stock at a fixed price.

**Systemically Significant:** A financial institution whose failure would impose significant losses on creditors and counterparties, call into question the financial strength of other similarly situated financial institutions, disrupt financial markets, raise borrowing costs for households and businesses, and reduce household wealth.

**Preferred Stock:** Equity ownership that usually pays a fixed dividend, gives the holder a claim on corporate earnings superior to common stock owners, and has no voting rights. Preferred stock also has priority in the distribution of assets in the case of liquidation of a bankrupt company.

### Financial Institution Support Programs

The primary tool of TARP for assisting financial institutions thus far has been a direct investment of capital. Financial institutions include bank holding companies and certain systemically significant institutions, such as American International Group, Inc. ("AIG").

- **Capital Purchase Program ("CPP").** Treasury created CPP to provide funds to "stabilize and strengthen the U.S. financial system by increasing the capital base of an array of healthy, viable institutions, enabling them [to] lend to consumers and business[es]."<sup>11</sup> As of June 30, 2009, Treasury had invested \$203.2 billion in institutions through CPP out of a maximum projected funding total of \$218 billion under the program, of which \$70.1 billion had been repaid.<sup>12</sup> See the "Capital Purchase Program" discussion in this section for more detailed information.
- **Capital Assistance Program ("CAP").** Similar to CPP, the goal of CAP is to "ensure the continued ability of U.S. financial institutions to lend to creditworthy borrowers in the face of a weaker than expected economic environment and larger than expected potential losses."<sup>13</sup> As originally envisioned by Treasury, CAP investments were to be targeted to financial institutions with more than \$100 billion in assets and would be sized to provide a capital buffer to be determined by a Supervisory Capital Assessment Program ("SCAP" or "stress test").<sup>14</sup> Treasury applied SCAP to 19 of the largest financial institutions and concluded that 10 of those institutions will be required to seek additional capital.<sup>15</sup> Those failing to raise such capital in the private market will be required to take CAP funds; however, many financial institutions have raised significant funds on their own, which could seemingly limit their need for CAP. In addition to the required participants, all qualifying financial institutions may apply under CAP for additional capital without the stress-test requirement. As of June 30, 2009, no transactions had occurred under this program. See the "Capital Assistance Program" part of this section for a detailed discussion of the stress tests and their results.
- **Systemically Significant Failing Institutions ("SSFI") Program.** Under the stated terms of the SSFI program, Treasury invests in systemically significant institutions to prevent their failure and the market disruption that would follow.<sup>16</sup> As of June 30, 2009, Treasury, through SSFI, had made, and is committed to make investments in, one institution — AIG. This support was provided through two transactions — \$40 billion<sup>17</sup> for the purchase of preferred stock from AIG and approximately \$29.8 billion for an equity capital facility that AIG can draw on as needed.<sup>18</sup> As of June 30, 2009, AIG had drawn down \$1.15 billion in equity from the capital facility.<sup>19</sup> See the "Systemically Significant

Failing Institutions" part of this section for a detailed discussion of the AIG transactions.

- Targeted Investment Program ("TIP").** The stated objective of TIP is to make targeted investments in financial institutions "to avoid significant market disruptions resulting from the deterioration of one financial institution that can threaten other financial institutions and impair broader financial markets and pose a threat to the overall economy."<sup>20</sup> As reported in SIGTARP's Initial Report to Congress ("Initial Report"), dated February 6, 2009, Treasury purchased \$20 billion of senior preferred stock and received warrants of common stock from both Citigroup and Bank of America, for a total expenditure of \$40 billion in TARP funds.<sup>21</sup> As of June 30, 2009, Treasury had made no additional funding available under this program. Subsequent to SIGTARP's April Quarterly Report, Citigroup finalized an exchange offering that will convert preferred stock, including preferred shares acquired by Treasury through TIP/AGP and CPP, to trust preferred shares and common stock, respectively. See the "Targeted Investment Program and Asset Guarantee Program" portion of this section for a detailed discussion of Citibank's exchange offering.
- Asset Guarantee Program ("AGP").** Through AGP, Treasury's stated goal is to use insurance-like protections to help stabilize at-risk financial institutions. AGP provides certain loss protections on a select pool of mortgage-related or similar assets held by participants whose portfolios of distressed or illiquid assets pose a risk to market confidence.<sup>22</sup> As discussed in SIGTARP's Initial Report, Treasury, the Federal Deposit Insurance Corporation ("FDIC"), and the Federal Reserve agreed to provide certain loss protections with respect to \$301 billion in troubled assets held by Citigroup.<sup>23</sup> Treasury's projected TARP investment through this program accounted for \$5 billion in protection for Citigroup as of June 30, 2009.<sup>24</sup> A similar arrangement with Bank of America was announced on January 16, 2009; Bank of America, however, recently requested not to go forward with the program. As of June 30, 2009, the matter had not yet been resolved.<sup>25</sup> See the "Targeted Investment Program and Asset Guarantee Program" discussion in this section for more information on Citigroup's transactions.

#### Asset Support Programs

The purpose of these programs is to support the liquidity and market value of assets owned by financial institutions. These assets may include various classes of asset-backed securities ("ABS") and several types of loans. These programs seek to bolster the balance sheets of the financial firms and help free up capital so that financial institutions can extend more credit to support the U.S. economy.

- Term Asset-Backed Securities Loan Facility ("TALF").** TALF was originally designed to increase the credit available for consumer and small-business loans

**Senior Preferred Stock.** Shares that give the stockholder priority dividend and liquidation claims over junior preferred and common stockholders.

**Illiquid Assets.** Assets that cannot be quickly converted to cash.

**Commercial Mortgage-Backed Securities ("CMBS"):** A financial instrument that is backed by a commercial real estate mortgage or a group of commercial real estate mortgages that are packaged together.

**Residential Mortgage-Backed Securities ("RMBS"):** A financial instrument that is backed by a group of residential real estate mortgages that are packaged together.

**Legacy Assets:** Also commonly referred to as troubled or toxic assets, legacy assets are real estate-related loans and securities (legacy loans and legacy securities) that remain on banks' balance sheets that have lost value but are difficult to price due to the recent market disruption.

**Legacy Loans:** Loans that are often underperforming real estate-related loans held by a bank that it wishes to sell, but recent market disruptions have made difficult to price.

**Legacy Securities:** Troubled real estate-related securities (RMBS, CMBS), and other asset-backed securities ("ABS") lingering on institutions' balance sheets because their value could not be determined.

**Secondary Market:** The secondary market, also known as the aftermarket, is the financial market where previously issued securities and financial instruments such as stocks, bonds, options, and futures are bought and sold.

through a Federal Reserve loan program backed by TARP funds. TALF provides non-recourse loans to investors secured by certain types of asset-backed securities. Treasury and the Federal Reserve expanded TALF to cover additional asset classes, including newly issued and legacy commercial mortgage-backed securities ("CMBS") with the potential to expand into residential mortgage-backed securities ("RMBS"). TALF as originally announced was to be a \$200 billion program that included \$20 billion of TARP funds to be used for purchasing surrendered collateral.<sup>26</sup> The facility can be expanded to \$1 trillion of lending; according to Treasury, it will provide up to \$80 billion of TARP funds to support this program,<sup>27</sup> but according to the Federal Reserve, the amount for which Treasury would be responsible would be up to \$100 billion.<sup>28</sup> As of June 30, 2009, the Federal Reserve Bank of New York ("FRBNY") had facilitated four TALF subscriptions of non-mortgage-related ABS, totaling approximately \$28.5 billion of TALF borrowing.<sup>29</sup> TALF had also launched a subscription for newly issued CMBS in June, for which no loans were issued. An overview of TALF, later in this section, provides more information on these activities.

- **Public-Private Investment Program ("PPIP").** As originally announced, Treasury, in coordination with FDIC and the Federal Reserve, intended PPIP to improve the health of financial institutions and restart frozen credit markets through the purchase of legacy assets (e.g., legacy loans, CMBS, RMBS).<sup>30</sup> In addition to the expansion of TALF to include legacy securities, as discussed previously, PPIP was intended to involve investments made through multiple Public-Private Investment Funds ("PPIFs") in two subprograms — one to purchase real estate-related loans ("legacy loans") and the other to purchase real estate-related securities ("legacy securities") from financial institutions. However, as of June 30, 2009, the future of the legacy loans program is in doubt because FDIC has shelved the program.<sup>31</sup> The legacy securities program is under development, and Treasury announced the selection of nine PPIF managers on July 8, 2009, that will receive up to \$30 billion in TARP funds. Treasury has stated that PPIP, originally intended to involve up to \$1 trillion in funds, is expected to utilize up to \$75 billion of TARP funds.<sup>32</sup> See the "Public-Private Investment Program" discussion later in this section for details about the program structure and fund manager terms.
- **Unlocking Credit for Small Businesses ("UCSB").** Under UCSB, Treasury announced that it will begin purchasing up to \$15 billion in securities backed by Small Business Administration ("SBA") loans.<sup>33</sup> As demand has diminished in the secondary market for these securities due to adverse credit conditions, there has been a reduction in the volume of new small-business loans written by banks. As of June 30, 2009, no transactions had occurred under this program. See the discussion of "Unlocking Credit for Small Businesses" in this section for more information on the program.

### Automotive Industry Support Programs

The stated objective of TARP's automotive industry support programs is to "prevent a significant disruption of the American automotive industry, which would pose a systemic risk to financial market stability and have a negative effect on the economy of the United States."<sup>34</sup>

- **Automotive Industry Financing Program ("AIFP").** Under this program, Treasury made emergency loans to Chrysler Holding LLC ("Chrysler"), Chrysler Financial Services Americas LLC ("Chrysler Financial"), and General Motors Corporation ("GM"). In addition to these investments, Treasury purchased senior preferred stock from GMAC LLC ("GMAC"). Subsequent to SIGTARP's April Quarterly Report, the manufacturers (Chrysler and GM) were unable to obtain necessary concessions from key stakeholders and, therefore, filed for bankruptcy on April 30, 2009, and June 1, 2009, respectively. These bankruptcies involved infusion of additional TARP funds. As of June 30, 2009, Treasury had expended or committed \$79.3 billion in AIFP investments, of which \$130.8 million had been repaid.<sup>35</sup> See the discussion of "Automotive Industry Financing Program" later in this section for a detailed discussion on the reorganizations of these companies.
- **Auto Supplier Support Program ("ASSP").** The stated purpose of ASSP is to provide Government-backed financing to break the adverse credit cycle affecting the auto suppliers and the manufacturers by "providing suppliers with the confidence they need to continue shipping their parts and the support they need to help access loans to pay their employees and continue their operations."<sup>36</sup> Treasury's commitment under this program was \$5 billion as of June 30, 2009 — \$3.5 billion for GM and \$1.5 billion for Chrysler.<sup>37</sup> See the discussion of "Auto Supplier Support Program" in this section for more information.
- **Auto Warranty Commitment Program ("AWCP").** The Auto Warranty Commitment Program was designed by the Administration with the intention of bolstering consumer confidence in automobile warranties on GM- and Chrysler-built vehicles. Under this program, Government-backed financing was to be provided for the warranties of cars sold during the GM and Chrysler restructuring periods. As of June 30, 2009, Treasury funded \$640.7 million toward this program — \$360.6 million was made available to GM and \$280.1 million was made available to Chrysler.<sup>38</sup> However, Treasury has stated that the funds are not expected to be used by the manufacturers. Treasury expects that after GM and Chrysler fully emerge from bankruptcy, the committed funds will be refunded to Treasury.<sup>39</sup> See the discussion of "Auto Warranty Commitment Program" in this section for more information.

### Homeowner Support Programs

The homeowner support programs are aimed at assisting troubled homeowners and financial institutions holding the affected assets.

- Making Home Affordable (“MHA”) Program.** According to Treasury, MHA is a foreclosure mitigation plan intended to “help bring relief to responsible homeowners struggling to make their mortgage payments while preventing neighborhoods and communities from suffering the negative spillover effects of foreclosure, such as lower housing prices, increased crime, and higher taxes.”<sup>40</sup> Treasury, along with other Federal agencies, “will undertake a comprehensive multiple-part strategy,” which will provide for (i) a \$75 billion loan modification program for homeowners in default on their payments or facing imminent default, (ii) a streamlined refinancing process for homeowners whose loans are serviced by Fannie Mae or Freddie Mac, and (iii) approximately \$200 billion to support Fannie Mae and Freddie Mac.<sup>41</sup> The funds for this effort will be provided from both TARP- and non-TARP-related sources. Treasury announced that up to \$50 billion of TARP funds could be expended for this program.<sup>42</sup> As of June 30, 2009, \$18 billion had been allocated to the program.<sup>43</sup>

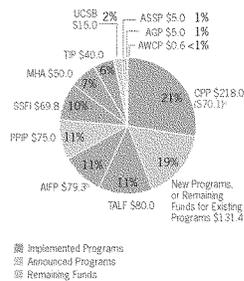
The following figures and tables provide a status summary of the implemented and announced TARP and TARP-related initiatives:

- total potential funds subject to SIGTARP oversight (Table 2.1)
- projected TARP funding by program (Figure 2.1)
- expenditure levels by program as of June 30, 2009 (Table 2.2)
- cumulative expenditures and repayments as of June 30, 2009 (Figure 2.2)
- cumulative expenditures over time for implemented programs (Figure 2.3)
- expenditures by program snapshot as of June 30, 2009 (Figure 2.4)
- summary of terms of TARP agreements (Table 2.3 and Table 2.4)
- summary of largest warrant positions held by Treasury by program as of June 30, 2009 (Table 2.5)
- summary of dividend and interest payments received by program (Table 2.6)

For a reporting of all purchases, obligations, expenditures, and revenues of TARP, see Appendix C: “Cross-Reference to Reporting Requirements.”

FIGURE 2.1

TARP PROJECTED FUNDING, BY PROGRAM  
\$ Billion, % of \$699 Billion



Notes: Numbers affected by rounding. As of 6/30/2009, funding for Capital Assistance Program (“CAP”) to be determined.

<sup>40</sup> As of 6/30/2009, \$70.1 billion of CPP funding had been repaid.  
<sup>41</sup> As of 6/30/2009, \$130.8 million of principal payments related to AIFP loans (Chrysler Financial) had been repaid.

Sources: See final endnote.

TABLE 2.1

| TOTAL POTENTIAL FUNDS SUBJECT TO SIGTARP OVERSIGHT, AS OF 6/30/2009 <sup>a</sup> (BILLIONS) |  |                                      |                             |
|---|--|--------------------------------------|-----------------------------|
| Program   | Brief Description or Participant   | Total Projected Funding at Risk (\$) | Projected TARP Funding (\$) |
| Capital Purchase Program ("CPP")  | Investments in 649 banks to date; 8 institutions total \$134 billion; received \$70.1 billion in capital repayments  | \$218.0<br>(\$70.1)                  | \$218.0<br>(\$70.1)         |
| Automotive Industry Financing Program ("AIFP")  | GM, Chrysler, GMAC, Chrysler Financial; received \$130.8 million in loan repayments (Chrysler Financial)             | 79.3                                 | 79.3                        |
| Auto Suppliers Support Program ("ASSP")   | Government-backed protection for auto parts suppliers  | 5.0                                  | 5.0                         |
| Auto Warranty Commitment Program ("AWCP")   | Government-backed protection for warranties of cars sold during the GM and Chrysler bankruptcy restructuring periods | 0.6                                  | 0.6                         |
| Unlocking Credit for Small Businesses ("UCSB")  | Purchase of securities backed by SBA loans   | 15.0 <sup>c</sup>                    | 15.0                        |
| Systemically Significant Failing Institutions ("SSFI")                                      | AG investment  | 69.8 <sup>b</sup>                    | 69.8 <sup>b</sup>           |
| Targeted Investment Program ("TIP")   | Citigroup, Bank of America investments   | 40.0                                 | 40.0                        |
| Asset Guarantee Program ("AGP")   | Citigroup, ring-fence asset guarantee  | 301.0                                | 5.0                         |
| Term Asset-Backed Securities Loan Facility ("TALF")   | FRBNY nonrecourse loans for purchase of asset-backed securities  | 1,000.0                              | 80.0                        |
| Making Home Affordable ("MHA") Program  | Modification of mortgage loans   | 75.0 <sup>c</sup>                    | 50.0                        |
| Public-Private Investment Program ("PPIP")  | Disposition of legacy assets; Legacy Loans Program, Legacy Securities Program (expansion of TALF)                    | 500.0 – 1,000.0                      | 75.0                        |
| Capital Assistance Program ("CAP")  | Capital to qualified financial institutions; includes stress test  | TBD                                  | TBD                         |
| New Programs, or Funds Remaining for Existing Programs                                      | Potential additional funding related to CAP; other programs  | 131.4                                | 131.4                       |
| <b>Total</b>  |  | <b>\$2,365.0 – \$2,865.0</b>         | <b>\$699.0</b>              |

<sup>a</sup> Notes: Numbers affected by rounding.

<sup>b</sup> Treasury announced that it would purchase up to \$15 billion in securities under the Unlocking Credit for Small Businesses program.

<sup>c</sup> Actual TARP expenditures as of 6/30/2009.

<sup>d</sup> \$75 billion is for mortgage modification.

Sources: Treasury, Office of Financial Stability, Chief of Compliance and CFO, SIGTARP interview, 3/30/2009; Treasury, Transactions Report, 7/2/2009, [http://www.financialstability.gov/docs/transactionsreport\\_070209.pdf](http://www.financialstability.gov/docs/transactionsreport/transactionsreport_070209.pdf), accessed 7/8/2009; Treasury, "Auto Supplier Support Program: Stabilizing the Auto Industry in a Time of Crisis," 3/19/2009, [http://www.treas.gov/press/releases/docs/autosupplier-support-program\\_3\\_18.pdf](http://www.treas.gov/press/releases/docs/autosupplier-support-program_3_18.pdf), accessed 3/19/2009; Treasury, "Unlocking Credit for Small Businesses Fact Sheet," 3/17/2009, <http://www.financialstability.gov/roadstability/unlockingcreditforsmallbusinesses.html>, accessed 6/10/2009; Treasury, "Treasury, Federal Reserve, and FDIC Provide Assistance to Bank of America," 1/16/2009, <http://www.treas.gov/press/releases/fp1558.html>, accessed 1/16/2009; Treasury Press Release, "U.S. Government Provides Types of CDO Guarantee Arranged in November," 1/16/2009, <http://www.financialstability.gov/press/fp1558.html>, accessed 6/8/2009; Treasury, "Financial Stability Plan Fact Sheet," 2/10/2009, <http://www.financialstability.gov/docs/factsheet.pdf>, accessed 6/8/2009; Treasury, "Making Home Affordable: Updated Detailed Program Description," 3/4/2009, [http://www.treas.gov/press/releases/mortgage\\_fact\\_sheet.pdf](http://www.treas.gov/press/releases/mortgage_fact_sheet.pdf), accessed 6/19/2009; Treasury, "Public-Private Investment Program," 4/6/2009, <http://www.financialstability.gov/roadstability/publicprivatefund.html>, accessed 6/9/2009.

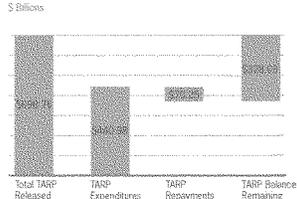
TABLE 2.2

| EXPENDITURE LEVELS BY PROGRAM, AS OF 6/30/2009 (IS BILLIONS)                      |                 |                |  |
|---|-----------------|----------------|--|
|   | Amount          | Percent (%)    | Section Reference                        |
| Authorized Under EESA   | \$700.0         |                |  |
| Released Immediately  | \$250.0         | 35.8%          |  |
| Released Under Presidential Certificate of Need                                   | 100.0           | 14.3%          |  |
| Released Under Presidential Certificate of Need & Resolution to Disapprove Failed | 350.0           | 50.1%          |  |
| Helping Families Save Their Homes Act of 2009                                     | (1.2)           | (0.2)%         |  |
| <b>Total Released</b>   | <b>\$698.8</b>  | <b>100.0%</b>  |  |
| Less: Expenditures by Treasury Under TARP <sup>a</sup>                            |                 |                |  |
| Capital Purchase Program ("CPP"):   |                 |                |  |
| Bank of America <sup>b</sup>  | \$25.0          | 3.6%           | *Financial Institution Support Programs* |
| Citigroup   | 25.0            | 3.6%           |  |
| JPMorgan  | 25.0            | 3.6%           |  |
| Wells Fargo   | 25.0            | 3.6%           |  |
| Goldman Sachs <sup>c</sup>  | 10.0            | 1.4%           |  |
| Morgan Stanley <sup>c</sup>   | 10.0            | 1.4%           |  |
| Other Qualifying Financial Institutions <sup>d</sup>                              | 83.2            | 11.9%          |  |
| <b>CPP Total</b>  | <b>\$203.2</b>  | <b>29.1%</b>   |  |
| Systemically Significant Failing Institutions ("SSFI") Program:                   |                 |                |  |
| AIG   | \$69.8          | 10.0%          | *Financial Institution Support Programs* |
| <b>SSFI Total</b>   | <b>\$69.8</b>   | <b>10.0%</b>   |  |
| Targeted Investment Program ("TIP"):  |                 |                |  |
| Bank of America   | \$20.0          | 2.9%           | *Financial Institution Support Programs* |
| Citigroup   | 20.0            | 2.9%           |  |
| <b>TIP Total</b>  | <b>\$40.0</b>   | <b>5.8%</b>    |  |
| Asset Guarantee Program ("AGP"):  |                 |                |  |
| Citigroup <sup>e</sup>  | \$5.0           | 0.7%           | *Financial Institution Support Programs* |
| <b>AGP Total</b>  | <b>\$5.0</b>    | <b>0.7%</b>    |  |
| Term Asset-Backed Securities Loan Facility ("TALF"):                              |                 |                |  |
| TALF LLC  | \$20.0          | 2.9%           | *Asset Support Programs*                 |
| <b>TALF Total</b>   | <b>\$20.0</b>   | <b>2.9%</b>    |  |
| Automotive Industry Financing Program ("AIFP"):                                   |                 |                |  |
| GM  | \$49.5          | 7.1%           | *Automotive Industry Support Programs*   |
| GMAC  | 13.4            | 1.9%           |  |
| Chrysler  | 14.9            | 2.1%           |  |
| Chrysler Financial <sup>f</sup>   | 1.5             | 0.2%           |  |
| <b>AIFP Total</b>   | <b>\$79.3</b>   | <b>11.3%</b>   |  |
| Automotive Supplier Support Program ("ASSP"):                                     |                 |                |  |
| GM Suppliers Receivables LLC <sup>g</sup>   | \$3.5           | 0.5%           | *Automotive Industry Support Programs*   |
| Chrysler Holding LLC <sup>g</sup>   | 1.5             | 0.2%           |  |
| <b>ASSP Total</b>   | <b>\$5.0</b>    | <b>0.7%</b>    |  |
| Automotive Warranty Commitment Program ("AWCP"):                                  |                 |                |  |
| GM  | \$0.4           | 0.1%           | *Automotive Industry Support Programs*   |
| Chrysler  | 0.3             | 0.0%           |  |
| <b>AWCP Total</b>   | <b>\$0.6</b>    | <b>0.1%</b>    |  |
| Making Home Affordable ("MHA"):   |                 |                |  |
| Countrywide Home Loans Servicing LP   | \$5.2           | 0.7%           | *Homeowner Support Programs*             |
| Chase Home Finance  | 3.6             | 0.5%           |  |
| Wells Fargo Bank, NA  | 2.4             | 0.3%           |  |
| CitiMortgage  | 1.1             | 0.2%           |  |
| GMAC Mortgage   | 1.0             | 0.1%           |  |
| Other Financial Institutions <sup>h</sup>   | 4.7             | 0.7%           |  |
| <b>MHA Total</b>  | <b>\$18.0</b>   | <b>2.5%</b>    |  |
| <b>Subtotal - TARP Expenditures</b>   | <b>\$441.0</b>  | <b>63.1%</b>   |  |
| <b>TARP Repayments<sup>i</sup></b>  | <b>\$(70.3)</b> | <b>(10.0)%</b> |  |
| <b>Balance Remaining of Total Funds Made Available as of 6/30/2009</b>            | <b>\$328.0</b>  | <b>46.9%</b>   |  |

Notes: Numbers affected by rounding.  
 1 From a budgetary perspective, what Treasury has committed to spend (e.g., signed agreements with TARP fund recipients).  
 2 Bank of America's share is equal to two CPP investments totaling \$25 billion, which is the sum of \$15 billion received on 10/28/2008 and \$10 billion received on 1/9/2009.  
 3 These institutions repaid their CPP funds pursuant to Title IV, Section 7001(g) of the American Recovery and Reinvestment Act of 2009.  
 4 Other Qualifying Financial Institutions ("OQFIs") include all QFIs that have received less than \$10 billion through CPP.  
 5 Treasury committed \$5 billion to Citigroup under AIFP; however, this funding is conditional based on losses realized and may potentially never be expended. This amount is not an actual outlay of cash.  
 6 Treasury's \$1.5 billion loan to Chrysler Financial represents the maximum loan amount. This \$1.5 billion has not been fully expended because the loan will be funded incrementally at \$100 million per week.  
 7 Represents a special purpose vehicle ("SPV") created by the manufacturer. Balance represents the maximum loan amount, which will be funded incrementally.  
 8 Other Financial Institutions that have received less than \$1 billion through MHA.  
 9 As of 6/30/2009, CPP repayments total \$70.1 billion and AIFP loan repayments (Chrysler Financial) total \$130.8 million.

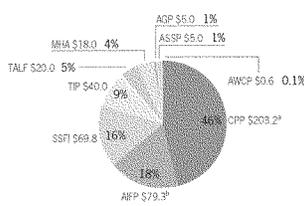
Sources:  
 Emergency Economic Stabilization Act, P.L. 110-343, 10/3/2008; Library of Congress, "A Joint Resolution Relating to the Disapproval of Obligations under the Emergency Economic Stabilization Act of 2008," 1/15/2009, www.thomas.loc.gov, accessed 1/25/2009; Helping Families Save Their Homes Act of 2009, P.L. 111-22, 5/20/2009, Treasury, Transactions Report, 7/2/2009, http://www.financial-stability.gov/docs/transactionsreports/transactionsreport\_072009.pdf, accessed 7/8/2009; Treasury, response to SIGTARP data call, 7/8/2009.

**FIGURE 2.2**  
 CUMULATIVE EXPENDITURE AND REPAYMENTS, AS OF 6/30/2009



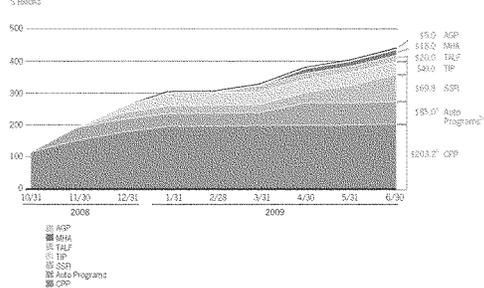
Note: Numbers affected by rounding.  
 Sources: Treasury, Transactions Report, 7/2/2009; Treasury, response to SIGTARP data call, 7/8/2009.

**FIGURE 2.4**  
 EXPENDITURES BY PROGRAM, SNAPSHOT



Notes: Numbers affected by rounding.  
 1 As of 6/30/2009, \$70.1 billion of CPP funding had been repaid.  
 2 As of 6/30/2009, \$130.8 million of principal payments related to AIFP loans (Chrysler Financial) had been repaid.  
 Sources: Treasury, Transactions Report, 7/2/2009; Treasury, response to SIGTARP data call, 7/8/2009.

**FIGURE 2.3**  
 EXPENDITURES, BY PROGRAM, CUMULATIVE, 10/2008 - 6/2009



Notes: Numbers affected by rounding.  
 1 As of 6/30/2009, \$130.8 million of principal payments related to AIFP loans (Chrysler Financial) had been repaid.  
 2 Auto Programs include AIFP, ASPP, and AWCP.  
 3 As of 6/30/2009, \$130.8 million of principal payments related to AIFP loans (Chrysler Financial) had been repaid.  
 Sources: Treasury, Transactions Report, 7/2/2009; Treasury, response to SIGTARP data call, 7/8/2009.

TABLE 2.3

| EQUITY AGREEMENTS |                 |                                   |                             |  |
|-------------------|-----------------|-----------------------------------|-----------------------------|--|
| TARP Program      | Company         | Date of Agreement                 | Cost Assigned               | Description of Investment  |
| CPP – Public      | 282 QFs         | 10/14/2008 <sup>a</sup> and later | \$199.1 billion             | Senior Preferred Equity  |
|                   |                 |                                   |                             | Common Stock Purchase Warrants                                   |
| CPP – Private     | 331 QFs         | 11/17/2008 <sup>b</sup> and later | \$3.8 billion               | Preferred Equity   |
|                   |                 |                                   |                             | Preferred Stock Purchase Warrants that are exercised immediately |
| SSFI              | AIG             | 4/17/2009                         | \$41.6 billion <sup>c</sup> | Non-Cumulative Preferred Equity                                  |
|                   |                 |                                   |                             | Common Stock Purchase Warrants                                   |
| SSFI              | AIG             | 4/17/2009                         | \$29.8 billion <sup>d</sup> | Non-Cumulative Preferred Equity                                  |
|                   |                 |                                   |                             | Common Stock Purchase Warrants                                   |
| TIP               | Citigroup       | 12/31/2008                        | \$20.0 billion <sup>e</sup> | Trust Preferred Securities                                       |
| TIP               | Bank of America | 1/16/2009 <sup>f</sup>            | \$20.0 billion              | Warrants   |
|                   |                 |                                   |                             | Senior Preferred Equity  |
| AIFP              | GMAC LLC        | 12/29/2008                        | \$5.0 billion               | Warrants   |
|                   |                 |                                   |                             | Senior Preferred Membership Interests                            |
| AIFP              | GMAC LLC        | 5/21/2009                         | \$7.5 billion               | Preferred Stock Purchase Warrants that are exercised immediately |
|                   |                 |                                   |                             | Mandatorily Convertible Preferred Stock                          |
| AIFP              | GMAC LLC        | 5/29/2009                         | \$0.9 billion               | Preferred Stock Purchase Warrants that are exercised immediately |
| AIFP              | GMAC LLC        | 5/29/2009                         | \$0.9 billion               | Common Equity Interest   |

Notes: Numbers affected by rounding.

<sup>a</sup> Announcement date of CPP Public Term Sheet.

<sup>b</sup> Announcement date of CPP Private Term Sheet.

<sup>c</sup> AIG exchanged Treasury's \$40 billion investment in Cumulative Preferred Stock (obtained on 11/25/2008) for Non-Cumulative Preferred Stock, effectively cancelling the original \$40 billion investment.

<sup>d</sup> The Equity Capital Facility was announced as a \$30 billion commitment, but Treasury reduced this amount by the value of the AIGFP Retention Payment Amount of \$165 million.

<sup>e</sup> Citigroup exchanged its \$20 billion Senior Preferred Equity (obtained on 12/31/2008) for Trust Preferred Securities.

<sup>f</sup> Date as of Treasury's 1/27/2009 Transactions Report. The Security Purchase Agreement has a date of 1/15/2009.

| Investment Information   | Dividends                           | Term of Agreement |
|--|-------------------------------------|-------------------|
| 1% - 3% of risk-weighted assets, not to exceed \$25 billion for each QFI   | 5% for first 5 years, 9% thereafter | Perpetual         |
| 15% of senior preferred amount   | ---                                 | Up to 10 years    |
| 1% - 3% of risk-weighted assets, not to exceed \$25 billion for each QFI   | 5% for first 5 years, 9% thereafter | Perpetual         |
| 5% of preferred amount   | 9%                                  | Up to 10 years    |
| \$41.6 billion aggregate liquidation preference  | 10%                                 | Perpetual         |
| 2% of issued and outstanding common stock on investment date; \$2.50 exercise price  | ---                                 | Up to 10 years    |
| Up to \$29.8 billion aggregate liquidation preference. As of 6/30/2009, the aggregate liquidation preference was \$1.15 billion.               | 10%                                 | Up to 5 years     |
| 150 common stock warrants outstanding; \$0.00002 exercise price  | ---                                 | Up to 10 years    |
| \$20 billion   | 8%                                  | Perpetual         |
| 10% of total preferred stock issued; \$10.61 exercise price  | ---                                 | Up to 10 years    |
| \$20 billion   | 8%                                  | Perpetual         |
| 10% of total preferred stock issued; \$13.30 exercise price  | ---                                 | Up to 10 years    |
| \$5 billion  | 8%                                  | Perpetual         |
| 5% of preferred amount   | 9%                                  | Up to 10 years    |
| \$7.5 billion  | 9%                                  | Perpetual         |
| 5% of preferred amount   | ---                                 | Up to 10 years    |
| This equity interest was obtained by exchanging a prior debt obligation with General Motors. See "Debt Agreements" table for more information. | ---                                 | Perpetual         |

Sources: Treasury, Transactions Report, 7/2/2009; Treasury, "TARP Capital Purchase Program Agreement, Senior Preferred Stock and Warrants, Summary of Senior Preferred Terms," 10/14/2008; Treasury, "TARP Capital Purchase Program Agreement, Non-Public QFIs, excluding S-Corps and Mutual Organizational Preferred Securities, Summary of Warrant Terms," 11/17/2008; Treasury, "Securities Purchase Agreement dated as of November 25, 2008 between American International Group, Inc. and United States Department of Treasury," 11/25/2008; Treasury, "TARP AG SSMF Investment, Senior Preferred Stock and Warrant, Summary of Senior Preferred Terms," 11/25/2008; Treasury, "Securities Purchase Agreement dated as of January 15, 2009 between Citigroup, Inc. and United States Department of Treasury," 1/15/2009; Treasury, "Citigroup, Inc. Summary of Terms, Single Asset Guarantee," 11/23/2008; "Securities Purchase Agreement dated as of January 15, 2009 between Bank of America Corporation and United States Department of Treasury," 1/15/2009; Treasury, "Bank of America Summary of Terms, Preferred Securities," 1/16/2009; Treasury, "GMAC LLC Automotive Industry Financing Program, Preferred Membership Interests, Summary of Preferred Terms," 12/29/2008; Treasury, response to SICDARP data call, 7/13/2009; Treasury, "FactSheet on Capital Purchase Program," 3/17/2009.

TABLE 2.4

| DEBT AGREEMENTS |                              |                                   |                             |  |
|-----------------|------------------------------|-----------------------------------|-----------------------------|--|
| TARP Program    | Company                      | Date of Agreement                 | Cost Assigned               | Description of Investment  |
| CPP - S-Corps   | 36 QFIs                      | 1/14/2009 <sup>a</sup>            | \$0.4 billion               | Senior Subordinated Securities                                       |
|                 |                              |                                   |                             | Senior Subordinated Security Warrants that are exercised immediately |
| AIFP            | General Motors               | 12/31/2008                        | \$19.8 billion <sup>b</sup> | Debt Obligation with Warrants and Additional Note                    |
| AIFP            | General Motors               | 1/16/2009                         | \$0.9 billion               | Debt Obligation  |
| AIFP            | Chrysler                     | 1/2/2009 <sup>c</sup>             | \$4.8 billion <sup>b</sup>  | Debt Obligation with Additional Note                                 |
| AIFP            | Chrysler Financial           | 1/16/2009                         | \$1.5 billion               | Debt Obligation with Additional Note                                 |
| AIFP            | Chrysler                     | 5/1/2009                          | \$3.8 billion               | Debt Obligation with Additional Note                                 |
| AIFP            | Chrysler                     | 5/27/2009                         | \$6.6 billion               | Debt Obligation with Additional Note, Equity Interest                |
| AIFP            | General Motors               | 6/3/2009,<br>amended<br>7/10/2009 | \$30.1 billion              | Debt Obligation with Additional Note                                 |
| ASSP            | GM Supplier Receivables LLC  | 4/9/2009                          | \$3.5 billion               | Debt Obligation with Additional Note                                 |
| ASSP            | Chrysler Receivables SPV LLC | 4/9/2009                          | \$1.5 billion               | Debt Obligation with Additional Note                                 |

Notes: Numbers affected by rounding.  
<sup>a</sup> Announcement date of CPP S-Corporation Term Sheet.  
<sup>b</sup> Amount includes AIFP commitments.  
<sup>c</sup> Date as of Treasury's 1/27/2009 Transactions Report. The Security Purchase Agreement has a date of 12/31/2008.

| Investment Information  | Interest / Dividends   | Term of Agreement  |
|---|--|--|
| Each QFI may issue Senior Securities with an aggregate principal amount of 1% - 3% of its risk-weighted assets, but not to exceed \$25 billion.   | 7.7% for first 5 years; 13.8% thereafter   | 30 years   |
| Treasury will receive warrants to purchase an amount equal to 5% of the Senior Securities purchased on the date of investment.  | 13.8%  | 10 years   |
| This loan was funded incrementally; \$4 billion funded on 12/31/2008, \$5.4 billion funded on 1/21/2009, \$4 billion funded on 2/17/2009. Subsequently, this loan was then amended; \$2 billion on 4/22/2009 and \$4 billion on 5/20/2009. In addition, on 5/27/2009, \$361 million was set aside in an SPV for the AWCP.   | LIBOR + 3%   | 12/29/2011   |
| This loan was exchanged for a portion of GM's common equity interest in GMAC LLC on 5/29/2009. See "Equity Agreements" table for more information.  | LIBOR + 3%   | 1/16/2012  |
| Loan of \$4 billion; additional note of \$267 million (6.67% of the maximum loan amount). Subsequently, this loan was then amended; \$500 million on 4/29/2009. In addition, on 4/29/2009, \$280 million was set aside in an SPV for the AWCP.  | 3% or 8% (if the company is in default of its terms under the agreement) plus the greater of (a) three-month LIBOR or (b) LIBOR floor (2.0%)   | 1/2/2012   |
| Loan is funded incrementally at \$100 million per week; additional notes is \$75 million (5% of total loan size), which vests 20% on closing and 20% on each anniversary of closing.  | LIBOR + 1% for first year<br>LIBOR + 1.5% for remaining years  | 1/16/2014  |
| Loan of \$3 billion committed to Chrysler for its bankruptcy period. Subsequently, this loan was amended; \$757 million was added on 5/20/2009. Treasury funded \$1.9 billion during bankruptcy period. The remaining amount will be de-obligated.  | (i) the greater of (a) LIBOR for the related interest period or (b) two percent (2%) plus (a) three and five-tenths percent (3.5%)   | 9/30/2009, subject to certain conditions   |
| Commitment to New CarCo Acquisition LLC (renamed Chrysler Group LLC on or about 6/10/2009) of up to \$6.642 billion. The total loan amount is up to \$7.142 billion including \$500 million of debt assumed from Treasury's 1/22/2009 credit agreement with Chrysler Holding LLC. The debt obligations are secured by a first priority lien on the assets of New CarCo Acquisition LLC (the company that purchased Chrysler LLC's assets in a sale pursuant to Section 363 of the Bankruptcy Code). | For \$2 billion: (i) the Eurodollar Rate, plus (ii) (a) 5% or, on loans extended past the original maturity date, (b) 6.50%. For \$5.142 billion note: (i) the Eurodollar Rate plus 7.91% and (ii) an additional \$17 million in PIK interest per quarter. For other notes: Eurodollar Rate plus 7.91% | For \$5 billion note: 12/10/2011; provided that issuer may extend maturity for up to \$400 million of principal to 6/10/2017. For other notes: 6/10/2017 |
| Original \$30.1 billion funded. Amended loan documents provided that \$986 million of the original DIP loan was left for the old GM.  | LIBOR + 3%   | Originally 10/31/2009, revised to remain outstanding during the pendency of the liquidation  |
| Original loan amount was \$3.5 billion, but it was decreased permanently to \$2.5 billion on 7/8/2009.  | (i) the greater of (a) LIBOR for the related interest period or (b) two percent (2%) plus (a) three and five-tenths percent (3.5%)   | 4/9/2010   |
| Original loan amount was \$1.5 billion, but it was decreased permanently to \$1 billion on 7/8/2009.  | (i) the greater of (a) LIBOR for the related interest period or (b) two percent (2%) plus (a) three and five-tenths percent (3.5%)   | 4/9/2010   |

Sources: Treasury, "Loan and Security Agreement By and Between General Motors Corporation as Borrower and The United States Department of Treasury as Lender Dated as of December 31, 2008," 12/31/2008; Treasury, "General Motors Corporation, Indicative Summary of Terms for Secured Term Loan Facility," 12/15/08; Treasury, "General Motors Promissory Note," 1/16/2009; Treasury, "Loan and Security Agreement By and Between Chrysler Holding LLC as Borrower and The United States Department of Treasury as Lender Dated as of December 31, 2008," 12/21/2008; Treasury, "Chrysler, Indicative Summary of Terms for Secured Term Loan Facility," 12/19/2008; Treasury, "Chrysler LB Receivables Trust Automotive Industry Financing Program, Secured Term Loan, Summary of Terms," 1/16/2009; GFS, response to SGIAPP draft report, 1/20/2009; Treasury, "Transactions Report," 6/20/2009; Treasury, response to SGIAPP data call, 7/13/2009; Treasury, "Fact Sheet on Capital Purchase Program," 3/17/2009; Treasury Press Release, "Treasury Releases Capital Purchase Program Terms," 1/14/2009; Treasury, "SAMP Capital Purchase Program (Subchapter S Corporation), Senior Securities, Summary of Terms," 1/14/2009.

TABLE 2.5

| LARGEST POSITIONS IN WARRANTS OUTSTANDING HELD BY TREASURY, BY PROGRAM, AS OF 6/30/2009 |                  |                                    |                                |  |                             |                         |   |
|---|------------------|------------------------------------|--------------------------------|--|-----------------------------|-------------------------|---|
| Participant   | Transaction Date | Stock Price as of Transaction Date | Number of Warrants Outstanding | Strike Price as Stated in the Agreements | Stock Price as of 6/30/2009 | In or Out of the Money? | Amount "In the Money" or "Out of the Money" as of 6/30/2009 |
| <b>Capital Purchase Program ("CPP"):</b>  |                  |                                    |                                |  |                             |                         |   |
| Citigroup   | 10/28/2008       | \$13.41                            | 210,084,034                    | \$17.85                                  | \$2.97                      | OUT                     | \$(14.88)   |
| Bank of America   | 10/28/2008       | 23.02                              | 73,075,674                     | 30.79                                    | 13.20                       | OUT                     | (17.59)   |
| Bank of America   | 1/9/2009         | 12.99                              | 48,717,116                     | 30.79                                    | 13.20                       | OUT                     | (17.59)   |
| Wells Fargo   | 10/28/2008       | 34.46                              | 110,261,688                    | 34.01                                    | 24.26                       | OUT                     | (9.75)  |
| JPMorgan Chase <sup>a</sup>   | 10/28/2008       | 37.60                              | 88,401,697                     | 42.42                                    | 34.11                       | OUT                     | (8.31)  |
| Morgan Stanley <sup>a</sup>   | 10/28/2008       | 15.20                              | 65,245,759                     | 22.99                                    | 28.51                       | IN                      | 5.52  |
| <b>Systemically Significant Failing Institutions ("SSFI") Program:</b>                  |                  |                                    |                                |  |                             |                         |   |
| AIG <sup>b</sup>  | 11/25/2008       | 35.40                              | 2,689,938                      | 50.00                                    | 23.20                       | OUT                     | (26.80)   |
| AIG <sup>b</sup>  | 4/17/2009        | 32.40                              | 150                            | 0.00 <sup>c</sup>                        | 23.20                       | IN                      | 23.20   |
| <b>Targeted Investment Program ("TIP"):</b>   |                  |                                    |                                |  |                             |                         |   |
| Citigroup   | 12/31/2008       | 6.71                               | 188,501,414                    | 10.61                                    | 2.97                        | OUT                     | (7.64)  |
| Bank of America   | 1/16/2009        | 7.18                               | 150,375,940                    | 13.30                                    | 13.20                       | OUT                     | (0.10)  |
| <b>Automotive Industry Financing Program ("AIFP"):</b>                                  |                  |                                    |                                |  |                             |                         |   |
| GM  | 12/31/2008       | 3.20                               | 122,035,597                    | 3.47                                     | 1.09                        | OUT                     | (2.38)  |
| <b>Asset Guarantee Program ("AGP"):</b>   |                  |                                    |                                |  |                             |                         |   |
| Citigroup   | 1/16/2009        | 3.50                               | 66,531,728                     | 10.61                                    | 2.97                        | OUT                     | (7.64)  |

Notes: Numbers affected by rounding.

<sup>a</sup> These institutions repaid their CPP funds pursuant to Title VII, Section 7001(g) of the American Recovery and Reinvestment Act of 2009. Treasury still holds these warrants in its portfolio for these institutions.

<sup>b</sup> All warrant and stock data for AIG are based on the 6/30/2009 reverse stock split of 1 for 20.

<sup>c</sup> \$0.00002 strike price.

Sources: Treasury, Transactions Report, 7/2/2009; Treasury, response to SIGTARP data call, 7/8/2009; Capital IQ, Inc. (a division of Standard & Poor's), www.capitaliq.com.

TABLE 2.6

| DIVIDEND AND INTEREST PAYMENTS BY PROGRAM (\$ MILLIONS) |                  |
|---|------------------|
| Program   | Amount           |
| CPP   | \$5,254.7        |
| SSFI  | —                |
| TIP   | 1,128.9          |
| AGP   | 107.6            |
| AIFP <sup>a</sup>                                       | 361.3            |
| ASSP  | 0.7              |
| <b>Total</b>  | <b>\$6,853.2</b> |

Notes: Numbers affected by rounding. Data as of 6/30/2009.

<sup>a</sup> Includes AIFCP.

Source: Treasury, response to SIGTARP data call, 7/8/2009.

## FINANCIAL INSTITUTION SUPPORT PROGRAMS

Treasury created five TARP programs that involve investment of capital or guarantee of assets in return for equity in financial institutions. Two investment programs, the Capital Purchase Program ("CPP") and the Capital Assistance Program ("CAP"), are open to all qualifying financial institutions ("QFIs"). The other three programs, the Systemically Significant Failing Institutions ("SSFI") program, Targeted Investment Program ("TIP"), and Asset Guarantee Program ("AGP") are made available on a case-by-case basis to specific institutions needing exceptional assistance above that of CPP and CAP.

### Capital Purchase Program

Treasury currently anticipates that \$218 billion of CPP TARP funds will eventually be invested in QFIs, which include private and public U.S.-controlled banks, savings associations, bank holding companies ("BHCs") (including insurance companies organized as BHCs), certain savings and loan holding companies ("SLHCs"), mutual banks, and mutual holding companies. According to Treasury, the intention of CPP is to invest in healthy, viable banks to promote financial stability, maintain confidence in the financial system, and permit institutions to continue meeting the credit needs of American consumers and businesses.<sup>44</sup> For a summary of the distribution of CPP funding by participant — not including any repayment — see Figure 2.5.

### Program Updates

CPP operations have remained similar to what has been outlined in SIGTARP's Initial Report and April Quarterly Report; however, on April 7, 2009, Treasury announced an extension of the program to mutual holding companies,<sup>45</sup> and, one week later, it released a program term sheet for mutual banks.<sup>46</sup> On May 13, 2009, Treasury announced an expansion of CPP known as "CPP for Small Banks."

**Bank Holding Company ("BHC").** A company that controls a bank. Typically, a company controls a bank through the ownership of 25% or more of its voting securities.

**Savings and Loan Holding Company ("SLHC").** A company (other than a BHC) that controls a savings association.

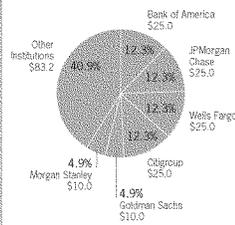
**Mutual Banks.** Depository institutions that are owned by their depositors and do not have a holding company associated with them.

**Mutual Holding Company.** A bank or savings and loan holding company that is part of a mutual bank that is owned by depositors; distributes income in proportion to the amount of business that members do with the company.

Qualifying Financial Institutions ("QFIs"): Private and public U.S.-controlled banks, savings associations, bank holding companies, certain savings and loan holding companies, and mutual organizations.

FIGURE 2.5

CPP EXPENDITURES, BY PARTICIPANT, CUMULATIVE<sup>a</sup>  
\$ Billion, % of \$203.2 Billion



Notes: Numbers affected by rounding. Data as of 6/30/2009. Bank of America = Bank of America Corporation; JPMorgan Chase = JPMorgan Chase & Co.; Wells Fargo = Wells Fargo and Company; Citigroup = Citigroup Inc.; Goldman Sachs = The Goldman Sachs Group, Inc.  
<sup>a</sup> \$203.2 billion represents total CPP funds expended before any CPP repayments. JPMorgan, Goldman Sachs, Morgan Stanley, and some other institutions have repaid their TARP funds under CPP.

Source: Treasury, Transactions Report, 7/2/2009.

For more information on the CPP application process, refer to SIGTARP's Initial Report, Section 3: "TARP Implementation and Administration."

TABLE 2.7

| KEY DATES AND DEADLINES FOR CPP APPLICATION PROCESS, BY APPLICANT CATEGORY |                |                      |                        |
|--|----------------|----------------------|------------------------|
| Type   | Announced Date | Application Deadline | Number of Participants |
| Publicly Held <sup>a</sup>   | 10/14/2008     | 11/14/2008           | 282                    |
| Privately Held <sup>b</sup>  | 11/17/2008     | 12/8/2008            | 331                    |
| "S" Corporation <sup>c</sup>   | 1/14/2009      | 2/13/2009            | 36                     |
| Mutual Organizations <sup>d</sup>  | 4/7/2009       | 5/7/2009             | —                      |
| Mutual Banks <sup>e</sup>  | 4/14/2009      | 5/14/2009            | —                      |
| Small Banks <sup>f</sup> (< \$500 million in assets)                       | 5/13/2009      | 11/21/2009           | 10 <sup>g</sup>        |

Notes: Private QFIs are those that are non-public QFIs, excluding S Corporations and mutual organizations.  
<sup>a</sup> Treasury, "Treasury Announces TARP Capital Purchase Program Description," 10/14/2008, [www.treas.gov](http://www.treas.gov), accessed 1/22/2009.  
<sup>b</sup> Treasury, "Process Related FAQs for Private Bank Capital Purchase Program," no date, [www.treas.gov](http://www.treas.gov), accessed 1/22/2009.  
<sup>c</sup> Treasury, "S Corporation FAQs," no date, [www.treas.gov](http://www.treas.gov), accessed 1/22/2009.  
<sup>d</sup> Treasury, "Process Related FAQs for the Capital Purchase Program, Mutual Holding Company FAQs," 4/7/2009, [www.financialstability.gov](http://www.financialstability.gov), accessed 6/7/2009.  
<sup>e</sup> Treasury, "Treasury Releases Capital Purchase Program Term Sheet for Mutual Banks," 4/14/2009, [www.financialstability.gov](http://www.financialstability.gov), accessed 6/7/2009.  
<sup>f</sup> Treasury, "Remarks by Secretary Geithner Before the Independent Community Bankers of America Annual Washington Policy Summit," 5/13/2009, [www.financialstability.gov](http://www.financialstability.gov), accessed 6/7/2009.  
<sup>g</sup> This number excludes publicly held institutions, privately held institutions, and "S" Corps.

In addition, on May 14, 2009, insurance companies that organized themselves under the terms of a BHC and applied within the initial application window were granted preliminary approval to participate in CPP.<sup>47</sup> The application process for these qualified financial institutions is the same as the process for the previously funded QFIs. Key dates for each type of institution that has or may apply for CPP funding are outlined in Table 2.7.

Unique term sheets provide CPP guidance for these three types of mutual holding companies:

- publicly traded, subsidiary holding companies
- privately held, mid-tier subsidiary holding companies
- top-tier, mutual holding companies that do not have subsidiary holding companies

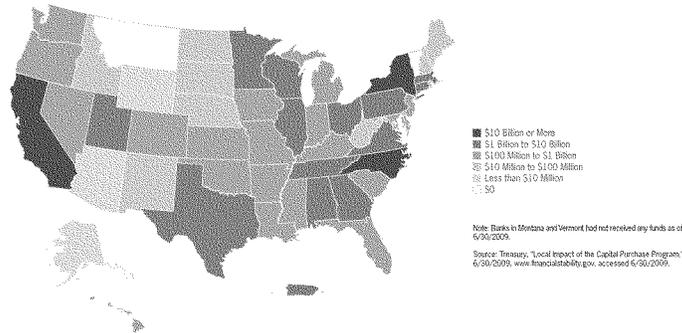
The terms for the publicly traded and privately held subsidiary holding companies are similar to those of public and private corporations receiving preferred shares and warrants currently under CPP.<sup>48</sup>

For its CPP investment in mutual banks and mutual holding companies, the Government will receive senior securities that carry a value equal to and not less than 1% of the recipient firm's risk-weighted assets and not more than \$25 billion or 3% of the recipient firm's risk-weighted assets. This is similar to the amount of preferred shares that are received by Treasury from participating public corporations. The senior securities have a maturity of 30 years and carry interest rates of

**Senior Securities:** A debt or equity security that has a higher priority over others.

**Risk-Weighted Assets:** The amount of a bank's total assets after applying an appropriate risk factor to each asset.

FIGURE 2.6  
TRACKING CAPITAL PURCHASE PROGRAM INVESTMENTS ACROSS THE COUNTRY



7.7% for the first five years and 13.8% for their remaining life. Due to the differing tax structures of mutual organizations, these interest rates approximate the economics of the 5% and 9% dividends required for many other CPP participants, including the publicly held BHCs. Just as it does with a private company under CPP, Treasury will receive warrants to purchase senior securities equal to 5% of the value of the CPP investment.<sup>48</sup> Additionally, on May 13, 2009, the Treasury Secretary announced that the CPP application window would be re-opened for banks with assets under \$500 million until November 21, 2009.<sup>49</sup> According to Treasury, it will be using the repayments of some of the largest banks to fund this expansion, which will permit small banks to receive an amount up to 5% of their risk-weighted assets. These increases apply to all QFIs with assets under \$500 million, including public and private corporations, S corporations, and mutual institutions.<sup>51</sup>

**Status of CPP Funds**

As of June 30, 2009, Treasury had purchased \$203.2 billion in preferred stock and subordinated debentures from 649 different QFIs in 48 states, the District of Columbia, and Puerto Rico. Closings for CPP purchases generally occur each week on Friday, and information regarding the transactions are made publicly available by the following Tuesday. For geographical distribution of all the QFIs that have received funding see Figure 2.6. For a full listing of CPP recipients, see Appendix D: “Transaction Detail.”

Although the original eight largest investments accounted for \$134.2 billion of the program, CPP has also had many more modest investments: 301 of 649 recipients received \$10 million or less.<sup>52</sup> Table 2.8 and Table 2.9 show the distribution of the investments by size.

TABLE 2.8

| CPP ORIGINAL INVESTMENT SUMMARY |                 |
|---------------------------------|-----------------|
| Largest Capital Investment      | \$25 Billion    |
| Smallest Capital Investment     | \$301,000       |
| Average Capital Investment      | \$312.1 Million |
| Median Capital Investment       | \$11.8 Million  |

Notes: Numbers affected by rounding. Data as of 6/30/2009. These numbers are based on total Treasury CPP investment since 10/28/2008. Bank of America Corporation and SunTrust Banks, Inc., each received investments in two separate transactions.

Sources: Treasury, Transactions Report, 7/2/2009. Treasury response to SICARP draft report, 7/13/2009.

TABLE 2.9

| CPP ORIGINAL INVESTMENT SIZE |            |
|------------------------------|------------|
| \$10 Billion or More         | 6          |
| \$1 Billion to \$10 Billion  | 19         |
| \$100 Million to \$1 Billion | 56         |
| Less than \$100 Million      | 568        |
| <b>Total</b>                 | <b>649</b> |

Notes: Data as of 6/30/2009. These numbers are based on total Treasury CPP investment since 10/28/2008. Bank of America Corporation and SunTrust Banks, Inc., each received investments in two separate transactions.

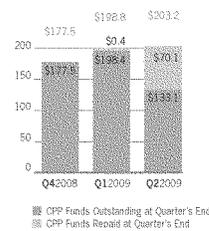
Source: Treasury, Transactions Report, 7/2/2009.

For more information on CPP repayment, see Section 2, "TARP Overview" in SIGTARP's April Quarterly Report.

Federal Banking Agency ("FBA"). One of four agencies:

- 1) Comptroller of the Currency
- 2) Board of Governors of the Federal Reserve System
- 3) Federal Deposit Insurance Corporation
- 4) Office of Thrift Supervision

FIGURE 2.7  
SNAPSHOT OF CPP FUNDS OUTSTANDING AND REPAYED, BY QUARTER  
\$ Billions



Note: Numbers affected by rounding.  
Source: Treasury, Transactions Report, 7/2/2009.

### Repayment of Funds

According to the CPP contracts between Treasury and the institutions, banks were not permitted to repay their CPP funds, subject to certain limitations, within the first three years; however, this portion of the agreement was changed by the enactment of the American Recovery and Reinvestment Act of 2009 ("ARRA"), which required Treasury to permit financial institutions to repay the capital infusions, subject to their consultation with the appropriate Federal Banking Agency ("FBA").<sup>53</sup>

Institutions seeking to buy back their preferred shares, in essence repay their TARP funds, must meet the standards required by their respective banking supervisor. According to Treasury, FBA supervisors will determine if the interested CPP recipient has sufficient equity without the CPP funds, an ability to lend, and a comprehensive internal capital-assessment process.<sup>54</sup> On June 1, 2009, the Federal Reserve announced additional specific criteria that it will use to review any request for repayment of CPP funds from the top 19 BHCs included in the Supervisory Capital Assessment Program ("SCAP") process.<sup>55</sup>

- fulfill its role as an intermediary to provide lending to creditworthy households and businesses without TARP capital
- maintain levels of capital consistent with supervisory expectations
- serve as financial and managerial support to its subsidiaries
- be able to access equity on the private markets
- meet its obligations and lending without reliance on FDIC's Temporary Liquidity Guarantee Program ("TLGP") (For more information on this program, see "TARP in Context — Other Government Programs to Assist the Financial Sector," in Section 3 of this report.)
- carry a capital level necessary to meet the more adverse economic scenarios under the SCAP testing

For further details on SCAP, refer to the "Capital Assistance Program" discussion later in this section.

As of June 30, 2009, 32 banks had repurchased their shares from Treasury. Treasury has received \$70.1 billion in principal and an additional \$316.1 million in accrued and unpaid dividends.<sup>56</sup> Figure 2.7 shows the amount of CPP funds outstanding, adjusted for repayments. For details of share repurchases conducted as of June 30, 2009, see Appendix D: "Transaction Detail."

### Repurchase of Warrants

To maximize the benefit to the taxpayer, EESA mandated that Treasury receive warrants when it invests in troubled assets. The warrants for publicly traded institutions provide Treasury the right to purchase shares of common stock, or, in the case

of non-publicly traded institutions, preferred stock or debt at a fixed price.<sup>57</sup> Under CPP, the warrants expire in 10 years. As of June 30, 2009, Treasury had not exercised its right under the warrants to purchase common shares in any of the public institutions but had done so for non-public institutions.<sup>58</sup>

With institutions beginning to repay their CPP funds, the U.S. Government has clarified its treatment of warrant repurchases in various ways. Under the standard CPP Securities Purchase Agreement ("SPA") and ARRA, publicly traded TARP recipients have the right to repurchase their warrants with proper notice to Treasury at the fair market value. Non-public TARP recipients have the right to repurchase the preferred shares and subordinated debt that Treasury took when it immediately exercised the warrants at the time their CPP transactions closed.<sup>59</sup> ARRA states that, following the repayment of TARP funding, Treasury "shall liquidate warrants associated with such assistance at the current market price."<sup>60</sup> On May 20, 2009, Congress passed the Helping Families Save Their Homes Act of 2009 (Public Law No. 111-22), which amended the ARRA provision requiring Treasury to liquidate its warrants immediately upon TARP repayment. Specifically, the phrase "shall liquidate" was changed to "may liquidate"—indicating that Treasury has discretion in deciding when it should sell or exercise its warrants.<sup>61</sup>

On June 26, 2009, Treasury announced guidance for the warrant repurchase process for publicly traded institutions. If an institution wishes to repurchase warrants from Treasury, it must first take the following steps:<sup>62</sup>

**Step 1: Notification to Treasury with Determination of Fair Market Value**

Any institution wishing to repurchase its warrants must notify Treasury within 15 days of repayment of TARP funds.<sup>63</sup> According to the CPP SPA, the notification must include the number of warrants to be repurchased and the determination of fair market value from the board of directors. Moreover, the board of directors must be acting in good faith with reliance on an "independent investment banking firm." The independent appraiser must be retained by the TARP recipient and approved by Treasury.<sup>64</sup>

**Step 2: Treasury Evaluates Repurchase Offer**

According to the CPP SPA and the guidance announced by Treasury, Treasury will have 10 days to evaluate the TARP recipient's offer of fair market value as required by ARRA.<sup>65</sup> According to Treasury, it will be using three different valuation methodologies to determine market values of the warrants:<sup>66</sup>

- **market-price approach** — For those warrants listed on a securities exchange, current market value is used. However, many of the warrants that Treasury

holds are not listed on a securities exchange. In these cases, Treasury will use market prices of securities with similar characteristics to assess the market value of the warrants. Securities with similar characteristics include traded warrants, traded options, common equity, and securities listed by similar institutions. Treasury has stated that it will be using 5-10 market participants, such as investment banks and asset management firms, to provide quotes on the value of the warrants.

- **financial models** — Treasury stated that it will conduct valuations based on well-known, common financial models, such as the binomial and Black-Scholes models. The models use various known inputs as well as assumptions about the volatility and dividends of the common stock of the institution to calculate the value of the warrants. To measure the volatility and assumptions of the common stock, Treasury will be using a 60-day trailing volatility for the past 10 years of the common stock price.
- **third-party valuation** — Treasury will be using the three asset managers that it has hired to manage TARP assets and other outside consultants to assess independently the value of each institution's warrants.

#### **Step 3: Negotiation Period**

Should Treasury reject the TARP recipient's repurchase offer, the Chief Executive Officer ("CEO") of the TARP recipient and a representative of Treasury shall meet to discuss Treasury's objections to the valuation proposed by the TARP recipient and attempt to reach an agreement.<sup>67</sup> As of June 30, 2009, all of the warrant repurchases have occurred as a product of this negotiation period.<sup>68</sup>

#### **Step 4: Appraisal Procedure**

If, in 10 days, no price is agreed upon, either the institution or Treasury may invoke the "Appraisal Procedure." This involves Treasury and the TARP recipient each choosing an independent appraiser to agree mutually upon the fair market value of the warrants. If, after 30 days, the two appraisers are not able to agree upon a fair market value, then a third independent appraiser will be chosen with the consent of the first two appraisers.<sup>69</sup> The third appraiser has 30 days to make a decision, and, subject to limitations — such as if one of the three valuations is significantly different from the other two — a composite valuation of the three appraisals is used to establish the fair market value.<sup>70</sup> Treasury and the institution will be bound by this price determination, but Treasury has stated that if the recipient is not satisfied with this price, it may withdraw its notification to repurchase the warrants.<sup>71</sup> Under the CPP SPA, the costs of conducting any appraisal procedure "shall be borne by the Company."<sup>72</sup>

#### **Alternate Disposition of Warrants**

If the institution and Treasury do not invoke the "Appraisal Procedure," or if the institution decides not to seek to repurchase its warrants, Treasury has various

options as to how it manages these investments over the 10-year exercisable period — it may sell them, exercise them, or hold them as it sees fit to otherwise maximize benefit to the taxpayers. When selling the warrants on the open market, Treasury has stated that it will do so through an auction process. As of June 30, 2009, guidance on this auction process has not yet been released.<sup>73</sup> Treasury has stated that it intends to liquidate the warrants of institutions that have redeemed their CPP preferred shares quickly.<sup>74</sup> While under the SPA, Treasury also has the right to auction 50% of the warrants of financial institutions that have not yet repaid TARP funds;<sup>75</sup> as of June 30, 2009, it had not done so.

As of June 30, 2009, 11 banks had repurchased their warrants for a total of \$18.7 million,<sup>76</sup> while three private institutions whose warrants were immediately exercised into preferred shares had repurchased those shares for a total of \$1.6 million.<sup>77</sup> For a list of institutions, both public and private, that have repaid their TARP funds and repurchased their warrants as of June 30, 2009, see Table 2.10. These institutions are no longer part of TARP.

TABLE 2.10

| CPP WARRANT REPURCHASES (PUBLIC) (S MILLIONS)  |   |                                |                                      |
|--|---|--------------------------------|--------------------------------------|
| Repurchase Date                                | Institution   | Number of Warrants Repurchased | Amount of Repurchase as of 6/30/2009 |
| 5/8/2009                                       | Old National Bancorp                                  | 813,008                        | \$1.2                                |
| 5/20/2009                                      | Iberiabank Corporation <sup>a</sup>                   | 138,490                        | 1.2                                  |
| 5/27/2009                                      | FirstMerit Corporation                                | 952,260                        | 5.0                                  |
| 5/27/2009                                      | Sun Bancorp, Inc.                                     | 1,543,376                      | 2.1                                  |
| 5/27/2009                                      | Independent Bank Corp.                                | 481,664                        | 2.2                                  |
| 6/17/2009                                      | Alliance Financial Corporation                        | 173,069                        | 0.9                                  |
| 6/24/2009                                      | First Niagara Financial Group <sup>b</sup>            | 953,096                        | 2.7                                  |
| 6/24/2009                                      | Berkshire Hills Bancorp, Inc.                         | 226,330                        | 1.0                                  |
| 6/24/2009                                      | Somerset Hills Bancorp                                | 163,065                        | 0.3                                  |
| 6/24/2009                                      | SCBT Financial Corporation                            | 303,083                        | 1.4                                  |
| 6/30/2009                                      | HF Financial Corp.                                    | 302,419                        | 0.7                                  |
| <b>Total Warrants – Public</b>                 |   | <b>6,049,860</b>               | <b>\$18.7</b>                        |
| CPP WARRANT REPURCHASES (PRIVATE) (S MILLIONS) |   |                                |                                      |
| Repurchase Date                                | Institution   | Number of Preferred Shares     | Amount of Repurchase as of 6/30/2009 |
| 4/15/2009                                      | Centra Financial Holdings, Inc./<br>Centra Bank, Inc. | 750                            | \$0.8                                |
| 4/22/2009                                      | First ULB Corp.                                       | 245                            | 0.2                                  |
| 5/27/2009                                      | First Manitowoc Bancorp, Inc.                         | 600                            | 0.6                                  |
| <b>Total Preferred Shares – Private</b>        |   | <b>1,595</b>                   | <b>\$1.6</b>                         |

Notes: Numbers affected by rounding. Data as of 6/30/2009. This does not include the \$60 million warrant repurchase by State Street Corporation that occurred on 7/8/2009.

<sup>a</sup> These institutions reduced the original amount of warrants issued through a qualified equity offering.

Source: Treasury, Transactions Report, 7/2/2009.

#### Treasury Lending Snapshots

Treasury snapshots were instituted in January 2009 as a means to track progress toward the stated goal of CPP: “building a capital base of viable U.S. financial institutions, enabling them to continue lending to businesses and consumers during this unprecedented financial crisis and economic downturn.”<sup>78</sup> Treasury continues to measure the lending activities of CPP recipients by performing both monthly and quarterly data analysis.<sup>79</sup> There are currently two types of monthly reports issued on CPP. Originally, the monthly intermediation snapshots were conducted for the 21 largest CPP participants. In March 2009, Treasury announced that it would require all CPP participants to submit data for a new monthly lending report that complements the monthly intermediation snapshots. The first monthly lending report for all CPP participants was published on June 1, 2009, and included data for February and March of 2009. A second monthly lending report with April data was issued on June 19, 2009. Going forward, this report will be released around the 20<sup>th</sup> of each month.<sup>80</sup> As of June 30, 2009, information from the 21 largest CPP participants had been collected and released through April 2009.

#### April 2009 Monthly Intermediation Snapshot

The most recent monthly intermediation snapshot for the 21 largest CPP recipients was released on June 15, 2009, reporting data for the period of April 1, 2009, to April 30, 2009. The responses found a decline in total new lending of 7% from March to April; the report also included new information on small-business lending that will be reported in all surveys going forward. Treasury reviewed and analyzed the data and came to the following conclusions:<sup>81</sup>

- Consumer lending levels decreased as a result of a weakening labor market and declines in household wealth.
- Commercial and industrial lending was reportedly “well below normal levels.”
- Banks reported \$267 billion in outstanding small-business loan balances, with \$8 billion in small-business loan originations over the month.

#### Capital Assistance Program

On February 10, 2009, Treasury announced the Capital Assistance Program (“CAP”).<sup>82</sup> The CAP process has two main steps for the 19 largest BHCs (all other QFIIs need not participate in the first step but have the option to participate in the second step).<sup>83</sup>

- a “stress test” (also known as the Supervisory Capital Assessment Program (“SCAP”)) to evaluate the 19 largest BHCs’ capital levels for their ability to withstand an adverse economic scenario

*For more information on the Capital Assistance Program, refer to SIGTARP’s April Quarterly Report, Section 2: “TARP Overview.”*

- an application to Treasury for funding in the form of additional capital infusions or as a means to convert CPP investments to CAP mandatorily convertible preferred ("MCP") shares (available to all QFHs)

CAP's stated goal is to "ensure the continued ability of U.S. financial institutions to lend to creditworthy borrowers in the face of a weaker-than-expected economic environment and larger-than-expected potential losses."<sup>84</sup> As of June 30, 2009, one institution had applied for but had not yet been approved for CAP.

Since SIGTARP's April Quarterly Report, the Federal Reserve released the results of SCAP and provided recommendations for further actions that certain institutions will need to take to meet enhanced capital requirements. Of the 19 institutions that participated in SCAP, the Federal Reserve determined that 10 needed approximately \$75 billion total in additional capital, and the other 9 institutions had sufficient capital to cover potential losses even in the more adverse scenario.<sup>85</sup>

Upon publication of the SCAP results, Treasury announced a November 9, 2009, deadline for those 10 institutions that need to raise additional capital to meet the enhanced capital requirements. Treasury also extended the application deadline for all institutions wishing to participate in CAP to November 9, 2009.<sup>86</sup> For a timeline and description of the CAP process, see Figure 2.8 on the next page.

#### Supervisory Capital Assessment Program ("SCAP")

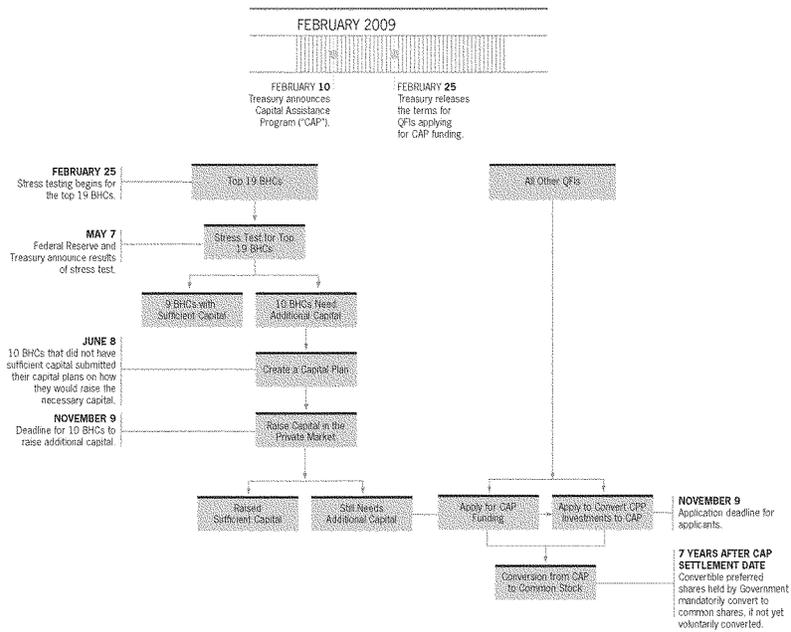
SCAP, otherwise known as the "stress test," was a key component of CAP. The stress test was conducted by the FBAs with the stated intention of ensuring that the largest financial institutions have sufficient capital to cover losses and continue lending in a more adverse economic scenario than was anticipated at the time the tests were conducted. All domestic BHCs with assets exceeding \$100 billion at the end of 2008 were required to participate. At the end of 2008, there were 19 BHCs with assets of more than \$100 billion, representing roughly two-thirds of aggregate U.S. BHC assets.<sup>87</sup>

According to the Federal Reserve, the stress test was a forward-looking exercise utilizing both a baseline and adverse scenario of the economy for the next two years. The test was administered by various teams of supervisors and analysts from the FBAs with specialized knowledge of the participating firms or expertise in specific asset classes or securities.<sup>88</sup>

On May 7, 2009, the Federal Reserve released the results of the SCAP process, revealing that 9 of the 19 BHCs had sufficient capital to withstand the most adverse scenario of the tests. As of June 30, 2009, eight of the nine institutions that had sufficient capital under SCAP were approved by their FBAs and had repaid their CPP funds, but had outstanding warrants owned by the Government. As of the drafting of this report, State Street Corporation repurchased its related warrants for \$60 million making it the only institution out of the nine to be out of

Mandatorily Convertible Preferred ("MCP") shares: A type of preferred share (ownership in a company that generally entitles the owner of the shares to collect dividend payments) that can be converted to common stock under certain parameters at the discretion of the company — and must be converted to common stock by a certain time.

FIGURE 2.8  
CAPITAL ASSISTANCE PROGRAM PROCESS AND TIMELINE



Note: Many of the 10 BHCs have raised significant funds on their own, which could seemingly limit their need for CAP.  
 Sources: Federal Reserve, "Banking Organizations Have Submitted Capital Plans to Bolster Their Capital," 6/8/2009, [www.federalreserve.gov](http://www.federalreserve.gov), accessed 6/8/2009; Treasury, "Statement from Treasury Secretary Tim Geithner Regarding the Treasury Capital Assistance Program and the Supervisory Capital Assessment Program," 5/7/2009, [www.financialstability.gov](http://www.financialstability.gov), accessed 5/7/2009; Treasury, "Secretary Geithner Introduces Financial Stability Plan," 2/10/2009, [www.treas.gov](http://www.treas.gov), accessed 3/25/2009; Treasury Press Release, "1.0," Treasury Releases Terms of Capital Assistance Program, 2/25/2009, [www.treas.gov](http://www.treas.gov), accessed 3/25/2009; Treasury, "Summary of Mandatorily Convertible Preferred Stock Terms," 3/25/2009, [www.treas.gov](http://www.treas.gov), accessed 3/25/2009.

TARP.<sup>89</sup> The ninth BHC, MetLife, is not a TARP recipient. The other 10 BHCs need to raise an additional \$75 billion total of new capital in order to meet the capital level deemed necessary to withstand a more adverse economic scenario. Options for raising the needed capital for these institutions include, but are not limited to: issuing common stock, exchanging preferred shares for common shares, selling non-core businesses, increasing corporate earnings, or applying for CAP investments. Those failing to raise private funds would be required to take CAP funds or convert their CPP funds to mandatory convertible shares; however, many financial institutions have raised significant funds on their own, which could seemingly limit their need for CAP.<sup>90</sup> Nine of the 10 BHCs needing additional capital have begun raising this capital in the private markets; the remaining BHC, Morgan Stanley, has already raised its additional capital and repaid its TARP funding.

#### SCAP Assumptions

The stress test was designed to determine how much additional capital each institution may need to remain well capitalized in adverse economic conditions until the end of 2010. Well capitalized was a standard defined as being able to maintain a 6% tier one risk-based capital ratio ("T1 Ratio") and a 4% tier one common risk-based ratio ("T1 Common Ratio"), which is also known as a tangible common equity ratio ("TCE Ratio").<sup>91</sup> Generally, the Federal Reserve's risk-based capital guidelines for BHCs require a minimum 4% T1 Ratio; however, supervisors expect BHCs to hold T1 well in excess of the minimum ratio. Supervisors have indicated that common equity (the component of T1 most able to absorb losses) should be the dominant component of T1. The calculation of a T1 Common Ratio assessed the composition of the BHCs' T1 Ratio to determine whether common equity was sufficiently dominant. Once these two ratios were calculated, supervisors followed the normal supervisory evaluation process to determine whether a firm's current capital was sufficient in light of its risk profile.<sup>92</sup> SCAP's required ratios are higher than current Federal regulations.

In SCAP, the regulators created two forward-looking economic scenarios. The first scenario was a baseline forecast for 2009 and 2010 based on the most recent projections available from three professional forecasters prior to the start of the stress test on February 25, 2009.<sup>93</sup> Although the baseline was intended to forecast likely economic metrics, the unemployment rate eclipsed the baseline assumption of an annual average of 8.4% unemployment with the June 2009 unemployment rate of 9.5%.<sup>94</sup> The second scenario evaluated the institutions under worse economic conditions than those provided in the baseline forecast — an "adverse case" scenario. The assumptions for the baseline and adverse case compared to the

**Tier One Capital ("T1") vs. Tier One Common ("T1 Common")**  
Two of the most relevant measures of capital adequacy are tier one capital ("T1") and tier one common ("T1 Common"). For many TARP recipients, these two measures are significantly divergent in the current market, capturing different aspects of the institution's health or lack thereof.

T1 or "core capital" consists primarily of common equity (including retained earnings), limited types and amounts of preferred equity, certain minority interests, and limited types and amounts of trust preferred securities. T1 does not include goodwill and certain other intangibles. Certain other assets are also excluded from T1. It can be described as a measure of the bank's ability to sustain future losses and still meet depositor's demands. Federal regulators look at T1 to calculate the tier one capital ratio ("T1 Ratio"), which determines what percentage of a bank's total assets is categorized as T1. Under traditional Federal regulations, a bank with a T1 Ratio of 4% or greater is considered adequately capitalized.

T1 Common, also known as tangible common equity ("TCE"), is calculated by removing all non-common elements from T1, e.g., preferred equity, minority interests, and trust preferred securities. It can be thought of as the amount that would be left over if the bank were dissolved and all creditors and higher levels of stock, such as preferred stock, were paid off. T1 Common is the highest "quality" of capital in the sense of providing a buffer against loss by claimants on the bank. T1 Common is used in calculating the tier one common risk-based ratio ("T1 Common Ratio") which determines what percentage of a bank's total assets is categorized as T1 Common. The higher the percentage, the better capitalized the bank. Preferred stock is an example of capital that is counted in T1, but not in T1 Common. For more information on a bank's capital structure, see the "Capital Structure Tutorial" in SIGTARP's April Quarterly Report.

Tier One Capital ("T1") = Common stockholders' equity + Preferred equity (subject to regulatory limits) + Minority interests + Trust preferred securities (subject to regulatory limits) – Goodwill – Certain other assets (subject to regulatory limits).

Tier One Common Equity ("T1 Common") = T1 – Preferred equity – Minority interests – Trust preferred securities.

Tier One Risk-based Capital Ratio ("T1 Ratio") = T1/Risk-weighted assets

Tier One Common Risk-based Ratio ("T1 Common Ratio") = T1 Common / Risk-weighted assets

Professional Forecasters: Economic expert firms that use various economic data to publish their own projections. The three forecasters used for the purpose of the stress test were the Consensus Forecasts, the Blue Chip Survey, and the Survey of Professional Forecasters. They are independent of Treasury.

SCAP Buffer: The amount of capital needed for an institution to sustain a 6% Tier One Ratio and a 4% Tangible Common Equity Ratio under the more adverse economic scenario.

economic indicators as of June 30, 2009, are in Table 2.11, and demonstrate that as of June 30, 2009, two of the three indicators (Real GDP and Unemployment) indicate that the economic downturn may be more severe than even the adverse scenario for 2009.

To understand how much capital is needed to withstand a certain amount of losses and still maintain a capital buffer of at least a 6% T1 Ratio and at least a 4% T1 Common Ratio, the BHCs were asked by their FBA regulators to project estimated losses on loans, securities, and trading-related exposures based upon 2008 year-end financial data.<sup>35</sup>

According to the Federal Reserve, under the more adverse scenario, together the 19 BHCs had approximately \$837 billion in T1, \$413 billion of which was T1 Common. These BHCs estimated their net losses to be \$185 billion for 2009 and 2010. That would leave them with a required SCAP buffer of \$74.6 billion under the adverse scenario. When calculating the required SCAP buffer, FBAs took into account financial results and any actions that BHCs may have taken during the first quarter of 2009.<sup>36</sup> For example, SCAP took into account Citigroup's announced exchange offer on February 27, 2009. The announced offer was to convert private preferred and Treasury's CPP investments to common equity, which

TABLE 2.11

|  | 2009 Scenarios |              | 2010 Scenarios |              | Economic Indicators, as of 6/30/2009 |
|--|----------------|--------------|----------------|--------------|--------------------------------------|
|  | Baseline       | More Adverse | Baseline       | More Adverse |                                      |
| Real GDP (% Change in Annual Average)                | (2.0%)         | (3.3%)       | 2.1%           | 0.5%         | (5.5%)                               |
| Annual Average Civilian Unemployment Rate            | 8.4%           | 8.9%         | 8.8%           | 10.3%        | 9.5% <sup>a</sup>                    |
| House Prices (% Change Relative to Q4 of Prior Year) | (14.0%)        | (22.0%)      | (4.0%)         | (7.0%)       | (18.6%) <sup>b</sup>                 |

Notes: As reported by the source document, baseline forecasts for real GDP and the unemployment rate equal the average of projections released by Consensus Forecasts, the Blue Chip Survey, and the Survey of Professional Forecasters in February 2009.

<sup>a</sup> 9.5% is the annualized rate, not the "annual average."

<sup>b</sup> Number is based off of the S&P Case-Shiller 10-city Home Price Index for first quarter of 2009.

Sources: Federal Reserve, "The Supervisory Capital Assessment Program: Design and Implementation," 4/24/2009; Real GDP as of 6/30/2009: Bureau of Economic Analysis, "Gross Domestic Product, 1<sup>st</sup> quarter 2009 (final)," 6/25/2009, www.bea.gov, accessed 7/9/2009; Unemployment rate as of 6/30/2009: Department of Labor, "The Employment Situation: June 2009," 6/30/2009, www.bls.gov, accessed 7/9/2009; Changes in Housing Prices as of 6/30/2009: Treasury Office of Debt Supervision, "First Quarter 2009 TRRP Industry Report — Economic Data," 6/2/2009, www.fes.ots.treas.gov, accessed 7/10/2009.

in effect, increased its T1 Common. The terms of the exchange offer subsequently were finalized on June 9, 2009, and are described later in this section.

Table 2.12 shows the SCAP buffer calculation in aggregate for all 19 BHCs under the more "adverse" scenario. Table 2.13 shows the results of SCAP for the 10 BHCs needing additional capital, and Table 2.14 shows the results of SCAP for the 9 BHCs that have sufficient capital to withstand the more adverse scenario detailed under SCAP.

#### Post-SCAP Alternatives

On June 8, 2009, the 10 BHCs requiring additional capital to meet the capital buffer requirement submitted detailed capital plans to their FBAs outlining how they planned to raise the necessary capital. According to the Federal Reserve, these capital plans, when implemented, "would provide sufficient capital to meet the required buffer under the assessment's more adverse scenario."<sup>92</sup> The Federal Reserve has also stated that it will work with the institutions to ensure their plans get

TABLE 2.12

| SCAP RESULTS FOR THE LARGEST 19 BHCs (\$ BILLIONS)                  |                |
|---|----------------|
| Tier One Capital  | \$836.7        |
| Tier One Common Capital (included in above amount)                  | 412.5          |
| Total Estimated Losses  | (599.2)        |
| Add Purchase Accounting Adjustments                                 | 64.3           |
| Add Resources other than Capital to Absorb Losses                   | 362.9          |
| <b>SCAP Buffer as of 12/31/2008</b>                                 | <b>\$185.0</b> |
| Less Capital Actions and Effects of 1 <sup>st</sup> Quarter Results | 110.4          |
| <b>Required SCAP Buffer</b>   | <b>\$74.6</b>  |

Source: Board of Governors of the Federal Reserve, "The Supervisory Capital Assessment Program: Overview of Results," 5/7/2009.

TABLE 2.13

| SCAP RESULTS FOR INSTITUTIONS NEEDING ADDITIONAL CAPITAL (\$ BILLIONS) |                 |               |               |              |              |              |                |              |              |              |               |
|--|-----------------|---------------|---------------|--------------|--------------|--------------|----------------|--------------|--------------|--------------|---------------|
|  | Bank of America | Wells Fargo   | GMAC          | Citigroup    | Regions      | Sun Trust    | Morgan Stanley | KeyCorp      | Fifth Third  | PNC          | Total         |
| Tier One Capital   | \$173.2         | \$86.4        | \$17.4        | \$118.8      | \$12.1       | \$17.6       | \$47.2         | \$11.6       | \$11.9       | \$24.1       |               |
| Tier One Common Capital  | 74.5            | 33.9          | 11.1          | 22.9         | 7.6          | 9.4          | 17.8           | 6.0          | 4.9          | 11.7         |               |
| Total Estimated Losses   | 136.6           | 86.1          | 9.2           | 104.7        | 9.2          | 11.8         | 19.7           | 6.7          | 9.1          | 18.8         |               |
| Purchase Accounting Adjustments  | 13.3            | 23.7          | —             | —            | —            | —            | —              | —            | —            | 5.9          |               |
| Projected Non-Capital Resources <sup>a</sup>                           | 74.5            | 60.0          | (0.5)         | 49.0         | 3.3          | 4.7          | 7.1            | 2.1          | 5.5          | 9.6          |               |
| SCAP Shortfall as of 12/31/2008  | 46.5            | 17.3          | 6.7           | 92.6         | 2.9          | 3.4          | 8.3            | 2.5          | 2.6          | 2.3          |               |
| 1 <sup>st</sup> Quarter Results and Actions                            | 12.7            | 3.6           | (4.8)         | 87.1         | 0.4          | 1.3          | 6.5            | 0.6          | 1.5          | 1.7          |               |
| <b>Additional Capital Required</b>                                     | <b>\$33.9</b>   | <b>\$13.7</b> | <b>\$11.5</b> | <b>\$5.5</b> | <b>\$2.5</b> | <b>\$2.2</b> | <b>\$1.8</b>   | <b>\$1.8</b> | <b>\$1.1</b> | <b>\$0.6</b> | <b>\$74.6</b> |

Notes: Numbers affected by rounding.

<sup>a</sup> Resources include Pre-provision Net Revenue (PPNR) and the resources available from the allowance for loan and lease losses.

Source: Board of Governors of the Federal Reserve, "The Supervisory Capital Assessment Program: Overview of Results," 5/7/2009.

TABLE 2.14

| SCAP RESULTS FOR INSTITUTIONS NOT NEEDING ADDITIONAL CAPITAL (S BILLIONS) |                     |          |                      |            |                  |                   |         |                 |        |
|---|---------------------|----------|----------------------|------------|------------------|-------------------|---------|-----------------|--------|
|   | American<br>Express | BB&T Co. | Bank of NY<br>Mellon | CapitalOne | Goldman<br>Sachs | JPMorgan<br>Chase | MetLife | State<br>Street | USB    |
| Tier One Capital  | \$10.1              | \$13.4   | \$15.4               | \$16.8     | \$55.9           | \$136.2           | \$30.1  | \$14.1          | \$24.4 |
| Tier One Common<br>Capital  | 10.1                | 7.8      | 11.0                 | 12.0       | 34.4             | 87.0              | 27.8    | 10.8            | 11.8   |
| Total Estimated Losses  | 11.2                | 8.7      | 5.4                  | 13.4       | 17.8             | 97.4              | 9.6     | 8.2             | 15.7   |
| Purchase Accounting<br>Adjustments  | —                   | —        | —                    | 1.5        | —                | 19.9              | —       | —               | —      |
| Projected Non-Capital<br>Resources <sup>2</sup>                           | 11.9                | 5.5      | 6.7                  | 9.0        | 18.5             | 72.4              | 5.6     | 4.3             | 13.7   |
| SCAP Shortfall as of<br>12/31/2008  | —                   | —        | —                    | —          | —                | —                 | —       | —               | —      |
| 1 <sup>st</sup> Quarter Results and<br>Actions                            | 0.2                 | 0.1      | (0.2)                | (0.3)      | 7.0              | 2.5               | 0.6     | 0.2             | 0.3    |
| <b>Additional Capital<br/>Required</b>                                    | —                   | —        | —                    | —          | —                | —                 | —       | —               | —      |

Notes: Numbers affected by rounding.

<sup>2</sup> Resources include PPMR and the resources available from the allowance for loan and lease losses.

Source: Board of Governors of the Federal Reserve, "The Supervisory Capital Assessment Program: Overview of Results," 5/7/2009.

implemented quickly and are completed by the November 9, 2009, capital-raising deadline.<sup>98</sup> The capital plan must include the following:<sup>99</sup>

- detailed description of the actions that will be taken to raise the amount of capital and/or type of capital needed to meet the SCAP buffer
- list of steps to address weaknesses in the BHC's internal processes for managing and maintaining effective capital
- outline of steps that the BHC will take to repay TARP funds over an allotted time and reduce reliance on guarantees through FDIC's TLGP

Should a BHC not meet its required SCAP buffer by November 9, 2009, it will have to take additional capital assistance through CAP. This may include either Treasury-approved conversion of the BHC's CPP investment to CAP MCP shares or the issuance of new CAP MCP shares.<sup>100</sup> As of June 30, 2009, many financial institutions have raised significant funds on their own, which could seemingly limit their need for CAP. Table 2.15 shows how the following banks have already begun to raise capital in different ways.

**Status of CAP**

According to Treasury, those institutions that were not part of SCAP have until November 9, 2009, to apply for the CAP program. When applying for CAP, QFIs can either apply directly for additional TARP funding in the form of CAP MCP shares or apply to convert their CPP preferred shares in exchange for CAP MCP shares.<sup>101</sup> As of June 30, 2009, only one institution had applied for CAP, and none had yet been funded.

*For more information on the Capital Assistance Program terms and conditions, see SIGTARP's April Quarterly Report, Section 2: "TARP Overview."*

TABLE 2.15

| SCAP PROGRESS AS OF 6/30/2009 (\$ BILLIONS) |                                      |  |                             |  |
|---|--------------------------------------|--|-----------------------------|--|
| Financial Institution                       | Capital Needed per SCAP <sup>1</sup> | Capital Raised/Announced as of 6/30/2009 | Capital Needed by 11/9/2009 | Method of Raising Capital  |
| Bank of America <sup>2</sup>                | \$33.9                               | \$33.9                                   | —                           | Exchange offering, common equity offering, reduced dividends, gain from dispositions                                     |
| Citigroup <sup>3</sup>                      | 5.5                                  | 5.5                                      | —                           | Expanded already announced exchange offer  |
| Fifth Third Bancorp <sup>4</sup>            | 1.1                                  | 2.2                                      | —                           | Exchange offering, tender offering   |
| GMAC LLC <sup>5</sup>                       | 11.5                                 | 3.5                                      | 8.0                         | Received \$7.5 billion from MCP share issuance to Treasury through AFP (\$3.5 billion used to meet capital requirements) |
| Keycorp <sup>6</sup>                        | 1.8                                  | 1.3                                      | 0.5                         | Exchange offering  |
| Morgan Stanley <sup>7,8</sup>               | 1.8                                  | 2.2                                      | —                           | Public equity offering   |
| PNC <sup>9</sup>                            | 0.6                                  | 0.6                                      | —                           | At-the-market equity offering  |
| Regions Financial Corp <sup>10</sup>        | 2.5                                  | 2.5                                      | —                           | Exchange offering  |
| SunTrust <sup>11</sup>                      | 2.2                                  | 2.1                                      | 0.1                         | Equity offering, tender offering   |
| Wells Fargo <sup>12</sup>                   | 13.7                                 | 8.6                                      | 5.1                         | Equity offering  |
| <b>Total</b>                                | <b>\$74.6</b>                        | <b>\$62.5</b>                            | <b>\$13.7</b>               |  |

Notes: Numbers affected by rounding. Data as of 6/30/2009.

## Sources:

<sup>1</sup> Bank of America, "Press Release," 6/25/2009, [www.bankofamerica.com/index.php?i=43&item=8485](http://www.bankofamerica.com/index.php?i=43&item=8485), accessed 6/23/2009.

<sup>2</sup> Citigroup Inc., "Press Release," 5/7/2009, [www.citigroup.com/citi/press/2009/09/05073.htm](http://www.citigroup.com/citi/press/2009/09/05073.htm), accessed 6/30/2009.

<sup>3</sup> Fifth Third Bancorp, 8-K, 5/4/2009, [www.sec.gov](http://www.sec.gov), accessed 6/23/2009.

<sup>4</sup> Treasury, Transaction Report, 7/2/2009, [www.financialstability.gov](http://www.financialstability.gov), accessed 7/2/2009.

<sup>5</sup> Keycorp, "Press Release," 6/3/2009, [www.snl.com/newslink/Re.asp?ID=10033487&ID=7893273](http://www.snl.com/newslink/Re.asp?ID=10033487&ID=7893273), accessed 6/23/2009.

<sup>6</sup> Morgan Stanley, "Press Release," 6/2/2009, [www.morganstanley.com/about/press/articles/be07116-49f1-11d9-9616-3f25a44c9933.html](http://www.morganstanley.com/about/press/articles/be07116-49f1-11d9-9616-3f25a44c9933.html), accessed 6/23/2009.

<sup>7</sup> Morgan Stanley has since repaid its TARP funds on 6/17/2009.

<sup>8</sup> PNC, "Press Release," 5/27/2009, <http://pnc.mediaroom.com/index.php?s=43&item=655>, accessed 6/23/2009.

<sup>9</sup> Regions Financial, "Press Release," 6/18/2009, [www.regions.com/about\\_regions/IR\\_newsreleases.html](http://www.regions.com/about_regions/IR_newsreleases.html), accessed 6/20/2009.

<sup>10</sup> SunTrust, 8-K, 6/8/2009, [www.sec.gov](http://www.sec.gov), accessed 6/23/2009.

<sup>11</sup> Wells Fargo, "Press Release," 5/8/2009, [www.wellsfargo.com/press/2009/20090508\\_stock](http://www.wellsfargo.com/press/2009/20090508_stock), none, results, accessed 6/23/2009.

<sup>12</sup> Board of Governors of the Federal Reserve, "The Supervisory Capital Assessment Program: Overview of Results," 5/7/2009.

**Equity Capital Facility:** A commitment to invest equity capital in a firm under certain future conditions.

**Securities Exchange:** An agreement between a firm and investors, permitting the investors to exchange one class of securities for another.

### Systemically Significant Failing Institutions Program

According to Treasury, the Systemically Significant Failing Institutions ("SSFI") program was established to "provide stability and prevent disruptions to financial markets from the failure of institutions that are critical to the functioning of the nation's financial system."<sup>102</sup> As of June 30, 2009, \$69.8 billion has been allocated through the SSFI program to American International Group, Inc. ("AIG"), the sole participant.

#### American International Group, Inc.

The \$69.8 billion of TARP funds allocated to AIG includes \$40 billion of preferred stock purchased from AIG on November 25, 2008, and the more recent establishment of a \$29.8 billion equity capital facility. AIG used the proceeds of Treasury's initial stock purchase to reduce the amount it had previously borrowed from the Federal Reserve.<sup>103</sup> On March 2, 2009, Treasury and the Federal Reserve announced a restructuring and sale of certain assets that will allow the company to repay a portion of the Federal Reserve's assistance packages to AIG. This overall restructuring of the Government's interests included a securities exchange, the previously mentioned \$29.8 billion equity capital facility, and an amendment to the Federal Reserve's Revolving Credit Facility. According to Treasury, the restructuring will strengthen the company's finances and is a long-term solution for AIG, its customers, U.S. taxpayers, and the financial system as a whole.<sup>104</sup> On April 17, 2009, Treasury and AIG signed the securities exchange agreement and the equity facility agreement as part of AIG's ongoing restructuring efforts.<sup>105</sup> According to Treasury, "orderly restructuring is essential to AIG's repayment of the support it has received from U.S. taxpayers and to preserving financial stability."<sup>106</sup>

#### Restructuring

AIG's "orderly restructuring" goes beyond the restructuring of its Government assistance to include an internal restructuring plan for the company's assets and risk positions. This internal restructuring, which includes asset sales, is an attempt by AIG to "protect and enhance the value of its key businesses, and position these franchises for the future as more independently run, transparent companies."<sup>107</sup> Subsequent to SIGTARP's April Quarterly Report, the following restructuring transactions have transpired:<sup>108</sup>

- **Government Agreements:** Agreements for a securities exchange and equity capital facility have been executed, and changes to the Federal Reserve Revolving Credit Facility have been made.
- **Separation Activities:** Two of AIG's largest foreign life insurance businesses — American International Company Ltd. ("AIA") and American Life Insurance Company ("ALICO") — have been put into special purpose vehicles ("SPVs"),

with significant preferred stock interests in those SPVs used to pay down the Federal Reserve Revolving Credit Facility.

- **Financial Products Corp. Unwind:** AIG continues to reduce the risk of its derivatives portfolios held by its subsidiary, Financial Products Corp.
- **Asset Sales:** AIG continues to sell off subsidiaries that are not part of its core business.

#### Government Agreements

The restructuring of the Government's assistance package for AIG involved three new agreements with two Government agencies. The securities exchange and equity capital facility are Treasury agreements, and the amended Revolving Credit Facility is with the Federal Reserve. All three agreements are subject to Government inspection and control requirements. Provisions for the AIG-Treasury contracts include, among others, inspection rights, internal control establishment, executive compensation limits, limited lobbying activity, use of funds reporting, and dividend rate adjustments. Table 2.16 illustrates these provisions in more detail.

TABLE 2.16

| STANDARD PROVISIONS FOR AIG TREASURY CONTRACTS |  |
|--|--|
| Provision                                      | Description  |
| Inspection Rights                              | Treasury, SIGTARP, and the Comptroller General of the United States have access to personnel, and any books, papers, records, or other data.   |
| Internal Controls                              | AIG must establish internal controls to ensure compliance with the terms of the contract, and must report on the implementation of the internal controls quarterly.  |
| Executive Compensation                         | AIG must comply with all EESA executive compensation requirements and any amendments. AIG must also make its best efforts to comply with the executive compensation restrictions to non-U.S.-based senior employees.   |
| Limited Lobbying Activity                      | AIG shall continue to maintain and implement its policy on lobbying, governmental, ethics, and political activities.   |
| Dividend Rate Adjustment                       | Treasury can change the dividend rate with the objective of protecting the U.S. taxpayer.  |
| Preferred Stock Directors                      | In the event that the board does not declare dividends for four quarters (does not need to be consecutive), Treasury has the right to elect the greater of (a) two members of the board of directors or (b) 20% of the entire board (currently there are 11 directors). Upon the receipt of four consecutive full dividend payments, the board members will step down. |

Note: The executive compensation requirements released on 5/15/2009 apply to AIG.  
 Source: Treasury, "Securities Exchange Agreement dated as of April 17, 2009, between American International Group, Inc. and United States Department of the Treasury," 4/17/2009, [www.financialstability.gov/docs/agreements/Series E\\_Securities Exchange Agreement.pdf](http://www.financialstability.gov/docs/agreements/Series E_Securities Exchange Agreement.pdf), accessed 6/8/2009.

**Cumulative Preferred Stock:** A type of stock that requires a defined dividend payment. If the company does not pay the dividend, it still owes the missed dividends to the owner of the stock.

**Non-cumulative Preferred Stock:** Unpaid dividends do not accrue on shares of stock when a company does not make a dividend payment.

**Reverse Stock Split:** A method used by corporations to reduce the number of shares outstanding and increase the share price proportionally. The total value of the shares outstanding remains the same. Based on the AIG reverse stock split, if a shareholder owned 100 shares of common stock valued at \$1 before the 1-for-20 reverse stock split, after the reverse stock split the shareholder would own 5 shares of stock valued at \$20 each.

#### Securities Exchange Agreement

The securities exchange allows AIG to replace the 4 million shares of cumulative preferred stock issued to Treasury in November 2008 ("Series D stock") worth \$40 billion with 400,000 shares of non-cumulative preferred stock ("Series E stock") worth \$41.6 billion.<sup>109</sup> The price of the Series E stock was set at the total value of the Series D stock plus any unpaid dividends.<sup>110</sup> The Series D stock paid a 10% annual dividend (paid quarterly), and the new Series E stock will pay a 10% dividend if the board of directors declares dividends.<sup>111</sup> AIG may only repurchase the new Series E stock with the proceeds of new sources of private capital.<sup>112</sup> In addition to the newly issued preferred stock, AIG has issued warrants to Treasury. These warrants are exercisable for 2,689,938.3 shares of common stock, which represent 2% of AIG's outstanding common stock as of June 30, 2009.<sup>113</sup> The warrants have a strike price of \$50, and, on June 30, 2009, the current price of AIG stock was \$23.20. On June 30, 2009, AIG had a 1-for-20 reverse stock split, which increased the stock price by a multiple of 20 and reduced the shares outstanding by a quotient of 20. The warrants adjust by the same multiple as the stock; the previously stated terms of the warrants reflect this reverse stock split.

#### Equity Capital Facility

The equity capital facility was announced as a five-year, \$30 billion agreement between AIG and Treasury.<sup>114</sup> Under the agreement, AIG agrees to issue and sell to Treasury 300,000 shares of 10% non-cumulative preferred stock ("Series F stock"), plus warrants to purchase 150 shares of common stock.<sup>115</sup> Dividends on the Series F stock do not accumulate and are only owed when declared by the board of directors. The strike price of the warrants is \$0.00002 per share.<sup>116</sup> On June 30, 2009, AIG's common stock price was \$23.20 per share. The agreement terms reflect the June 30, 2009, reverse stock split.

Technically, Treasury has already acquired all 300,000 shares of Series F stock, but the shares had no value until cash was disbursed from Treasury to AIG. Upon such disbursements, the facility is said to be "drawn upon," and the value of Series F stock increases by the amount of the drawdown.<sup>117</sup> In order to draw down the equity capital facility, AIG must provide an outline of the expected uses of the funds.<sup>118</sup> As of June 30, 2009, AIG has drawn down \$1.15 billion to improve the capitalization of its domestic life insurance and retirement services businesses.<sup>119</sup>

In March 2009, AIG made \$165 million in retention payments to certain employees in its Financial Products Corp. and Trading Group Inc. subsidiaries ("AIGFP Retention Payment Amount").<sup>120</sup> In an attempt to recoup the \$165 million from AIG, Treasury reduced the amount of capital available through the equity capital facility by \$165 million. This reduced the \$30 billion value of the facility to \$29.835 billion. In addition to the AIGFP Retention Payment Amount, Treasury assigned a \$165 million commitment fee to AIG for the use of the facility.<sup>121</sup> The

commitment fee is due in three installments of \$55 million on each of the following dates: December 17, 2010; August 17, 2012; and April 17, 2014, and must be paid from the operational capital of AIG.<sup>122</sup>

#### Federal Reserve Revolving Credit Facility

The Federal Reserve will make several modifications to the Revolving Credit Facility established in September 2008:

- The credit facility will be repaid and reduced in exchange for up to approximately \$26 billion in preferred interests in two special purpose vehicles created to hold all of the outstanding common stock ALICO and AIA.<sup>123</sup>
  - The total amount available under the Revolving Credit Facility will be reduced to \$25 billion.
- The Federal Reserve will make up to \$8.5 billion in new loans to AIG. The loans will be repaid by the cash flow received from designated blocks of the domestic life insurance subsidiaries of AIG.<sup>124</sup>
- The interest rate on the facility is the three-month London Interbank Offered Rate ("LIBOR") plus 300 basis points. The previous interest rate floor of 3.5% will be removed from the credit facility.<sup>125</sup>

#### AIG Financial Products Corp. Unwind

AIG Financial Products Corp. ("AIGFP") is a subsidiary of AIG whose primary business is trading in derivatives of stocks, bonds, credit, and commodities as well as energy trading and trading in the foreign exchange markets. Derivatives are financial instruments that "derive" their value from something else (residential mortgage-backed securities, commercial mortgage-backed securities, etc.). AIG's financial woes were largely a result of AIGFP's position as underwriter of one type of derivative, credit default swaps ("CDSs"), that sustained substantial losses in 2008. AIGFP's CDS exposure on multi-sector collateralized debt obligations ("CDOs") alone accounted for approximately \$19 billion of the \$24.5 billion in losses AIG announced in the third quarter of 2008.

The downgrade of AIG's AAA credit rating by the rating agencies triggered a credit event under many of its derivative contracts. This event required AIGFP to post additional collateral to its counterparties. As of November 5, 2008, AIGFP had posted or agreed to post \$37.3 billion in collateral to its counterparties. These collateral postings payments exceeded the funds AIG had available, and that is when the Federal Reserve and Treasury began providing assistance to stabilize the company. Part of AIG's restructuring plan involves the unwinding of AIGFP's derivative exposure. According to AIG's first-quarter financial statements, released May 7, 2009, AIGFP has begun to reduce the exposed risk of AIG; the notional amount of AIG's derivative portfolio exposure has been reduced by more than 40% — from approximately \$2.7 trillion to approximately \$1.5 trillion.

**Derivative:** A financial instrument whose value is based on ("derived from") a different underlying asset, indicator, or financial instrument.

**Credit Default Swap ("CDS"):** A contract where the seller receives a series of payments from the buyer in return for agreeing to make a payment to the buyer when a particular credit event outlined in the contract occurs (for example, if the credit rating on a particular bond or loan is downgraded or goes into default). It is commonly referred to as an insurance product where the seller is providing the buyer insurance against the failure of a bond. The buyer, however, does not need to own the asset covered by the contract, which means it can serve essentially as a "bet" against the underlying bond.

**Collateralized Debt Obligation ("CDO"):** A financial instrument that entitles the purchaser to some portion of the cash flows from a portfolio of assets, which may include bonds, loans, mortgage-backed securities, or other CDOs.

**Notional:** Face value.

**Asset Sales**

AIG has also begun a large-scale asset divestiture plan in a move to “protect and enhance the value of its key business.”<sup>126</sup> AIG has completed the sale of eight subsidiaries and one large office building in Tokyo. When AIG sells an asset, the total sale price could be in the form of cash or AIG debt assumed by the purchaser. The total sales price of the nine completed sales is approximately \$5.3 billion, including approximately \$4.6 billion cash and notes and \$726 million debt assumed by the purchasers. Table 2.17 lists the assets and the respective sale prices with the applicable debt assumptions by the purchasers.<sup>127</sup>

TABLE 2.17

| <b>AIG ASSET SALES (\$ MILLIONS)</b>  |                |                                  |                         |
|---|----------------|----------------------------------|-------------------------|
| <b>Subsidiary</b>   | <b>Cash</b>    | <b>Debt Assumed by Purchaser</b> | <b>Total Sale Price</b> |
| AIG PhilAm Savings Bank, PhilAm Auto Financing and Leasing, and PFL Holdings  | \$43           | \$ —                             | \$43                    |
| Hartford Steam Boiler   | 739            | 76                               | 815                     |
| AIG Insurance Company of Canada   | 263            | —                                | 263                     |
| AIG Retail Bank Public Company Limited and its credit card operations, AIG Card (Thailand) Company Limited, in Thailand | 45             | 495                              | 540                     |
| AIG Private Bank Limited  | 253            | 55                               | 308                     |
| Deutsche Versicherungs- und Rückversicherungs-Aktiengesellschaft  | 26             | —                                | 26                      |
| AIGFP Commodity Index Business  | 150            | —                                | 150                     |
| 21 <sup>st</sup> Century Insurance Group  | 1,900          | 100                              | 2,000                   |
| Tokyo Office Building   | 1,200          | —                                | 1,200                   |
| <b>Total</b>  | <b>\$4,619</b> | <b>\$726</b>                     | <b>\$5,345</b>          |

Note: These numbers and announcements are from the unaudited quarterly report and press releases.

Sources: American International Group, Inc., 10-Q, “Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934,” 3/31/2009, [www.sec.gov/Archives/edgar/data/5272/000095012309028272/090331a10vq.htm](http://www.sec.gov/Archives/edgar/data/5272/000095012309028272/090331a10vq.htm), accessed 7/9/2009, pp. 3-4; AIG Press Release, “AIG Completes Sale of Prime Tokyo Real Estate Asset to Nippon Life Insurance Company,” 5/28/2009, [aigcorporate.com/news-center/761153a-releases/14484-11235578right](http://aigcorporate.com/news-center/761153a-releases/14484-11235578right), accessed 7/10/2009; AIG Press Release, “AIG Financial Products Corp. Completes Sale of Commodity Index Business,” 5/7/2009, [aigcorporate.com/news-center/761153a-releases/14484-12857718right](http://aigcorporate.com/news-center/761153a-releases/14484-12857718right), accessed 7/10/2009.

### Targeted Investment Program and Asset Guarantee Program

Under the Targeted Investment Program ("TIP"), Treasury had invested, as of June 30, 2009, \$40 billion of TARP funds in Citigroup and Bank of America. Furthermore, under the Asset Guarantee Program ("AGP"), Treasury had committed a total of \$5 billion to support \$301 billion of assets held by Citigroup. As of June 30, 2009, Citigroup is the sole participant in AGP.

- **Stated goal of TIP:** To invest funds, on a case-by-case basis, "to strengthen the economy and protect American jobs, savings, and retirement security" where "the loss of confidence in a financial institution could result in significant market disruptions that threaten the financial strength of similarly situated financial institutions."<sup>128</sup>
- **Stated goal of AGP:** To use insurance protections to help stabilize at-risk financial institutions. Treasury insures a select pool of troubled assets and collects premiums in return. This program differs from other financial institution solvency programs in that Treasury does not invest TARP funds in the institution directly; rather, TARP funds are reserved to cover a portion of the possible losses in the selected assets.<sup>129</sup>

#### Citigroup Inc.

Treasury has provided no financing to Citigroup beyond its earlier CPP, TIP, and AGP funding. Citigroup has received a total of \$50 billion in TARP funding over three installments:

- CPP: \$25 billion on October 28, 2008
- TIP: \$20 billion on December 31, 2008
- AGP: \$5 billion loss protection on January 15, 2009

The \$5 billion AGP commitment is for Treasury's portion of the loss exposure on the ring-fencing of approximately \$301 billion worth of troubled Citigroup assets. This amount has not been paid directly to Citigroup, but rather, has been placed in reserve against the possibility of future losses on the assets in the ring-fence.<sup>130</sup> There have been no additional TARP funds allocated to Citigroup since SIGTARP's April Quarterly Report. However, Treasury's investments in Citigroup have been modified through a set of exchange offerings that were finalized on June 9, 2009.<sup>131</sup> The effects of these exchange offers are mixed. The CPP exchange will reduce the dividends payable to Treasury, and Treasury will receive a more junior position on the conversion of those shares in the event of a bankruptcy. The TIP and AGP exchange to trust preferred securities will result in Treasury having a

**Ring-fencing:** Segregating assets from the rest of a financial institution, often so that asset problems can be addressed in isolation.

**Exchange:** In reference to Citigroup agreement, taking one type of stock (e.g., preferred) and converting it at a specific rate to another type of stock (e.g., common).

For more information on Treasury's original investments in Citigroup, see SIGTARP's Initial Report and SIGTARP's April Quarterly Report.

**Loss Carry Forward:** Technique used to apply a loss from the current year to a future year in order to reduce the company's future tax liability.

**Interim Security:** In the case of the Citigroup exchange, a preferred stock that is convertible and designated as a common stock equivalent.

**Treasury-Owned Preferred Stock:** Comprises CPP preferred stock, ACP preferred stock, and TIF preferred stock.

more senior claim in bankruptcy and Treasury will have a higher priority to receive regular interest payments.<sup>132</sup> Additionally, Citigroup is implementing a Tax Benefit Preservation Plan to protect its shareholders from the potential loss of value of tax benefits through the dilution that is caused by the exchanges. If followed by shareholders, this plan will protect a large amount of tax benefits — such as loss carry-forwards — that Citigroup can use to offset future income.<sup>133</sup> A more detailed description of this plan is provided later in this section.

#### Citigroup Exchange Offering

On June 9, 2009, Citigroup finalized several private and public preferred securities exchange offers that were announced on February 27, 2009. These exchanges generally involve arranging for preferred shareholders, including Treasury, to trade in their shares for new interim securities that can be converted to common stock at the request of Citigroup.<sup>134</sup> This will permit the interim securities to be counted as "tangible common equity," thus strengthening Citigroup's capital structure. When Citigroup originally announced this exchange offering in February 2009, it intended to exchange up to \$27.5 billion of its non-Treasury held preferred securities, and Treasury had announced that it would match up to \$25 billion of the non-Treasury held shares exchanged with its CPP preferred shares (Treasury-owned preferred stock). Since then, Citigroup participated in Treasury's stress test (Supervisory Capital Asset Program, or SCAP) to determine an appropriate capital buffer for the firm in case of adverse economic conditions. Treasury concluded that Citigroup needed to raise \$5.5 billion in tangible common equity, even after receiving credit, during the SCAP testing, for the \$52.5 billion to be exchanged. On May 7, 2009, Citigroup announced it will expand the original private portion of its exchange offering by \$5.5 billion to meet the required buffer under SCAP.<sup>135</sup> Refer to the "Capital Assistance Program" discussion in this section for more detail on SCAP.

Citigroup has offered the exchange until July 24, 2009, to both its private and public preferred shareholders, with Treasury agreeing to match up to \$25 billion of its CPP preferred shares in the transactions. Should there be full (private, public, and Treasury) participation, Citigroup would convert approximately \$58

TABLE 2.18

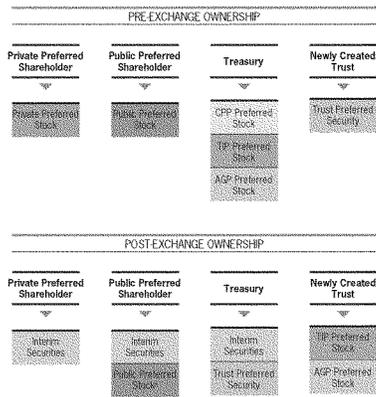
| CITIGROUP PREFERRED STOCK EXCHANGE PARTICIPANTS (\$ BILLIONS) |               |                       |
|---|---------------|-----------------------|
|   | Outstanding   | Maximum Participation |
| Private Preferred   | \$12.5        | \$12.5                |
| Public Preferred and Trust Preferred                          | 30.6          | 20.5                  |
| Treasury-Owned Preferred                                      | 50.0          | 25.0                  |
| <b>Total</b>  | <b>\$93.1</b> | <b>\$58.0</b>         |

Note: Public preferred and trust preferred are combined because public preferred shareholders will exchange first during the exchange of public preferred shares, and trust preferred will make up the difference to complete the transaction.

Source: Citigroup, Schedule 14A, 6/10/2009, [www.sec.gov/Archives/edgar/data/831001/000119312509128779/afrr14a.htm](http://www.sec.gov/Archives/edgar/data/831001/000119312509128779/afrr14a.htm), accessed 5/15/2009.

FIGURE 2.9

CITIGROUP EXCHANGE OVERVIEW



Notes: Private preferred stock, public preferred stock, and COP preferred stock will be exchanged for interim securities until shareholders approve the transaction.  
 \* If the Public Preferred Exchange has maximum participation, there will be \$10.05 billion of Public Preferred Stock outstanding.

Source: Citigroup Exchange Agreement, 6/9/2009. www.pcc.gov, accessed 6/10/2009.

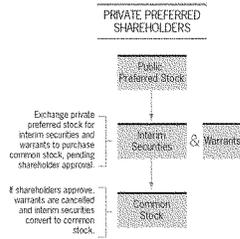
billion of its preferred stock.<sup>18</sup> Table 2.18 lists the total value of the outstanding preferred stock by exchange participants and the maximum participation allowed by Citigroup in the exchange agreement.

The exchange offer closing and conversion to common stock is dependent on many factors, including regulatory and shareholder approvals. Figure 2.9 illustrates the ownership of the participating shareholders pre- and post-exchange. Treasury, public shareholders, and private shareholders are holding interim securities until they receive shareholder approval. The details of each transaction are discussed in the following sections.

**Private Preferred Exchange Offer**

According to the exchange agreements, the private preferred shareholders will exchange their shares first on the condition that they elect to exchange at least

FIGURE 2.10  
CITIGROUP PRIVATE PREFERRED EXCHANGE PROCESS



Source: Citigroup, "Exchange Agreement," 6/9/2009, www.sec.gov, accessed 6/10/2009.

\$11.5 billion of preferred shares. Under the exchange, Treasury will convert a portion of its CPP investment that is matched to the amount of preferred shares being exchanged by private preferred shareholders and will receive from Citigroup the following assets in exchange:<sup>177</sup>

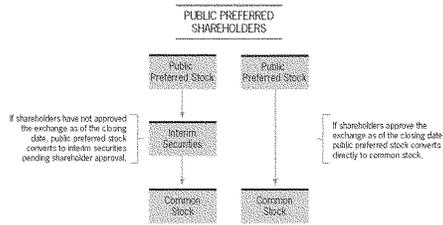
- interim securities that will convert to common stock upon shareholder approval
- a warrant to purchase common shares should shareholder approval not be obtained

The interim securities are designed to encourage shareholder approval of their exchange. For example, they will pay a 9% dividend that, should shareholder approval not be obtained within six months, will increase by two percentage points each quarter to a maximum of 19%. For example, during the first quarter following the six-month deadline, the dividends will be increased from 11% to 13% if the shareholder approval is not obtained. The warrant will have \$0.01 exercise price and permit purchase up to 790 million shares of common stock. Should shareholder approval be obtained, the warrants will be cancelled.<sup>178</sup> For a more detailed description on the private preferred exchange process, see Figure 2.10.

**Public Preferred Exchange Offer**

After the private preferred shareholders have exchanged their shares, Citigroup will provide exchanges to its public preferred shareholders. Treasury will match both the public and private exchanges dollar-for-dollar up to \$25 billion at a conversion rate of \$3.25 per share. If shareholder approval is not obtained upon closing, Citigroup will issue to Treasury interim securities that will be convertible

FIGURE 2.11  
CITIGROUP PUBLIC PREFERRED EXCHANGE PROCESS



Source: Citigroup, Exchange Agreement, 6/9/2009, www.sec.gov, accessed 6/10/2009.

to common stock upon approval.<sup>139</sup> For a more detailed description on the public preferred exchange process, see Figure 2.11.

In addition to the exchange of up to \$25 billion of its preferred shares obtained under CPP, Treasury will be exchanging the preferred stock it received under the TIP and AGP programs, to new trust preferred securities. According to Treasury, the new securities will have "greater structural seniority," than the existing stock; for example, they will have a more senior claim in bankruptcy and will have a higher priority to receive regular monthly interest payments.<sup>140</sup> They will have an annual coupon rate of 8% maturing in 2039 — meaning Citigroup will be paying 8% interest payments on Treasury's investments.<sup>141</sup> Citigroup will also create a new trust that will issue and sell the trust preferred securities to Treasury in exchange for the TIP and AGP shares, as well as any remaining CPP shares that are not exchanged to interim securities or common stock.<sup>142</sup>

#### Tax-Benefits Preservation Plan

On June 9, 2009, Citigroup announced that the Board of Directors had unanimously adopted a tax-benefits preservation plan. Citigroup cited this as an effort to protect Citigroup's ability to utilize certain tax assets, such as operating loss carry-forwards to offset future income.<sup>143</sup> Under current tax law, should there be an ownership change, Citigroup's ability to offset future income with its current and recent losses for tax purposes could be eliminated or drastically reduced.

In order to preserve the value of these potential tax benefits, Citigroup must avoid certain events that might be deemed to be a change of ownership. Accordingly, Citigroup's plan contains two provisions that discourage the following changes in ownership:<sup>144</sup>

- any person or group from becoming a 5% shareholder
- existing 5% (or more) shareholders from acquiring more than a specified number of additional shares of Citigroup

In an attempt to preserve the future tax benefits of the losses, Citigroup prepared a strategy to dilute any increase in ownership that could jeopardize any of the tax loss carry-forward. Citigroup's strategy included declaring a stock dividend on the interim securities and common stock allowing shareholders to purchase more stock thus permitting the dilution of the stock to avoid a change in control, thereby protecting the tax benefits.

#### Bank of America Corporation

As of June 30, 2009, Treasury has provided no financing to Bank of America beyond its earlier CPP and TIP funding. Bank of America has received a total of \$45 billion in three installments:

- CPP: \$15 billion on October 28, 2008
- CPP: \$10 billion on January 9, 2009
- TIP: \$20 billion on January 16, 2009

**Trust Preferred Security:** A security that has both equity and debt characteristics, created by establishing a trust and issuing debt to it. A company would create a trust preferred security to realize tax benefits, since the trust is tax deductible.

**Coupon Rate:** Interest rate to be paid as a percentage of the face value of the security. For example, if a \$100 security has an 8% coupon, the owner of the security will receive \$8 each year for the life of the security.

**Ownership Change:** Under U.S. income tax law, an ownership change will occur if an owner that controls at least 5% of the company increases its holding by 50% or more over a rolling three-year period.

On January 16, 2009, Treasury had announced the potential participation by Bank of America in AGP. On May 7, 2009, Bank of America announced it was no longer seeking such assistance.<sup>145</sup> As of June 30, 2009, according to Treasury officials, the matter remains unresolved.

#### Use of Funds Reports

Under their TARP agreements, based on SIGTARP's recommendations, both Citigroup and Bank of America are required to submit a quarterly "use of funds report." The use of funds report must include the following information:<sup>146</sup>

- how TARP funds were used
- the implementation of internal controls for TARP funds
- compliance or non-compliance with restrictions on use of TARP funds

#### Use of Funds Report: Citigroup, Inc.

On May 12, 2009, Citigroup released its second use of funds report. The 60-page "TARP Progress Report for First Quarter 2009," describes the steps taken to deploy TARP capital received.<sup>147</sup> According to the report, Citigroup's Special TARP Committee (the "TARP Committee") of senior executives had approved nearly \$45 billion in initiatives to support the U.S. economy and expand the flow of credit.<sup>148</sup> The report lists and describes its procedures for deployment of TARP capital as well as executive compensation reductions.<sup>149</sup> Included in Citigroup's report is a list of some of the internal controls put in place in connection with TARP-related lending. The internal controls include the following guidelines:<sup>150</sup>

- The TARP Committee may approve deployment of TARP-related capital for authorized purposes, up to a certain maximum, without gaining further approval.
- Businesses are required to report quarterly to the TARP Committee on TARP-related activities, the performance of any investments, and the benefit of any activities to the flow of credit and the U.S. housing system.
- The TARP Committee will report quarterly to Citigroup's board of directors on the specific uses of TARP funds.
- Use of TARP capital must be reported to Head of Financial Planning and Analysis with appropriate supporting materials to ensure effective monitoring.
- The committee will ensure that the Citigroup Finance Department has appropriate financial reporting concerning the uses of TARP capital.
- The TARP Committee will meet as often as required but no less than every quarter.

The report details Citigroup activities, including approximately \$8.25 billion in TARP-related new loans for the first quarter between municipal lending, supplier

Municipal Lending: Loans to city and state governments.

Supplier Financing: The purchase of accounts receivables of small- and medium-sized businesses.

financing, residential mortgages, and auto loans. Citigroup further reported that it expanded its assistance to homeowners by modifying mortgages for approximately 80,000 homeowners with a total combined debt of more than \$9 billion.<sup>151</sup> Table 2.19 lists the TARP-related use of funds reported by Citigroup.

**Use of Funds Report: Bank of America Corporation**

On May 11, 2009, Bank of America submitted a four-page use of funds report pursuant to its TJP agreement. Included in the report is a certification by the Chief Accounting Officer ("CAO") that the required internal controls are in place, a description of the requirements stated in the contract, and a one-page discussion of the use of funds.

According to the report submitted by Bank of America, the internal controls are described as "incorporated."<sup>152</sup> In contrast to Citigroup's use of funds report, Bank of America's report does not provide any details of its lending or the amount of lending that has occurred as a result of the increased capital provided by TARP. Bank of America acknowledged that it did not segregate the \$20 billion of TARP funds on its balance sheet and included it as part of the operating capital, stating that, "since all TARP investment funds are part of our operating capital, they cannot effectively be segregated and they cannot be 'inspent."<sup>153</sup> According to Bank of America, the additional \$20 billion was used to "bolster the company's capital and liquidity positions."<sup>154</sup> In its report, Bank of America listed the contract requirements as part of its internal controls relating to executive compensation, lobbying, and other expenses. It did not provide detail as to how it is implementing the internal controls.

TABLE 2.19

| <b>CITIGROUP USE OF FUNDS,<br/>AS OF 6/30/2009 (\$ BILLIONS)</b> |               |
|--|---------------|
| Conforming Mortgage Securities                                   | \$10.0        |
| Non-Conforming Mortgage Loans                                    | 8.2           |
| U.S. Prime Residential Mortgage Securities                       | 7.5           |
| Credit Cards   | 5.8           |
| Municipal Financing  | 5.0           |
| Business and Personal Loans                                      | 2.5           |
| Supplier Financing   | 2.0           |
| Corporate Loan Securitization                                    | 1.5           |
| Student Loans  | 1.0           |
| Residential Mortgages  | 1.0           |
| Auto Loans   | 0.3           |
| <b>Total</b>   | <b>\$44.8</b> |

Source: Citigroup, "What Cit is Doing to Expand the Flow of Credit, Support Homeowners and Help the U.S. Economy: TARP Progress Report for First Quarter 2009," 5/12/2009, [www.citigroup.com](http://www.citigroup.com), accessed 6/17/2009.

Commercial Mortgage-Backed Securities ("CMBS"). A financial instrument that is backed by a commercial real estate mortgage or a group of commercial real estate mortgages that are packaged together.

## ASSET SUPPORT PROGRAMS

Treasury, either on its own or in conjunction with the Federal Reserve, has created three programs to support demand in financial markets for hard-to-value assets and to restart the credit markets by supporting new loans: the Term Asset-Backed Securities Loan Facility ("TALF"), the Public-Private Investment Program ("PPIP"), and Unlocking Credit for Small Businesses ("UCSB").

The Federal Reserve's TALF program will provide up to \$1 trillion in funding to institutions pledging asset-backed securities ("ABS") as collateral. According to Treasury, it will provide \$80 billion of TARP funds to absorb losses on TALF (although the Federal Reserve characterized Treasury's commitment as up to \$100 billion).<sup>155</sup> As announced on May 1, 2009, TALF was expanded to include commercial mortgage-backed securities ("CMBS") as eligible collateral for TALF loans.<sup>156</sup> Through June 30, 2009, the Federal Reserve had facilitated five TALF subscriptions: four subscriptions related to non-mortgage-backed ABS totaling approximately \$28.5 billion in TALF loans, and one commercial mortgage-backed subscription with no TALF loans issued.

In addition to the expansion of TALF, PPIP, as announced, included two sub-programs, the Legacy Loans Program and the Legacy Securities Program. The Legacy Loans Program was intended to utilize equity provided by Treasury and debt guarantees provided by FDIC to facilitate purchases of legacy mortgage loans held by banks; the program, however, has been shelved by FDIC. The Legacy Securities Program utilizes equity provided by Treasury and debt potentially provided by Treasury, through TARP, and/or the Federal Reserve, through TALF, to facilitate purchases of legacy mortgage-backed securities ("MBS") held by various financial institutions.

Through the UCSB program, Treasury will purchase up to \$15 billion in securities backed by Small Business Administration ("SBA") loans.

### Term Asset-Backed Securities Loan Facility

#### Program Summary

In November 2008, the Federal Reserve and Treasury announced TALF, under which the Federal Reserve Bank of New York ("FRBNY") would issue up to \$200 billion in loans to make credit available to consumers and small businesses, backed by \$20 billion of TARP funds.<sup>157</sup> Subsequently, in February 2009, Treasury and the Federal Reserve announced that they were prepared to expand TALF up to \$1 trillion, which, according to Treasury, will include up to \$80 billion of TARP funds.<sup>158</sup> TALF is divided organizationally into two parts:

- **lending program** – originates loans to eligible institutions
- **asset disposition facility** – an SPV used by FRBNY to purchase and manage any collateral surrendered by borrowers from the TALF lending program

FRBNY will manage both the lending program and the asset disposition facility. The funding for the lending program comes from FRBNY. According to Treasury, the funding for the asset disposition SPV will first come from interest payments made by borrowers from the lending program, then from Treasury's use of up to \$80 billion in TARP funds to purchase subordinated debt from the SPV, and finally, from FRBNY non-recourse loans.

#### TALF Mechanics

As discussed in SIGTARP's April Quarterly Report to Congress, borrowers in the TALF lending program post ABS as collateral for non-recourse loans issued by FRBNY. The eligibility of the TALF borrower and the TALF collateral is determined through an application process.

Prior to SIGTARP's April Quarterly Report, only certain newly issued ABS — securities issued on or after January 1, 2009 — were eligible for TALF. The loans supporting the ABS were limited to:

- auto, student, and credit-card loans
- equipment loans
- floorplan loans
- commercial and rental fleet leases
- receivables related to residential mortgage servicing advances (servicing advance receivables)
- small-business loans guaranteed by the SBA

On May 1, 2009, the Federal Reserve added *insurance premium finance loans* and CMBS to the list of eligible ABS for TALF. Additionally, the Federal Reserve announced the inclusion of select legacy CMBS for the July TALF subscription; this marks the first time that legacy securities will be included in TALF. Legacy securities are those securities issued before January 1, 2009, and account for a large percentage of the ABS currently lingering on the books of financial institutions. For a more detailed discussion about collateral eligibility, see the "Term Asset-Backed Securities Loan Facility" discussion in Section 2: "TARP Overview" in SIGTARP's April Quarterly Report.

Once the collateral is deemed to be eligible, a *haircut* is assigned to the collateral. Haircuts represent the borrower's "skin in the game" — or the amount of money the borrower must invest — and are required for all TALF loans in varying amounts based on the type and riskiness of the ABS securing the TALF loan. Under TALF, FRBNY will lend each borrower the amount of the purchase price of the pledged ABS minus the haircut, subject to certain limitations. The initial haircuts for non-mortgage-backed collateral as a percentage of collateral value are posted on FRBNY's website.

*For more information on TALF mechanics, see Section 2: "TARP Overview" of SIGTARP's April Quarterly Report.*

**Floorplan:** Revolving lines of credit used to finance inventories of items.

**Servicing Advance Receivables:** Receivables related to residential mortgage loan securitizations that grant the servicer first priority in any insurance or liquidation proceeds from a loan, and, if those proceeds are insufficient, grants the servicer a first priority to general collections of the related securitization.

**Insurance Premium Finance Loan:** Loan issued to small businesses so they may obtain property or casualty insurance.

**Haircut:** Difference in the value of the collateral and the value of the loan (the loan value is less than the collateral value).

Much like haircuts, the interest rates for TALEF loans are based on the loan asset class, and most are quoted at a spread over LIBOR, which is a generally accepted interest rate standard. Interest payments on the TALEF loans are payable monthly or quarterly, depending on the frequency of the interest payments on the collateral. TALEF loan interest rates may be fixed or floating, as determined by the collateral, and are generally below what is currently available in the private markets. FRBNY posts the interest rates for TALEF loans on its website.

#### Program Developments

As the TALEF program matures, a number of updates have been introduced, which, according to the Federal Reserve, serve three primary purposes:

- to maximize TALEF's impact on all sectors of the ABS market
- to provide transparency to investors and the marketplace
- to protect the taxpayers' interests

Subsequent to SIGTARP's April Quarterly Report, the following program-related developments occurred and are discussed in greater detail in this section:

- Three additional TALEF subscriptions (for a total of five) were conducted by FRBNY.
- TALEF-eligible collateral criteria were expanded to include: insurance premium finance loans and CMBS — both legacy and newly issued.
- Two new nationally recognized statistical rating organizations ("NRSROs") were added to provide ratings for CMBS only: Realpoint, LLC, and DBRS.
- A proposed change to Standard & Poor's ("S&P's") current ratings methodology for CMBS could result in ratings downgrades for CMBS that might otherwise have been eligible collateral for TALEF loans.
- CMBS-specific haircut methodology was established.
- The role of collateral monitor for CMBS was created to act as another layer of risk mitigation.
- Updated program mechanics were introduced for risk mitigation through mandatory pre-payment of principal on loans collateralized by CMBS.
- The Federal Reserve hired a law firm to assist in the performance of a fraud risk assessment for TALEF.

#### TALEF Subscription Activity

As of June 30, 2009, FRBNY had conducted five subscriptions of TALEF. Four of these subscriptions related to newly issued, non-mortgage-backed ABS (and occurred in the first part of March, April, May, and June), and one subscription related to newly issued CMBS (which occurred on June 16, 2009) for which there was no activity.

Subscription: Process of investors signing up and committing to invest in a financial instrument before the actual closing of the purchase.

TABLE 2.20

| TALF LOANS BY ABS SECTOR, 3/2009 – 6/2009<br>(NON-MORTGAGE-BACKED COLLATERAL) (\$ BILLIONS) |               |               |               |               |               |
|---|---------------|---------------|---------------|---------------|---------------|
| ABS Sector  | March<br>2009 | April<br>2009 | May<br>2009   | June<br>2009  | Total         |
| Auto Loans  | \$1.9         | \$0.8         | \$2.2         | \$3.3         | \$8.2         |
| Student Loans   | —             | —             | 2.4           | 0.2           | 2.6           |
| Credit Card Receivables   | 2.8           | 0.9           | 5.5           | 6.2           | 15.4          |
| Equipment Loans   | —             | —             | 0.5           | 0.6           | 1.1           |
| Floorplan Loans   | —             | —             | —             | —             | —             |
| Small-Business Loans  | —             | —             | 0.1           | 0.1           | 0.2           |
| Servicing Advance Receivables   | —             | —             | —             | 0.5           | 0.5           |
| Premium Finance   | —             | —             | —             | 0.5           | 0.5           |
| <b>Total</b>  | <b>\$4.7</b>  | <b>\$1.7</b>  | <b>\$10.6</b> | <b>\$11.5</b> | <b>\$28.5</b> |

Notes: Numbers affected by rounding. Data as of 6/30/2009. As of 6/30/2009, \$28.2 billion in TALF loans were outstanding. The 7/7/2009 subscription was for approximately \$5.4 billion in TALF loans.

Sources: FRBNY, "Term Asset-Backed Securities Loan Facility: Operation Announcement," 6/2/2009, [www.ny.frb.org/markets/talf\\_operations\\_090602.html](http://www.ny.frb.org/markets/talf_operations_090602.html), accessed 6/3/2009; FRBNY, "Term Asset-Backed Securities Loan Facility: Operation Announcement," 5/5/2009, [www.newyorkfed.org/markets/TALF\\_operations\\_090512.html](http://www.newyorkfed.org/markets/TALF_operations_090512.html), accessed 5/29/2009; FRBNY, "Term Asset-Backed Securities Loan Facility: Operation Announcement," 4/7/2009, [www.newyorkfed.org/markets/TALF\\_operations\\_090407.html](http://www.newyorkfed.org/markets/TALF_operations_090407.html), accessed 5/29/2009; FRBNY, "Term Asset-Backed Securities Loan Facility: Operation Announcement," 3/13/2009, [www.newyorkfed.org/newsevents/news/markets/2009/mar090313.html](http://www.newyorkfed.org/newsevents/news/markets/2009/mar090313.html), accessed 5/29/2009; FRBNY, "Term Asset-Backed Securities Loan Facility: non-CMBS," 7/7/2009, [www.newyorkfed.org/markets/TALF\\_operations.html](http://www.newyorkfed.org/markets/TALF_operations.html), accessed 7/8/2009.

#### Subscriptions Using Non-Mortgage-Backed Collateral

As of June 30, 2009, FRBNY had facilitated four TALF non-mortgage-backed ABS subscriptions, totaling approximately \$28.5 billion. As Table 2.20 illustrates, TALF lending for non-mortgage-backed ABS has grown since the initial subscription in March 2009.

TALF loans issued for the purchase of ABS backed by student loans and ABS backed by loans guaranteed by the SBA may have up to five-year maturities, as opposed to up to three-year maturities for the non-mortgage-backed loans extended thus far.

#### Subscriptions Using Mortgage-Backed Collateral

On June 16, 2009, FRBNY concluded the first subscription of TALF related to newly issued CMBS. This was the first subscription with mortgage-backed securities as collateral. No loans were issued to borrowers during the subscription. Prior to the subscription, during public remarks, the President of FRBNY indicated that participation would be minimal because there had been little advance notice. According to industry sources, for commercial real estate "it can take as long as six months from the time a loan is originated to when it's securitized."<sup>150</sup>

**Amortization Schedule:** A complete schedule of periodic blended loan payments, showing the amount of principal and the amount of interest in each payment so that the loan will be paid off over a certain time period.

**Term:** The period of time assigned as the lifespan of any investment.

**Bullet Payment:** A one-time, lump-sum repayment of an outstanding loan, typically made by the borrower after very little, if any, amortization of the loan.

#### Commercial Mortgage-Backed Securities

On May 1, 2009, the Federal Reserve issued a press release announcing the expansion of TALF to include qualifying newly issued CMBS as eligible collateral for TALF loans.<sup>160</sup> On May 19, 2009, the Federal Reserve announced that legacy CMBS would also be included.<sup>161</sup> According to the Federal Reserve, "The CMBS market came to a standstill in mid-2008. The inclusion of CMBS as eligible collateral for TALF loans will help prevent defaults on economically viable commercial properties, increase the capacity of current holders of maturing mortgages to make additional loans, and facilitate the sale of distressed properties."<sup>162</sup>

Commercial real estate mortgages that back CMBS are typically structured so that mortgage borrowers are required to make monthly payments consistent with a 20- to 30-year amortization schedule, but have a shorter term, which requires the borrower to make a bullet or balloon payment as the term reaches maturity. In other words, the term of the mortgage may be five years, but unlike most residential mortgages, at the end of the commercial real estate loans, most of the principal has not yet been repaid, leaving a very large final payment. As a result, most commercial mortgages are refinanced, that is, a new loan is sought at the end of the term. Commercial lenders often make mortgage loans with the understanding that borrowers will seek to refinance when the bullet becomes due.

As discussed in further detail in "TARP Tutorial: Securitization" in Section 2: "TARP Overview" of SIGTARP's April Quarterly Report, securities issuance provides financial institutions a significant source of liquidity to make new loans and refinance existing loans. When the CMBS market shut down last year, commercial mortgage borrowers discovered that commercial lenders were not willing to refinance commercial real estate loans. Because many borrowers are unable to make the final bullet payment without financing, this has created a potential crisis in the commercial real estate market.

#### Which CMBS Will Meet Collateral Eligibility Requirements?

In order to qualify as TALF collateral, newly issued CMBS and legacy CMBS must meet a number of eligibility requirements. Some eligibility requirements are the same for both newly issued and legacy CMBS.<sup>163</sup>

- Eligible CMBS must evidence an interest in a trust fund consisting of fully funded mortgage loans and not other CMBS, other securities, interest rate swap or cap instruments, or other hedging instruments.
- Eligible CMBS must have a credit rating in the highest long-term investment-grade rating category from at least two TALF CMBS-eligible rating agencies and must not have a credit rating below the highest investment-grade rating category from any TALF CMBS-eligible rating agency.
- Eligible CMBS must entitle its holders to payments of principal and interest.

- Eligible CMBS must not be issued by an agency or instrumentality of the United States or a Government-sponsored enterprise.
- Eligible CMBS must include a mortgage or similar instrument on a fee or leasehold interest in one or more income-generating commercial properties.

Some eligibility requirements for newly issued CMBS are similar to requirements for legacy CMBS with minor, but important, differences:

*Newly issued CMBS:*<sup>164</sup>

- Eligible newly issued CMBS must evidence first-priority mortgage loans that are current in payment at the time of securitization.
- Eligible newly issued CMBS must not be junior to other securities with claims on the same pool of loans.
- Each property underlying eligible newly issued CMBS must be located in the United States or one of its territories.

*Legacy CMBS:*<sup>165</sup>

- Eligible legacy CMBS must not have been junior to other securities with claims on the same pool of loans upon issuance.
- As of the TALF loan subscription date, at least 95% of the properties underlying eligible legacy CMBS, by related loan principal balance, must be located in the United States or one of its territories.
- If issued during or after 2005, eligible legacy CMBS must be "super senior" in priority at the time of the TALF loan, meaning the holder is entitled to first payment. It became common practice in 2005 to sub-tranche (or further subdivide cash flows), and TALF will only accept the most senior of these sub-tranches in the highest rating category.<sup>166</sup>

For CMBS, the Federal Reserve has retained the services of a *collateral monitor* to evaluate ABS to ensure that specific risks to the Federal Reserve and Treasury are mitigated. For more on the role of the collateral monitor, refer to the "Compliance and Fraud Prevention" discussion later in this section.

#### **Nationally Recognized Statistical Rating Organizations for CMBS**

The ratings assigned by NRSROs to CMBS are developed through methodologies intended to provide a depiction of a financial instrument's likelihood of default, or riskiness. NRSRO methodologies often involve proprietary models, drawing on basic assumptions about the MBS and comparisons of similarly structured investments, which may periodically be reviewed and could result in changes to ratings issued by an NRSRO.

*Collateral Monitor:* Independent third party engaged by the Federal Reserve to assess the riskiness of the underlying mortgage pools.

The ratings issued by NRSROs are integral to participation in the TALF program. The terms and conditions of TALF have two distinct requirements related to ratings for pledged collateral:

- At the time of subscription for the TALF loan, pledged collateral must have the highest long-term investment-grade rating category (e.g., AAA) from two or more TALF-eligible rating agencies.
- Collateral cannot have a credit rating less than the highest rating from any TALF-eligible rating agency, nor can it be currently on review or on watch for downgrade by any of the approved NRSROs.

If collateral pledged for a TALF loan does not possess the necessary ratings, the borrower may not pledge that collateral as security for a TALF loan.

Prior to the expansion of TALF, the Federal Reserve would accept ratings from S&P's, Moody's Investors Service, and Fitch Ratings for non-mortgage-backed ABS. On May 19, 2009, the Federal Reserve announced the addition of two new NRSROs to its list of acceptable NRSROs — DBRS and Realpoint, LLC — specifically for their experience in dealing with CMBS.<sup>167</sup> These five NRSROs are known as TALF-eligible ratings agencies, because the ratings they issue may be relied on for determining collateral eligibility. In light of TALF's expansion to additional asset classes, "the Federal Reserve will periodically review its use of NRSROs for the purpose of determining TALF-eligible ABS."<sup>168</sup>

#### Potential Downgrade of CMBS

On May 26, 2009, S&P's proposed changes to the methodology it uses to rate CMBS.<sup>169</sup> The change in methodology will likely cause significant downgrades for CMBS issued within the past three years, particularly with respect to the highest long-term rating. It is being reported that, "25%, 60%, and 90% of the most senior tranches of the 2005, 2006, and 2007 issuances, respectively, could be downgraded."<sup>170</sup> On June 26, 2009, S&P affirmed that it would adopt this stance.<sup>171</sup> Because of the eligibility requirement that collateral cannot have a credit rating less than the highest rating from any major TALF-eligible rating agency, these downgrades by S&P will render a significant portion of the legacy CMBS market ineligible for participation in the TALF program. SIGTARP will follow these developments closely and report on substantive changes to program design in subsequent reports.

#### Haircuts for Legacy CMBS Collateral

Similar to collateral requirements for other types of ABS collateral, TALF loans secured by CMBS require borrowers to put up a portion of their own money, or the haircut. The amount of the haircut is designed to reflect the inherent riskiness of the collateral and the potential for it to decline in value. Haircuts for newly issued CMBS will be at 15%, increasing by one percentage point for each year of

TABLE 2.21

| EXAMPLE CMBS EFFECTIVE HAIRCUT CALCULATION |               |           |              |           |            |           |                   |
|--|---------------|-----------|--------------|-----------|------------|-----------|-------------------|
| CMBS Value                                 | Expected Life | Par Value | Market Value | Haircut % | Haircut \$ | TALF Loan | Effective Haircut |
| High                                       | Five Years    | \$1,000   | \$1,000      | 15%       | \$150      | \$850     | 15%               |
| Medium                                     | Five Years    | 1,000     | 700          | 15%       | 150        | 550       | 21%               |
| Low  | Five Years    | 1,000     | 400          | 15%       | 150        | 250       | 38%               |

additional average life over five years.<sup>172</sup> Although also at 15%, haircuts on legacy CMBS provide an additional technical-downside protection in that “the haircuts are based on a percentage of par value, but applied on a dollar basis to market prices.”<sup>173</sup> For example, assume that a TALF borrower pledges legacy CMBS with a par value of \$1,000 for a TALF loan. The CMBS have an average life of five years, which would require a 15% haircut from the borrower. If the legacy CMBS were trading at full value, the borrower could get a loan for \$850, putting up \$150 (taking a \$150 haircut). If, however, the legacy CMBS are trading at \$700, the borrower will only be able to secure a \$550 TALF loan (the haircut is still \$150 but it now represents 21% of the now-lower market value). This formulation creates an “effective haircut” that considers the proportion of the haircut to loan amount. The lower the market value of the legacy CMBS, the higher percentage of market value will be the haircut. See Table 2.21 for scenarios based on differing market values for legacy CMBS.

Calculating haircuts in this manner acknowledges that legacy CMBS with large differences between par value and market value are generally likely to be experiencing performance problems with the underlying assets. This approach to calculating the required haircut minimizes the loan amount extended by the Federal Reserve and thus the potential exposure to loss.

Haircuts are designed to consider the *weighted average life* of a security, which provides insight regarding how many years it will take to repay the principal. The loans underlying a CMBS typically have a longer life than those of non-mortgage ABS. The standard haircut for CMBS is 15%. To see the CMBS haircut percentages across a range of average life for the underlying collateral, see Table 2.22.

#### Compliance and Fraud Prevention

As discussed in detail in Section 4: “Looking Forward: SIGTARP’s Recommendations to Treasury” of SIGTARP’s April Quarterly Report, SIGTARP made a series of recommendations regarding TALF program mechanics and fraud prevention procedures. Subsequently in two letters to SIGTARP, dated May 5, 2009, and May 22, 2009, the Board of Governors of the Federal Reserve responded to many of the recommendations from the past quarterly report and outlined plans to implement procedures to address these concerns in subsequent

Par Value: The dollar value assigned to a security by the issuer.

Weighted Average Life: The average number of years for which each dollar of unpaid principal on a loan or mortgage remains outstanding.

TABLE 2.22

| CMBS HAIRCUT PERCENTAGES |     |     |     |     |     |  |
|--------------------------|-----|-----|-----|-----|-----|--|
| Average Life (years)     |     |     |     |     |     |  |
| 0-5                      | 6   | 7   | 8   | 9   | 10  |  |
| 15%                      | 16% | 17% | 18% | 19% | 20% |  |

Source: FRBNY, “Term Asset-Backed Securities Loan Facility: Terms and Conditions” 5/19/2009, [www.newyorkfed.org/markets/tal\\_firm2.html](http://www.newyorkfed.org/markets/tal_firm2.html), accessed 5/19/2009.

Primary Dealers: Banks and securities broker-dealers that trade in U.S. Government securities with the Federal Reserve Bank of New York for the purpose of carrying out open market operations. There are currently 16 primary dealers.

*For further detail regarding the primary dealer's role in TALE, see Section 2: "TARP Overview" of SIGTARP's April Quarterly Report.*

TALF operations. Those letters are included in Appendix G: "Correspondence Regarding SIGTARP Recommendations."

#### Compliance Summary

Under TALE, the primary dealers are responsible for many of the compliance-related activities, including performing due diligence regarding the eligibility of pledged ABS and the TALE applicant. Specifically, each primary dealer is responsible for applying its "Know Your Customer" / "Anti-Money Laundering" identification program to each TALE borrower and making a representation to FRBNY that the borrower is eligible for participation in TALE.<sup>174</sup>

#### CMBS Risk Mitigation through Collateral Monitoring

In addition to haircuts, which are predetermined, fixed percentages, FRBNY will conduct an actual valuation of any pledged collateral using adverse economic assumptions to determine the maximum price at which it will be willing to lend. This may lead to lower TALE loan values than would have been issued relying solely on haircuts for risk mitigation, and this practice is designed to ensure that the total amount of money lent to the borrower will not exceed the total value of the CMBS should the market continue to deteriorate. The process will also help to deter collusion, in that a proposed price that is deemed too high may be rejected by the Federal Reserve. FRBNY has retained the services of a collateral monitor to assist with this collateral evaluation using certain eligibility requirements provided by the Federal Reserve. According to FRBNY, the collateral monitor will also assess the pledged collateral pool for diversity of loan size, geography, property type, and borrower sponsorship to avoid over-concentration in any particular sector. The collateral monitor will "estimate the value of the collateral under adverse economic conditions, and the FRBNY will not make a loan that exceeds the stressed valuation."<sup>175</sup>

For example, a stressed valuation performed by the collateral monitor may evaluate the performance of CMBS in light of increased unemployment. Any increase to the unemployment rate would likely decrease the need for corporate office space, thus increasing vacancies and reducing rent collection. Commercial borrowers that recently took out a mortgage for the development of office space may thus default on the mortgage because of less income, which subsequently would harm the performance of CMBS. The collateral monitor's evaluation may show that CMBS with a market value of \$600 under current economic conditions would be worth \$400 if the unemployment rate increases. Under this scenario, a TALE borrower pledging the CMBS as collateral for a TALE loan would not be granted a loan greater than the stressed value of \$400. Specific information about the Federal Reserve's stress valuation of CMBS will not be made public.

On June 16, 2009, FRBNY announced the retention of Trepp LLC as its first collateral monitor for the assessment of CMBS eligibility, both newly issued and legacy. According to FRBNY, Trepp will "assist the New York Fed by providing valuation, modeling, analytics and reporting."<sup>176</sup> FRBNY further clarified that it may rely upon other firms as collateral monitors.

#### **Risk Mitigation through Prepayment**

The expansion of TALF includes additional protections to limit the Federal Reserve's exposure to losses from collateral declining in value and to encourage borrowers to repay principal instead of abandoning the collateral at the end of the TALF loan term.

Any remittance of principal for legacy CMBS must be used immediately to pay down the TALF loan in proportion to the haircut of that loan.<sup>177</sup> In the case of CMBS, these principal remittances occur when a borrower prepays the mortgage, entitling the security holder to payment beyond the security's normal cash flow. For example, if a TALF borrower obtained a three-year TALF loan with a 15% haircut, the borrower would keep only 15% of any principal remittance, and the remaining 85% would go to FRBNY to pay down the loan. In other words, if \$1,000 of principal was remitted, the TALE borrower would receive \$150, and \$850 would go to FRBNY to pay down principal on the borrower's TALE loan.

A second CMBS risk mitigation involves the use of interest payments received by the holder of the CMBS. The interest generated by the CMBS is received by FRBNY's custodian and distributed in the following order:

- pay interest on TALE loan
  - pay the TALE borrower subject to a cap
  - pay down outstanding principal on the TALE loan
- Assuming the interest received from CMBS is greater than interest payable on the TALE loan, interest will be remitted to the TALE borrower until the following limits are reached (on a five-year TALE loan) after which interest will go to pay down remaining principal on the TALE loan:
- 25% of the haircut amount (annually) for the first three years of the TALE loan
  - 10% of the haircut amount during the fourth year of the TALE loan
  - 5% of the haircut amount during the fifth year of the TALE loan

For example, if a TALE borrower puts up a haircut of \$100 for a five-year TALE loan, the interest remitted to the borrower from the CMBS — above and beyond the interest that is paid to the Federal Reserve for the loan — cannot exceed \$25 for the first year, \$25 for the second year, \$25 for the third year, \$10 for the fourth year, and \$5 for the fifth year. All payments more than these amounts go to the Federal Reserve to repay the principal on the loan. In this way, the surrendering of assets at the end of the TALE loan term will be discouraged as some principal will

have been repaid and the borrower will have retained some "skin in the game." Otherwise, a borrower could recoup its entire haircut and profit, and have no incentive to pay off the loan, and reacquire the CMBS, at the end of the loan.

#### **Fraud Risk Assessment**

In a May 22, 2009, letter to SIGTARP, the Federal Reserve indicated that FRBNY had retained the services of a law firm to assist in the performance of a comprehensive fraud risk assessment for TALF.<sup>178</sup> According to the Federal Reserve, the assessment "will include a review of fraud cases and investigation consultation with a wide range of relevant law enforcement, government agencies, academics, law firms and public and private investors and recommendations regarding additional measures, strategies or controls to reduce the potential fraud risk associated with the program."<sup>179</sup> SIGTARP has met with FRBNY and a representative of the law firm.

Additionally, FRBNY is developing an inspection program of the primary dealers facilitating TALF loans to ensure they are performing the required due diligence of collateral and borrowers.

#### **Performance of ABS Markets**

On June 4, 2009, the president and chief executive of FRBNY, William C. Dudley, addressed the Securities Industry and Financial Markets Association and Pension Real Estate Association's Public-Private Investment Program Summit in New York City regarding TALE.

During the remarks, Mr. Dudley stated, "TALF loans have accounted for a bit more than half of total issuance volume of ABS (since the initial TALE subscription)...this means that the TALE is helping to restart the market, rather than the TALE being the market."<sup>180</sup> Additionally, Mr. Dudley noted that, "spreads on consumer ABS have been coming down sharply from their peak levels reached late last year. For example, the spreads on AAA-rated credit card ABS have narrowed from a peak of about 600 basis points over LIBOR to slightly above 200 basis points currently."<sup>181</sup>

### Public-Private Investment Program

On March 23, 2009, Treasury, in combination with FDIC and the Federal Reserve, announced the Public-Private Investment Program ("PPIP"), a \$500 billion to \$1 trillion effort to improve the health of financial institutions holding legacy assets on their balance sheets and to restart frozen credit markets.<sup>182</sup> As noted by FDIC, these troubled loans and securities "have depressed market perceptions of banks and impeded new lending."<sup>182</sup> PPPI is designed to purchase these legacy assets from institutions through multiple Public-Private Investment Funds ("PPIFs") funded by Government and private-investor capital as well as desirable debt financing. PPPI will initially focus on assets related to mortgages on residential and commercial real estate.<sup>184</sup> At program announcement, Treasury declared its intention to commit up to \$100 billion to PPPI and the expansion of TALF to legacy assets.<sup>185</sup> On July 8, 2009, Treasury announced that it will initially invest up to \$30 billion of equity and debt in nine PPIFs for the purchase of legacy securities.<sup>186</sup>

### Understanding the Current Environment

PPPI's success in meeting its goal of taking toxic assets off of banks' books is dependent on banks' willingness to sell such assets. In order to assess the incentive for banks to participate and sell their troubled assets, it is necessary to understand how institutions must account for these assets. Companies have traditionally held certain assets — like stocks of other companies and asset-backed securities ("ABS") — on their books at market value. Accounting standards required banks to value certain assets at the current market price (i.e., mark-to-market). Consequently, if the market value decreased, the company had to recognize a loss on its balance sheet equal to the amount of the drop in value of the security, even though it has not sold it. Similarly, if the market value increased, banks could recognize a gain, or profit, on their balance sheet, improving their capital position with no actual sale taking place. The mark-to-market methodology is a snapshot of value — it does not capture the expected future earnings or the expected lifetime losses of the securities.<sup>187</sup> Illiquid and inactive markets make this fair value determination more difficult. The recent turmoil in the economy caused the market value of ABS to drop significantly, and, for some legacy securities, the market ceased to exist. As a result, institutions have had to recognize losses on their balance sheets reflective of the much lower market value of these assets.

The economic crisis focused scrutiny on the Financial Accounting Standards Board ("FASB"), which sets corporate accounting principles, and on mark-to-market accounting. This scrutiny is based on the belief that the current market is priced for a "fire sale," and not an "orderly transaction" between "informed parties."<sup>188</sup> As a result, Section 133 of EESA mandated that the Securities and Exchange Commission ("SEC") conduct a study on mark-to-market accounting standards and whether it should be a governing accounting standard. On

**Legacy Assets:** Also known as troubled or toxic assets, legacy assets are real estate-related loans and securities (legacy loans and legacy securities) that remain on banks' balance sheets and that have lost value, but are difficult to price due to the recent market disruption.

**Market Value:** Price at which a security could be bought or sold.

**Mark-to-market:** Assets are carried at fair market value on a continual basis with periodic changes in the fair value. Fluctuations in value are shown in the corporate earnings.

**Illiquid market:** A market in which assets cannot be quickly converted to cash.

**Fair Value:** The price that would be received by the holder of that asset in an orderly transaction.

**Recognized:** Gains or losses that occur when an asset is re-valued or sold.

**Financial Accounting Standards Board ("FASB"):** Established in 1973, FASB is the regulatory body responsible for establishing rules for financial accounting and the reporting of public, private, and not-for-profit companies. Those standards govern the preparation of financial reports and are officially recognized as authoritative by the Securities and Exchange Commission ("SEC") and the American Institute of Certified Public Accountants (regulators).<sup>189</sup> These standards are necessary for investors, creditors, and others to rely on the accuracy, transparency, timeliness, and comparability of financial statements.<sup>190</sup>

Financial Accounting Standard 157-4 (FAS157-4). On April 9, 2009, FASB issued FAS157-4 to offer more clarity on valuing and accounting for assets in an inactive market when pricing represents distressed conditions.

**Legacy Loans:** Underperforming real estate-related loans held by a bank that it wishes to sell, but recent market disruptions have made difficult to price.

**Legacy Securities:** Troubled real estate-related securities (residential mortgage-backed securities, commercial mortgage-backed securities, and asset-backed securities) lingering on institutions' balance sheets because their value could not be determined.

December 30, 2008, the SEC provided a study resulting in recommendations for improvement in mark-to-market rules relating to the application of fair value measures in illiquid or inactive markets.<sup>191</sup>

There are arguments for and against mark-to-market accounting for legacy assets. According to the Chairman of FASB, the mark-to-market accounting is seen in the current environment by financial institutions and their trade groups as "overstating the extent of losses and capital erosion and as a factor exacerbating the crisis."<sup>192</sup> On the other side of the argument, investors, financial analysts, and other users of financial reporting "have urged [FASB] not to suspend or weaken the current requirements, fearing that would enable institutions to improperly avoid or delay the recognition of economic losses and depleted capital."<sup>193</sup>

On April 9, 2009, FASB issued Financial Accounting Standard 157-4 ("FAS157-4") to "establish a consistent definition of fair value"<sup>194</sup> and provide a framework for valuing assets in differing market conditions.<sup>195</sup> FAS157-4 offers further clarification on which type of assets (i.e., company stock) should rely on market price and which assets (i.e., ABS) can use other valuation methods when the markets are not orderly. This clarification directly affects the legacy assets being purchased by the PPIFs. FAS157-4 may allow banks to hold assets on their balance sheets at a higher value than the previous rule. With the legacy assets now valued higher on their balance sheets, institutions may be less willing to sell their assets to PPIFs because they would have to recognize as a loss (and a reduction in their capital), the difference between the value at which they held the asset on their books and the price at which they sold it.

#### Program Details

In response to the economic crisis and the problems with legacy assets, Treasury has announced programs intended to help remove the troubled assets from the balance sheets of banks and to restart illiquid markets. PPIP, as originally announced, would provide between \$500 billion and \$1 trillion of capital for the purchase of legacy assets through the following programs:

- **Legacy Loans Program:** PPIFs purchase legacy loans with TARP funds and private-equity capital combined with FDIC-guaranteed debt.
- **Legacy Securities Program:** PPIFs purchase legacy securities using TARP funds and private investment capital combined with TARP-issued debt and/or optional leveraging from the expanded TALF for TALF-eligible securities.
- **Expanded TALE:** The Federal Reserve has expanded eligible ABS to include CMBS and is considering expansion to RMBS.

**Legacy Loans Program**

As announced, the Legacy Loans Program was designed to purchase hard-to-value real estate-related loans from financial institutions.<sup>196</sup> In the Legacy Loans Program, Treasury would form PPIFs with private investors and would match the private investment dollar-for-dollar (i.e., for every \$1 invested by the private investor, Treasury would also invest \$1). FDIC would provide a debt guarantee of up to a 6-to-1 leverage ratio (i.e., debt-to-equity ratio) on the pool of loans. The allowed amount of leverage would be predetermined by FDIC after an independent, third-party analysis of the loans.

On June 3, 2009, FDIC announced that, although it is continuing to develop the Legacy Loans Program, the program would be postponed indefinitely. It cited recent successful capital-raising efforts by financial institutions as reflecting “renewed investor confidence in our banking system.”<sup>197</sup> SIGTARP will provide updates when more information on the Legacy Loans Program is available.

**Legacy Securities Program**

According to Treasury, “the Legacy Securities Program is intended to restart the market for legacy securities, allowing banks and other financial institutions to free up capital and stimulate the extension of new credit.”<sup>198</sup> Legacy securities are ABS supported by a pool of real estate-related loans, and for the purposes of PPIF, issued before January 1, 2009.<sup>199</sup> Private investors and Treasury will co-invest to purchase these assets from banks, insurance companies, mutual funds, pension funds, and any other eligible institutions.<sup>200</sup>

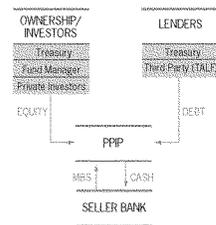
In the Legacy Securities Program, Treasury will invest equity alongside private investors in a PPIF. In addition to the equity investment, Treasury will also offer debt financing equal to or double the amount of the private investment. Furthermore, Treasury and the Federal Reserve will allow the PPIFs to obtain additional financing, up to certain limits, from the Federal Reserve’s TALF program for those assets that are eligible for TALF (currently only CMBS).<sup>201</sup>

**Expanded TALF**

The Federal Reserve, as described in the previous “Term Asset-Backed Securities Loan Facility” discussion in this report, has expanded its eligible asset classes to include legacy CMBS. This expansion allows, but does not require, participants in PPIF’s Legacy Securities Program to also participate in TALF, subject to applicable haircuts. According to OFS, “haircuts will be increased so that the combination of Treasury- and TALF-supplied debt will not exceed the total amount of TALF debt that would be available leveraging the PPIF equity alone.”<sup>202</sup> See the previous “Term Asset-Backed Securities Loan Facility” discussion in this section for more information on the mechanics and the eligible collateral of TALF. Treasury and the Federal Reserve are continuing to assess whether to expand TALF to new and legacy RMBS, but, as of June 30, 2009, no final decision has been made.

*For more information on the Legacy Loans Program, see Section 2: “TARP Overview” in SIGTARP’s April Quarterly Report.*

FIGURE 2.12  
PPIP ASSET/CASH FLOW



Sources: OFS, "Legacy Securities Public-Private Investment Partnership: Summary of Indicative Terms and Conditions," received from SIGTARP 7/1/2009; OFS, "Public-Private Investment Program: White Paper," 3/23/2009; www.treas.gov, accessed 6/13/2009.

**Legacy Securities Program Process**

The following steps detail the process for participation in the Legacy Securities Program and Figure 2.12 details the flow of cash and assets:

1. Fund managers apply to Treasury to participate in the program.
2. Approved fund managers must raise necessary private capital for the PPIF.
3. Treasury matches the capital raised, dollar-for-dollar (up to a predetermined maximum amount, currently \$1.1 billion).
  - Treasury also receives warrants so it can further participate if profits are earned by the PPIF.
4. Fund managers can borrow additional money from Treasury.
  - Managers can borrow 50-100% of the total equity investment (currently \$1.1 billion or up to \$2.2 billion).
  - If managers take no more than 50% financing from Treasury, PPIF may receive TALF loans for TALF-eligible assets (subject to leverage limits) or other third-party debt.
5. Fund manager purchases and manages the legacy securities and provides monthly reports to Treasury.

There are many participants in the operation and oversight of PPIF. Treasury, in particular, has many roles. Table 2.23 describes the participants and their respective roles.

TABLE 2.23

| PPIP PARTICIPANTS AND ROLES |                  |   |
|-----------------------------|------------------|---|
| Role                        | Participant      | Description   |
| Investor                    | Private Investor | Invests in a PPIF to purchase legacy assets   |
|                             | Treasury         | Provides an equity investment matching the contributions made by the private investors and fund manager                             |
|                             | Fund Manager     | Required to invest at least \$20 million in the PPIF — limited to 9.9% ownership of the total capital provided by private investors |
| Lender                      | Treasury         | Lends PPIF either 50% or 100% of the value of the total equity investment   |
|                             | Third Party      | Lends to PPIF — can be private lender or FRBNY via TALF — subject to leverage caps  |
| PPIF Manager                | Fund Manager     | Will make investment decisions and manage the operation of the PPIF — paid management fees  |
| Administrator               | Custodian        | Provides reports on the PPIF and provides asset test on the purchased securities  |
|                             | Valuation Agent  | Values assets purchased by the PPIF   |
| Oversight                   | SIGTARP          |   |
|                             | Treasury-OFS     | Allows access to all personnel and records involved in the activities of the PPIF   |
|                             | GAO              |   |

Source: Treasury, "Letter of Intent and Term Sheet," 7/8/2009; www.financialstability.gov/docs/PPIP\_LOI\_Term-Sheets.pdf, accessed 7/8/2009.

**PPIF Manager Selection**

According to Treasury officials, fund manager selection was a multistep process that began with the initial applications; followed by minimum criteria review; then final committee review, interviews, and comparison; and culminated in the selection of fund managers. All of the applicants were reportedly evaluated by a committee of five voting members and two non-voting members.<sup>203</sup>

Treasury reported that it initially received 141 applications and narrowed them down to 104 applicants based on incomplete or duplicative applications and other eligibility criteria. The 104 applicants were then compared against the minimum criteria. Failure to meet any two of the five criteria reportedly disqualified an applicant. According to Treasury officials, these criteria included, but were not limited to:<sup>204</sup>

- a demonstrated ability to raise \$500 million of private capital
- a demonstrated experience investing in eligible assets
- having \$10 billion in eligible assets under management
- a demonstrated capacity to manage the fund consistent with Treasury's goals for the program
- being headquartered in the United States

After eliminating the non-conforming applicants and dropouts, the committee narrowed the possible fund managers to 11 for further review, interviews, and ranking.<sup>205</sup> Upon completion, Treasury announced the following fund managers:<sup>206</sup>

- AllianceBernstein, L.P. and its sub-advisors Greenfield Partners, LLC, and Rialto Capital Management, LLC
- Angelo, Gordon & Co., L.P., and GE Capital Real Estate
- BlackRock, Inc.
- Invesco Ltd.
- Marathon Asset Management, L.P.
- Oaktree Capital Management, L.P.
- RIJ Western Asset Management, L.P.
- The TCW Group, Inc.
- Wellington Management Company, L.L.P.

In addition to the 9 announced fund managers, 10 leading small-, veteran-, minority-, and women-owned businesses will provide "meaningful" partnership roles to the PPIFs.<sup>207</sup> These roles include, but are not limited to, asset management, capital raising, broker-dealer, investment sourcing, research, advisory, cash management, and fund administration.<sup>208</sup>

**Terms Agreed to by Fund Managers**

On July 8, 2009, Treasury announced the terms of its equity and debt term sheets with the newly selected PPIF managers that will work to “generate attractive returns” through “long-term opportunistic investments.”<sup>209</sup> The debt term sheet set forth three financing options with respective leverage limits for the PPIF. The PPIF will purchase originally AAA-rated CMBS and non-agency RMBS issued prior to 2009 and other approved temporary investments.<sup>210</sup> The three financing options are:

1. equity matching, 100% debt financing as a percentage of total equity, and no additional debt financing is allowed
2. equity matching, 50% debt financing as a percentage of total equity, and a leverage cap for borrowing from a third party at 5:1
3. equity matching, 50% debt financing as a percentage of total equity, and leverage from the Federal Reserve through TALF at an amount in combination with Treasury that will “not exceed the total amount of TALF debt that would be available leveraging the PPIF equity alone”<sup>211</sup>

A fund manager has several options to leverage PPIF funds, depending on whether it seeks to purchase TALF-eligible securities. For example, if a fund manager raises \$50 in equity and receives a matching \$50 Treasury equity investment, it has three different options to seek Government leverage to buy MBS:

1. The fund manager can borrow 100% of equity (\$100) from Treasury as a non-recourse loan and buy a total of \$200 worth of MBS. Under this option, the fund manager may not borrow from TALF.
2. The fund manager can borrow nothing from Treasury and apply the full \$100 of equity to TALF as a haircut. If a particular MBS has a 20% haircut, the fund manager could obtain a maximum non-recourse loan from FRBNY of \$400 and purchase \$500 of MBS.
3. The fund manager can borrow 50% of the total equity (\$50) from Treasury under PPIF and seek additional funding from TALF to purchase MBS. However, because of the prohibition of leverage-on-leverage in the interaction between PPIF and TALF, the total leverage for the PPIF (using both Treasury and TALF debt) is based on the original equity. In this example, because the equity is \$100, the maximum leverage at a 20% TALF haircut is \$400. Because the PPIF fund manager has already received a \$50 loan from Treasury through PPIF, the maximum additional leverage that it can receive from TALF is an additional \$350, giving the fund manager the ability to purchase \$500 worth of MBS. As the program was originally designed, the PPIF would have been able to apply both the PPIF debt and equity (\$150 total) to TALF as the haircut, and in this

Temporary investments: For the purposes of PPIF, they are cash, Treasuries, money market mutual funds, and interest rate hedges.

example, would have been able to receive a \$600 loan under TALF and thus able to purchase \$750 worth of MBS.

If a PPIF is going to use third-party debt, the PPIF must form a subsidiary to finance, acquire, and hold the assets. Any recourse from the third-party debt is restricted to the subsidiary, and no further actions can be taken against the PPIF or its investors.

As the PPIFs begin to have normal operations, the fund managers will be required to submit an audited annual report, unaudited quarterly reports, monthly reports, and in some cases, weekly reports on behalf of the PPIFs. In the monthly reports the PPIF is required to report on the following:

- PPIF holdings (including CUSIP or ISIN, security description, par value, cost, fair market value, and accrued income)
- purchases and sales
- capital activity including contributions and withdrawals of securities and cash
- a summary of the change in the fair market value of the PPIF's investments
- performance data (including 1-month, 3-month, year-to-date, latest 12-months, since inception [cumulative] and since inception [annualized])
- management discussion and analysis of the partnership's investment activities
- an analysis of current market conditions

All PPIFs are required to have continuous testing of their solvency and liquidity. These tests include an asset coverage test, and, for PPIFs that choose debt financing, a leverage ratio test. The asset coverage test requires total assets to be proportionally larger than total debt, and the leverage ratio test, if applicable, requires the total debt to be proportionally larger than the total equity. Based on the requirements, a PPIF choosing 50% leverage must have an asset coverage ratio of at least 225% (i.e., if the PPIF has \$100 in debt, then the asset value of its portfolio must be at least \$225). On the other hand, if the PPIF chooses 100% debt financing, then it must have an asset coverage ratio of at least 150% (i.e., if the PPIF has \$100 debt, then the asset value must be at least \$150). Those PPIFs that do not comply with the standards set by the asset coverage test or the leverage test cannot purchase any more assets until the PPIF is in compliance and must submit weekly reports until the PPIF is in compliance. To determine the value of the assets, Treasury will employ a valuation agent that will report to Treasury its estimate of the value of the assets in the funds.

#### PPIP Safeguards and Conflict Mitigation

As SIGTARP noted in its April Quarterly Report, there are numerous potential opportunities for fraud, waste, and abuse in PPIP. On July 8, 2009, Treasury issued

**CUSIP:** Unique identifying number assigned to all registered securities in the United States and Canada.

**International Securities Identification Number (ISIN):** Unique identifying number assigned to all internationally traded securities.

**Solvency:** A company's ability to pay its debts with available cash.

**Asset Coverage Test:** For the purposes of PPIP, a requirement that the total assets of a PPIF be proportionally larger than total debt. The asset coverage ratio is calculated as:  $(\text{market value of PPIF assets}) + (\text{market value of any assets held by a subsidiary}) - (\text{any debt associated with those subsidiary assets}) / \text{total debt}$ .

**Leverage Ratio Test:** For the purposes of PPIP, the application of the leverage cap to determine if a PPIF exceeds its debt limit. Calculated as:  $\text{total debt} / \text{net assets}$ .

**Net Assets:** The value of all of the assets minus any debt associated with those assets.

*For more information on PPIP vulnerabilities and SIGTARP's recommendations, see Section 4: "Looking Forward: SIGTARP's Recommendations to Treasury" in SIGTARP's April Quarterly Report.*

updated guidance on safeguards put in place to protect the taxpayer against losses. Table 2.24 describes some of the safeguards included in the PPIP debt and equity agreements. In addition, Treasury announced specific conflict standards for PPIF managers. Table 2.25 describes these conflicts and the possible mitigating efforts put in place by Treasury to protect its investment in the PPIFs.

TABLE 2.24

| PPIP SAFEGUARDS                |   |
|--------------------------------|---|
| Interest Reserve               | PPIF must set aside three months of expected interest payments to Treasury.   |
| Investor Withdrawal Prevention | Investors cannot withdraw investment. The PPIF is supposed to be a long-term investment.  |
| Fund Manager Investment        | Fund managers must have at least \$20 million invested so they have some "skin in the game." Investment cannot exceed 9.9% of the total private investment.                                   |
| Independent Valuation          | A valuation agent is responsible for calculation of market value of eligible assets and temporary investments on a monthly basis. The same valuation agent will be used for all of the PPIFs. |
| Leverage Cap                   | There is a limit to the amount of debt a PPIF can take on.  |
| Distribution Waterfall         | When distributions are made, there is a defined order to ensure repayment of Treasury debt prior to distributions to private investors.   |
| Ethics                         | Fund managers are required to develop, implement, and monitor an ethics standard.   |
| Conflict Standards             | Fund managers are required to develop, implement, and monitor a conflicts standard.   |
| Eligible Asset Watch List      | In addition to the PPIP transactions, the fund manager and its affiliates must disclose information on all transactions with eligible assets outside of the PPIF.                             |

Source: Treasury, "Letter of Intent and Term Sheet," 7/8/2009, [www.financialstability.gov/docs/SPPP\\_LOI\\_Term\\_Sheets.pdf](http://www.financialstability.gov/docs/SPPP_LOI_Term_Sheets.pdf), accessed 7/8/2009.

**Leverage Cap:** For the purposes of PPIP, a limit to the amount of debt a PPIF can assume based on its equity. Calculated as: total debt / net assets.

TABLE 2.25

| <b>PPIF CONFLICTS OF INTEREST AND MITIGATING EFFORTS</b> |   |   |
|--|---|---|
| <b>Conflict:</b>   | <b>PPIF manager may have proprietary interest and/or interest for other clients in eligible collateral which could lead to a more favorable treatment of non-PPIF clients over PPIF investors and Treasury.</b>                               |   |
|  | Investment Advisors Act of 1940   | Shall comply with act, including, but not limited to: anti-fraud provisions, rules regarding record keeping, contracts, advertising, custody of client funds and assets, disclosure and transparency.   |
|  | Allocation and Valuation Pricing Policy   | Shall adopt a fair trade allocation policy that requires a pro rata or comparably equitable allocation of trades and investment opportunities between the PPIF and non-PPIF funds that invest in eligible assets.                                   |
|  | Co-investment   | Required to invest a minimum of \$20 million.   |
|  | Fiduciary Duty  | Acknowledge that it owes Treasury and the private investors fiduciary duties of loyalty and care when performing services for the PPIF.   |
|  | Record Access   | Treasury and SIGTARP have access to books and records of the PPIF.  |
| <b>Mitigating Efforts:</b>                               | Reviews   | Treasury and SIGTARP can conduct an annual or <i>ad hoc</i> review of compliance with these policies.   |
|  | Eligible Assets Watch List  | Will establish a list of securities in which the PPIF manager, its clients, and/or its named affiliates hold positions, or they are analyzing for current investment.   |
|  | Disclosure of Conflicts   | Shall disclose to Treasury all actual and potential conflicts of interest and who within the PPIF manager's firm will have access to PPIF investment and strategy decisions.  |
|  | Disclosure of Beneficial Ownership Interest   | Will disclose to Treasury all information regarding the beneficial owners of equity in a PPIF.  |
|  | Disclosure of Top 10 PPIF Positions   | Will report to Treasury and SIGTARP quarterly on the 10 largest positions of the PPIF.  |
|  | Investor Diligence  | Will comply with "Know Your Customer" regulations, Office of Foreign Asset Control statutes and regulations, and all relevant Federal securities screening laws.  |
|  | Independent Oversight   | Internal controls will be audited annually, with reports submitted to Treasury and SIGTARP. Valuation and return calculations and methodology will also be independently verified.  |
| <b>Conflict:</b>   | <b>PPIF manager may have conflicts with named affiliates holding or servicing eligible assets. The PPIF manager could have control over the affiliate's decisions, or the affiliate could have control over the PPIF manager's decisions.</b> |   |
|  | All controls from above.  |   |
| <b>Mitigating Efforts:</b>                               | Transaction Restrictions  | May not acquire or sell eligible assets to:<br>(1) fund manager<br>(2) sub-advisors of the fund manager<br>(3) any named affiliates of the fund manager<br>(4) any other PPIF   |
|  | Disclosure regarding asset acquisition  | Cannot inform PPIF investors or any other fund managed by the PPIF manager of potential acquisitions except to the extent necessary to facilitate a transaction for the PPIF  |
|  | Quarterly Disclosure  | Disclose quarterly when any affiliates:<br>(1) service eligible assets<br>(2) invest in any of the same categories of securities  |
| <b>Conflict:</b>   | <b>PPIF manager may have conflicts with fund raisers and broker-dealer relationships. These relationships could have revenue-sharing relationships which could improperly influence the decisions of the PPIF manager.</b>                    |   |
|  | All controls from above.  |   |
| <b>Mitigating Efforts:</b>                               | Relationship Restrictions   | (1) no trades for PPIF allowed by broker-dealer affiliates<br>(2) must disclose any such relationships and the terms of the relationship<br>(3) compliance department to put controls in place to prohibit, monitor, and test for such transactions |

Continued on next page.

| PPIF CONFLICTS OF INTEREST AND MITIGATING EFFORTS (CONTINUED) |  |   |
|---|--|---|
| <b>Conflict:</b>  | <b>PPIF managers may have personal conflicts of interest.</b>                      |   |
| <b>Mitigating Effort:</b>                                     | Personal Conflicts Policies  | All related parties, employees, and the like subject to conflict rules and code of ethics   |
| <b>Conflict:</b>  | <b>The PPIF manager may engage in asset crossing, flipping, or round tripping.</b> |   |
|   | All controls from above  |   |
| <b>Mitigating Efforts:</b>                                    | Transaction Restrictions   | (1) best price and/or best execution to be achieved<br>(2) no crossing trades<br>(3) no purchases with the intent of selling within one week<br>(4) no resale of assets within limited window of time of purchase |
| <b>Conflict:</b>  | <b>PPIF manager could be involved in other recovery-related programs.</b>          |   |
| <b>Mitigating Efforts:</b>                                    | Disclosure Requirement   | Must disclose to Treasury activities such as asset acquisition, disposition, or management services to the Federal Reserve or FDIC  |
| <b>Conflict:</b>  | <b>PPIF manager may improperly represent its relationship with Treasury.</b>       |   |
| <b>Mitigating Efforts:</b>                                    | Marketing Restrictions   | Cannot advertise its relationship with Treasury except for its participation in PPIF  |

Source: Treasury, response to SIGTARF draft report, 7/13/2009.

Asset Crossing: Buying or selling assets from affiliates, either directly or through third parties.

Asset Flipping: buying assets with the intention of reselling these assets in the short term.

Round Tripping: Buying an asset from an entity and reselling the asset back to the entity or its affiliates.

7(a) Program: SBA loan program guaranteeing a percentage of loans for small businesses that cannot otherwise obtain conventional loans at reasonable terms.

504 Community Development Loan Program: SBA program combining Government-guaranteed loans with private-sector mortgage loans to provide loans of up to \$10 million for community development.

### Unlocking Credit for Small Businesses

On March 16, 2009, Treasury initiated the Unlocking Credit for Small Businesses ("UCSB") program to encourage banks to extend more credit to small businesses.<sup>212</sup> Under the UCSB program, Treasury announced that it would purchase up to \$15 billion in securities backed by pools of Small Business Administration ("SBA") loans from two SBA participating programs: the 7(a) Program and the 504 Community Development Loan Program. According to Treasury, the UCSB program was designed to provide banks the liquidity necessary to start writing new small-business loans again.<sup>213</sup> As of June 30, 2009, Treasury had not expended any funds under the UCSB program.

## AUTOMOTIVE INDUSTRY SUPPORT PROGRAMS

For the U.S. automotive industry, the quarter ending June 30, 2009, was dominated by the bankruptcy filings of Chrysler and General Motors ("GM"). TARP is playing a key role in the financing of these companies as they undergo and emerge from bankruptcy, as well as in the support of critical related industries.

Through TARP, Treasury has initiated three distinct programs to support the automotive industry: the Automotive Industry Financing Program ("AIFP") to assist automakers and their financing arms,<sup>214</sup> the Auto Supplier Support Program ("ASSP") to assist the firms that supply them,<sup>215</sup> and the Auto Warranty Commitment Program ("AWCP") to support consumer confidence in these companies.<sup>216</sup> Investments in these three programs are summarized in Table 2.26.

TABLE 2.26

| TARP AUTOMOTIVE PROGRAMS FUNDING COMMITTED |                    |                  |                       |               |               |
|--|--------------------|------------------|-----------------------|---------------|---------------|
| AS OF 6/30/2009 (in billions)              |                    |                  |                       |               |               |
|  | Bankrupt Entities  |                  | Non-Bankrupt Entities |               | Total         |
|  | Chrysler           | GM               | Chrysler Financial    | GMAC          |               |
| Pre-Bankruptcy:                            |                    |                  |                       |               |               |
| AIFP                                       | \$4.5 <sup>a</sup> | \$19.4           | \$1.5                 | \$13.4        | \$38.8        |
| ASSP                                       | 1.5 <sup>b</sup>   | 3.5 <sup>c</sup> | --                    | --            | 5.0           |
| AWCP                                       | 0.3                | 0.4              | --                    | --            | 0.6           |
|  | <b>\$6.3</b>       | <b>\$23.3</b>    | <b>\$1.5</b>          | <b>\$13.4</b> | <b>\$44.4</b> |
| In-Bankruptcy (OP Financing):              |                    |                  |                       |               |               |
| AIFP                                       | \$3.8 <sup>d</sup> | \$30.1           | --                    | --            | \$33.9        |
| Post-Bankruptcy (Working Capital):         |                    |                  |                       |               |               |
| AIFP                                       | \$6.6 <sup>e</sup> | --               | --                    | --            | \$6.6         |
| Subtotals by Program:                      |                    |                  |                       |               |               |
| AIFP                                       |                    |                  |                       |               | \$79.3        |
| ASSP                                       |                    |                  |                       |               | 5.0           |
| AWCP                                       |                    |                  |                       |               | 0.6           |
| <b>Total</b>                               | <b>\$16.7</b>      | <b>\$53.4</b>    | <b>\$1.5</b>          | <b>\$13.4</b> | <b>\$85.0</b> |

Notes: Numbers affected by rounding. Data as of 6/30/2009.

<sup>a</sup> \$500 million of this commitment was never funded.

<sup>b</sup> Commitment was decreased to \$1 billion on 7/8/2009.

<sup>c</sup> Commitment was decreased to \$2.5 billion on 7/8/2009.

<sup>d</sup> \$1.9 billion of this commitment was never funded.

<sup>e</sup> Approximately \$4.7 billion of this commitment was provided in working capital, approximately \$2 billion was used to pay senior secured lenders.

Sources: Treasury, Transactions Report, 7/2/2009; Treasury, Transactions Report, 7/10/2009; Treasury, response to SIGTARP draft, 7/13/2009.

*For more information regarding the background of AIFP, refer to the AIFP discussions in SIGTARP's Initial Report and SIGTARP's April Quarterly Report.*

TABLE 2.27

| <b>AIFP FUNDING COMMITTED TO AUTO COMPANIES</b> |                  |
|---|------------------|
| <b>AS OF 6/30/2009 (\$ BILLIONS)</b>            |                  |
| <b>Institution</b>                              | <b>Total</b>     |
| Chrysler  | \$14.9           |
| GM  | 49.5             |
| Chrysler Financial                              | 1.5 <sup>a</sup> |
| GMAC  | 13.4             |
| <b>Total</b>                                    | <b>\$79.3</b>    |

Notes: Does not include funds invested under ASSP or AWCF. Numbers affected by rounding. Data as of 6/30/2009.

<sup>a</sup>As of 6/30/2009, \$130.8 million of principal payments related to the Chrysler Financial loan had been repaid.

Sources: Treasury, Transactions Report, 7/2/2009; Treasury, response to SIGTARP data call, 7/8/2009.

#### **Automotive Industry Financing Program**

The Automotive Industry Finance Program ("AIFP"), under which Treasury invests in automakers and their financial arms, was created on December 19, 2008, with the stated goal of preventing a significant disruption to the American automotive industry that would pose a systemic risk to financial market stability and have a negative effect on the U.S. economy.<sup>217</sup>

#### **Status of Funds**

As of June 30, 2009, Treasury had committed, through AIFP, \$79.3 billion to two automakers and their two financial affiliates of which, \$130.8 million has been repaid.<sup>218</sup> Treasury has received \$160 million in dividends and \$202 million in interest payments from its AIFP investments.<sup>219</sup> Table 2.27 summarizes Treasury's commitments under AIFP.

#### **Auto Supplier Support Program**

Because of the rapid decline in auto sales, many auto parts suppliers are struggling to access credit, and they face uncertainty regarding the future of their businesses. In a typical sales cycle, auto suppliers ship parts to manufacturers 45 to 60 days before receiving payment. The suppliers typically fund operations by borrowing from banks, using their receivables as collateral while payments are outstanding. However, the current credit crisis has made it very difficult for suppliers to get loans from banks. According to Treasury, the Auto Supplier Support Program ("ASSP") will provide select suppliers with access to Government-backed protection that guarantees money owed to them will be paid.<sup>220</sup>

### Program Goals

On March 19, 2009, Treasury announced the formation of ASSP to provide up to \$5 billion in financing to suppliers to the U.S. auto manufacturing industry. The program was designed to give suppliers confidence to continue shipping parts, paying employees, and maintaining operations.<sup>221</sup> Although all domestic auto companies were eligible to participate, Chrysler and General Motors are the only two that decided to take advantage of the program. However, any domestic supplier that ships parts to Chrysler or General Motors is also eligible, as well as any receivables for goods shipped after March 19, 2009, purchased on qualifying terms between an eligible manufacturer and an eligible supplier. The auto companies can select the suppliers and specific receivable accounts that will be included in the program. Selected suppliers sell their receivable accounts into the program at a small discount, as a fee for participation.<sup>222</sup>

### Status of Funds

On April 9, 2009, Treasury executed agreements to fund \$5 billion under ASSP. Both Chrysler and General Motors created special purpose vehicles ("SPVs") to receive these funds. Chrysler Receivables SPV, LLC received a commitment for \$1.5 billion and GM Supplier Receivables, LLC received a commitment for \$3.5 billion.<sup>223</sup> Table 2.28 summarizes the ASSP funds that were committed as of June 30, 2009.

Because most suppliers have been paid during the course of the companies' bankruptcies, a diminished amount of activity is expected under the program going forward. Under the original loan agreements for each SPV, the Treasury commitments could be decreased if the outstanding amounts did not exceed the commitments made on June 30, 2009. At the request of Chrysler and GM, on July 8, 2009, the original commitments were reduced to \$1.0 billion and \$2.5 billion respectively.<sup>224</sup>

Special Purpose Vehicle ("SPV"). An off-balance sheet legal entity that holds the transferred assets presumptively beyond the reach of the entities providing the assets (e.g., legally isolated).

TABLE 2.28

| ASSP FUNDING COMMITTED AS OF 6/30/2009 (\$ BILLIONS) |                     |
|--|---------------------|
| Institution  | Original Commitment |
| Chrysler Receivables SPV, LLC                        | \$1.5               |
| GM Supplier Receivables, LLC                         | 3.5                 |
| <b>Total</b>   | <b>\$5.0</b>        |

Notes: Numbers affected by rounding. Data as of 6/30/2009. Data does not include reductions that took place on 7/8/2009.

Source: Treasury, Transactions Report, 7/2/2009.

### Auto Warranty Commitment Program

How to maintain consumer confidence during their respective restructuring periods was a major issue for both Chrysler and GM. With the long-term futures of Chrysler and GM in doubt, there were concerns that some consumers would be reluctant to purchase vehicles because the manufacturers might not be able to honor the warranties. The Auto Warranty Commitment Program ("AWCP") was created to alleviate these concerns and encourage consumers to continue buying Chrysler and GM vehicles.

#### Program Goals

On March 30, 2009, Treasury announced the creation of AWCP to give retail consumers confidence that their automobile warranties would be honored. The program covers all warranties on new vehicles purchased during the participating manufacturers' restructuring period. Any retail consumer who purchases a new vehicle during this time will be automatically eligible for the program. According to Treasury, the program is designed to encourage the continued viability of restructuring auto companies by mitigating consumer uncertainty and increasing vehicle sales.<sup>225</sup>

#### Status of Funds

Prior to Chrysler's bankruptcy filing on April 30, 2009, Treasury made \$280 million available through an SPV to backstop warranties on new car sales. Similarly, Treasury made \$361 million available to GM prior to its bankruptcy.<sup>226</sup> Table 2.29 summarizes the funds that have been invested under AWCP.

As of June 30, 2009, the AWCP remains operational but Treasury has stated that the funds are not expected to be used by the manufacturers. Both companies are continuing to honor consumer warranties while in bankruptcy. Treasury expects that after Chrysler and GM emerge from bankruptcy, their respective SPVs will refund the committed funds back to Treasury.<sup>227</sup>

TABLE 2.29

| AWCP FUNDING COMMITTED AS OF 6/30/2009 (\$ MILLIONS) |                   |
|--|-------------------|
| Institution  | Investment Amount |
| Chrysler Warranty SPV LLC                            | \$280             |
| GM Warranty LLC                                      | 361               |
| <b>Total</b>   | <b>\$641</b>      |

Notes: Numbers affected by rounding. Data as of 6/30/2009.

Source: Treasury, Transactions Report, 7/2/2009.

## TARP TUTORIAL: BANKRUPTCY

As reported in SIGTARP's April Quarterly Report, Chrysler and GM were given 30- and 60-day extensions, respectively, to submit revised restructuring plans to the President's Auto Task Force. After the April Quarterly Report, both manufacturers were unable to obtain the voluntary stakeholder concessions needed to implement restructuring plans that would achieve long-term viability; each company thus filed for bankruptcy as a means to bring those plans to fruition. A basic tutorial on the bankruptcy process is provided below.

For more information on the President's Auto Task Force see Section 2: "TARP Overview" in SIGTARP's April Quarterly Report.

### Alternatives Available to a Financially Troubled Business

When a company's total liabilities are greater than its assets, it is considered *insolvent* and it has several options:

- pursuit of operational solutions such as merging with another company, refinancing business loans, or cutting costs
- dissolution of the company
- negotiations or some form of out-of-court arrangement with its creditors to pay off debts
- bankruptcy

### Dissolution

Among the alternatives available to financially troubled businesses (i.e., businesses that are or may become insolvent) is dissolution. Dissolution is the orderly liquidation of a company's operations under state law and involves the liquidation of the company's assets to pay, or partially pay, debts. Depending upon the nature of the business (e.g., partnership, limited partnership, limited liability company, corporation, etc.), dissolution may not fully release the business from its liability for debts not paid in full.

### Negotiations with Creditors

If a business is in financial trouble but wishes to continue operations, it may first request a meeting with *creditors*, the people or entities to whom it owes money, to try to come to an agreement (i.e., *workout*) regarding on how the business can pay back or settle outstanding debt. During these negotiations, the business discusses the reasons for the failure and tries to convince the creditors that working out an agreement would benefit all

**Insolvent:** A company's total liabilities (debts) are greater than its total assets.

**Liquidation:** The sale of a company's assets in order to pay off outstanding debts with the remaining amount being distributed to shareholders. Once this process is complete, the company goes out of business.

**Creditor:** A person or entity that is owed money by another person or entity.

|  |   |
|--|---|
| <p><b>Moratorium:</b> An authorized period to delay the payment of a debt obligation.</p> <p><b>Composition:</b> A settlement reached between a debtor and a creditor prior to bankruptcy. The settlement discharges the debt owed to the creditor for an amount less than the original amount owed.</p> | <p>parties because creditors would receive more money through a workout than if the business was forced to go into bankruptcy. A workout usually involves “an extension of time (a moratorium), a <i>pro rata</i> settlement (composition), or a combination of the two.”<sup>228</sup> The objective of a workout is similar to a formal reorganization bankruptcy proceeding in that the company is attempting to resolve its obligations to creditors and continue in business; however, it is generally much faster, less expensive, and more flexible than bankruptcy.</p>   |
| <p><b>Discharge:</b> A court action that releases a debtor from liability for certain types of debts.</p>  | <p><b>Bankruptcy</b></p> <p>If a business fails to reach an agreement with its creditors to restructure obligations in order to achieve more manageable payment terms, it may have to file for bankruptcy relief. The principal purpose of the United States Bankruptcy Code (the “Code”) is to grant a “fresh start” to the “honest but unfortunate debtor.”<sup>229</sup> In this context, a fresh start signifies “a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.”<sup>230</sup></p> <p>The discharge of debts in bankruptcy is a “permanent order prohibiting the creditors of the debtor from taking any form of collection action” against the discharged debts.<sup>231</sup> It is important to note that not all debts are discharged in a bankruptcy proceeding; but rather each form of bankruptcy (discussed in detail below) identifies the various categories of debts that are granted a discharge.</p> <p>The Code is a series of Federal statutes codified under Title 11 of the United States Code and is the “uniform federal law that governs all bankruptcy cases.”<sup>232</sup> Within Title 11, several subsections define the different types of bankruptcy proceedings (e.g., Chapter 7, Chapter 9, Chapter 11, Chapter 12, etc.) available to individuals, businesses, and other entities.</p> <p><b>What Happens in Bankruptcy</b></p> <p>Two common forms of bankruptcy available to businesses are liquidation and reorganization.</p> <p><b>Liquidation</b></p> <p>Chapter 7 of the Code relates to liquidation in bankruptcy, which is the most common form of bankruptcy filed by businesses in the United States.<sup>233</sup> According to a press release from the U.S. Courts, Chapter 7 – Liquidation “is used only when the corporation sees no hope of being able to operate successfully or to obtain the necessary creditor agreement.”<sup>234</sup></p> <p>The process of liquidation refers to the sale of a company’s assets for the satisfaction of creditors and the subsequent dissolution of the business. Under Chapter 7, a</p> |

bankruptcy trustee gathers and sells a bankrupt company's nonexempt assets and uses the proceeds of such assets to pay creditors in accordance with the priority of creditors established by the Code. See the "Hierarchy of Claims, by Priority" discussion later in this section for information on priority payments.

#### Reorganization

Reorganization in bankruptcy falls under Chapter 11 of the Code and is the second-most common form of bankruptcy filed by businesses in the United States.<sup>229</sup> Chapter 11 business reorganization "can be used as the means of working out an arrangement with creditors where the debtor is allowed to continue in business ... [or] can be used for a complete reorganization of the corporation."<sup>230</sup>

Under Chapter 11, the company files a "plan of reorganization," which is prepared in cooperation with its creditors, and details the necessary steps the company must take in order to emerge from bankruptcy as a viable entity. The plan of reorganization may call for any number of actions the business and its advisors deem necessary for a successful reorganization of the business, including, for example, the sale of non-essential business units to third parties or the reworking of labor contracts.<sup>231</sup> The "plan of reorganization" must be reasonable in its attempt to restructure the business because it must obtain approval from the creditors' committee and the bankruptcy court. Since the plan of reorganization generally includes concessions from all interested parties, showing favor to any particular group of creditors will likely cause the plan to be rejected by competing creditors whose interests are impacted more severely by the bankruptcy. Further, as it ordinarily occurs, if a creditor or class of creditors rejects a plan of reorganization, then the bankruptcy court may confirm or approve the plan over such objection — but only upon a demonstration that the creditor or creditor class would have fared no better had the bankruptcy been processed under Chapter 7 — Liquidation.

#### Prepackaged Reorganization

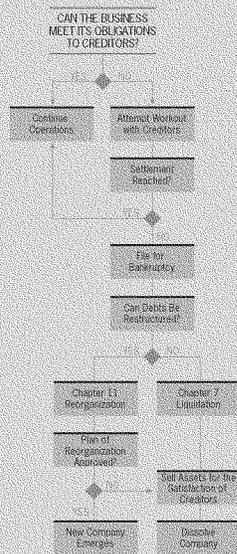
A prepackaged bankruptcy is similar to a workout and refers to a proceeding in which the business filing for protection has met with its creditors to negotiate their expected recoveries prior to the actual filing of a petition under the Code. The goal of a prepackaged bankruptcy is to shorten the bankruptcy process to save fees a company would typically pay to bankruptcy advisors. A prepackaged bankruptcy also minimizes the amount of time spent in bankruptcy restructuring a business and, consequently, can return an operating entity to its core business and generating revenue much sooner than if it had participated in a standard reorganization.

**Trustee:** A person who holds property on behalf of a beneficiary.

**Nonexempt Assets:** Property that belongs to a debtor which can be liquidated to satisfy creditor claims. Examples include motor vehicles, real estate, factories, etc.

**Creditors' Committee:** A group representing several entities that have claims against a business in a bankruptcy proceeding.

FIGURE 2.13  
BANKRUPTCY DECISION FLOW



**Secured Creditor:** A creditor that holds a special assurance of debt payment, through holding collateral or possessing a lien on the same.

**Collateral:** Tangible assets pledged against debts owed.

#### Section 363 Sale

It may become apparent that a company cannot reorganize and maintain its current ownership structure and therefore must pursue a sale of most, if not all, of its assets under Section 363 of the Code. In this scenario, the company does not emerge from bankruptcy but, instead, comes under new ownership — as in the cases of the Chrysler and GM bankruptcies.

Regardless of the nature of the reorganization, many companies face the same decisions in the process leading up to declaring bankruptcy. These decisions are described in Figure 2.13.

#### Who Is Involved in Bankruptcy?

##### Creditors

When a business enters into a bankruptcy proceeding, a variety of individuals or organizations may have claims — employees may be owed wages, banks may be owed loans, and other financial institutions may have unfulfilled contracts with the business. These individuals or companies are all referred to as creditors because the business owes them something. At the point of bankruptcy, the likelihood of any of these creditors being repaid depends on whether the company has enough assets to repay its debts. The Code provides for circumstances in which a business does not have enough assets to satisfy all of its debts by establishing a hierarchy of priority among creditors.

In some cases, the creditors and the business may have already negotiated terms of repayment and developed a restructuring or liquidation plan in advance of filing. Such arrangements can improve the speed and efficiency of a restructuring or even liquidation. However, this is often not the case and, as experienced by Chrysler, certain creditors may take issue with the plan and try to block or stall the bankruptcy plan until they are satisfied or until their objections have been overruled by the court.

Claimants to the assets of a company are categorized as either secured creditors or unsecured creditors. A *secured creditor* must present proof of its claim to the bankruptcy court for the claim to be honored. Secured claims are then paid directly from forfeiture of the company's collateral or proceeds from the sale of its collateral. If the collateral is insufficient to pay the claim in full, the balance becomes an unsecured claim and enters into the queue of other unsecured creditors. As the name implies, unsecured creditors do not have any tangible assets pledged against the debts owed to them by the business.

TABLE 2.30

**PRIORITIES, PER THE U.S. BANKRUPTCY CODE**

| Priority | Claim   |
|----------|---|
| First    | Allowed unsecured claims: <ul style="list-style-type: none"> <li>• Domestic support obligations (debts to spouse or children for court-ordered support)</li> <li>• Administrative expenses of the bankruptcy (lawyers, trustees, etc.)</li> <li>• "Gap" claims (unsecured, post-petition claims in an involuntary bankruptcy case arising after initiation of case but before appointment of trustee, relating to ordinary business or finances)</li> <li>• Wages, commissions (claims of employees/independent salespersons up to \$10,000 per claim)</li> <li>• Employee benefit plans (contributions of up to \$10,000 per employee)</li> <li>• Specific claims of farmers and fishermen against bankrupt storage or processing facilities</li> <li>• "Layaway" claims (individuals did not receive the goods/services for which they made deposits)</li> <li>• Government taxes (recent income, sales, employment, or gross receipts taxes)</li> <li>• Regulatory obligations (to FDIC or equivalent to maintain capital of insured depository institution)</li> <li>• Vehicle-related personal injury or death (if debtor used vehicle/vessel under the influence of drugs/alcohol)</li> </ul> |
| Second   | Other claims, filed on time, that do not fall into "First," "Third," or "Fourth" category below   |
| Third    | Allowed unsecured tardy or late claims  |
| Fourth   | Allowed secured or unsecured claims for any fines, penalties, damages from before the bankruptcy which are not compensation for actual pecuniary loss suffered by the claimant  |
| Fifth    | Interest accrued, at legal rate, from the date of the filing to payment of allowed claims   |
| Sixth    | To the debtor   |

Source: Mtu Code Special Reprinted Edition, United States Bankruptcy Code, 2006 Edition, Texas: AWNEY, L.P., 2005.

**Hierarchy of Claims, by Priority**

The term "priority" refers to the order in which unsecured claims in a bankruptcy case are paid from the money available in the bankruptcy estate. Claims in the higher priority are paid in full before claims in a lower priority receive anything. Once a company pays all of its debts, any remaining assets are returned to its shareholders.

Section 726 of the Code lists six classes of unsecured creditors in a bankruptcy, in order of priority.<sup>228</sup> Table 2.30 provides a summary outline of those classes. Note the first grouping of claims is defined by Section 507 of the Code and is further broken down into a sub-hierarchy.

**Trustee**

The role of the trustee varies greatly, based on the chapter under which a company files. A Chapter 7 trustee is broadly responsible for managing the financial aspects of a bankrupt business undergoing liquidation. The trustee can be an individual or a team of professionals who, among other things:

- account for property received
- investigate the financial affairs of the debtor

- review proofs of claim
- oppose the debtor's discharge, if appropriate
- furnish information to interested parties
- report on the administration of the case

The trustee is paid out of the proceeds of the liquidation and is second in order among the first class of unsecured creditors.

A Chapter 11 trustee serves more in an administrative capacity, focusing more directly on the reporting requirements associated with the bankruptcy case and fee applications for compensation that are submitted by professionals and advisors rendering bankruptcy-related services to the company. The trustee receives a quarterly fee from the business as compensation.

#### **Bankruptcy Court**

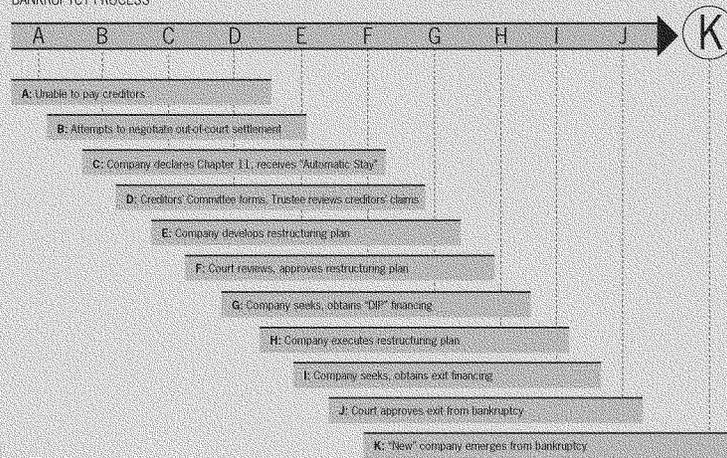
Bankruptcies, both personal and corporate, are administered by U.S. Federal courts; bankruptcy cases cannot be filed in state court. The Federal court system is composed of 94 districts, all of which handle bankruptcy matters, and substantially all of which have a court specifically designated for bankruptcy.<sup>299</sup>

#### **Example of Chapter 11 Bankruptcy Process**

This section provides a simplified step-by-step example of a Chapter 11 bankruptcy process for a hypothetical business, "Sample Company," walking through the key steps from the initial realization that it cannot repay its creditors to the new company emerging from the process. A bankruptcy process can be lengthy, especially if the negotiation with creditors is difficult — all it takes is one creditor to delay the approval of a restructuring plan (or a pre-bankruptcy restructuring agreement). The process detailed below and illustrated in Figure 2.14 for Sample Company is a simplified version, focused on the key steps of the process.

- A. Sample Company is operating in a difficult market environment. Its revenues have shrunk, but its obligations have not. It discovers that it no longer can afford to pay its debts to its creditors without cutting back on its variable costs. It cancels all non-essential purchases, suspends dividend payments to its shareholders, but still this does not generate enough cash to pay its obligations. Sample Company begins to lay off employees to shrink its payroll and closes unprofitable plants to cut operating costs, but still cannot bring its expenditures in line with its new, lower revenues.

FIGURE 2.14  
BANKRUPTCY PROCESS



- B. Sample Company owes a lot of money; it is saddled with expensive debts to creditors incurred when it borrowed heavily to grow a few years earlier. These creditors range from banks that provided loans, to bondholders whose bonds were issued at high rates because the company's debt was not highly rated, to obligations for employees' benefit plans (such as pensions). Seeing that it cannot continue to meet all these obligations, Sample Company seeks to renegotiate some or all of its debts to a more manageable level.
- C. Some of Sample Company's creditors agree to reduce the debt that they are owed, thinking that a voluntary restructuring is preferable to a court-administrated bankruptcy or liquidation where it is uncertain what they would receive for their claims. However, certain creditors are uncompromising, thinking that the company's offers understate what they think the company can actually afford to repay them. They refuse the offer of

Debtor in Possession ("DIP"). A company which is operating under Chapter 11 bankruptcy protection, which still technically owns its assets but is operating them to maximize the benefit to its creditors.

a voluntary restructuring, which forces Sample Company to file a petition for Chapter 11 bankruptcy with the U.S. court in its district. With its filing, Sample Company receives an "Automatic Stay" meaning that creditors are temporarily prohibited from enforcing their claims outside of the bankruptcy forum.

- D. With the filing of the bankruptcy petition, Sample Company becomes what is known as the debtor in possession ("DIP"). DIPs retain possession of the operations and assets of the business until otherwise ordered by the court (which could be the case if the court ultimately decides Chapter 7 -- Liquidation is the best option and appoints a trustee to manage the company through that process). Sample Company also provides to the court a range of documents certifying its assets and liabilities, income and expenditures, contracts and unexpired leases, and a statement certifying its financial affairs. Meanwhile, the U.S. Trustee, appointed by the court to monitor Sample Company during its bankruptcy, works with creditors to assemble a Creditors' Committee. The Creditors' Committee hires an attorney to advocate for the creditors' claims with the court. Any creditors whose claims are not listed on the schedules provided to the court by Sample Company must provide a proof of claim to be included in the case.
- E. As DIP, Sample Company assumes all of the fiduciary responsibilities of a trustee, aside from the investigative role, and uses this authority to hire a team of lawyers, accountants, consultants, appraisers, and auctioneers — whose compensation represents unsecured claims with priority over all other unsecured claims except "super-priorities" — to help it throughout the restructuring process. Sample Company works with this team to develop a restructuring plan that both shrinks the company and its debts. Ideally, Sample Company will emerge as a leaner, profitable company with more manageable debts. The plan that Sample Company develops includes closing down additional unprofitable plants, selling certain business lines, and converting some of its debt holders into equity holders by exchanging their bonds or loans for shares of stock, making them partial owners in the new company. In addition to selling just portions of a business, a company's restructuring plan can include an arrangement whereby the entire business is sold to another company (a Section 363 sale). An example of a Section 363 sale can be found in the recent restructuring of Chrysler, where the operating business was sold to a new group of owners.
- F. Once Sample Company has developed its restructuring plan, it must seek the consent of its creditors to approve the plan. In order to receive that consent, Sample Company files a disclosure providing creditors with information about its plan and Sample

Company's affairs so that they can make an informed decision about the proposed plan. The court then holds a hearing. In Sample Company's case, the creditors approve its plan, which is confirmed in a court hearing as being feasible, in good faith, and compliant with the Code, allowing it to begin implementation of the restructuring process. Additionally, the confirmation of the plan effectively discharges Sample Company from its dischargeable pre-filing debts (i.e., debts not part of the bankruptcy claims), and replaces them with the agreed-upon obligations contained in the plan.<sup>240</sup>

- G. Since Sample Company has taken on additional expenses such as lawyers and consultants, its plan provides for operating capital to help it complete the restructuring process. It obtains this financing, called "DIP financing," from a bank which receives court-appointed "super-priority" in claims — placing it above all other unsecured creditors in the priority list.
- H. After the confirmation of the restructuring plan, Sample Company operates as a functioning company; it is now obligated to begin making any payments it promised in the plan, and is bound by all commitments contained in the provisions of the plan (which supersede its pre-bankruptcy contracts). Sample Company's restructuring process is relatively straightforward, and it achieves the key objectives rapidly. It sells several non-core units, and converts the debt to its bondholders to an equity stake as determined in the plan. Further, it converts some of the unpaid obligations to employees' benefit plans into equity stakes. Throughout this process Sample Company reports regularly to the court and the Creditors' Committee on the progress made since confirmation of the plan.
- I. As Sample Company nears the completion of its restructuring and recapitalization process, it seeks exit financing — actually a key component of its restructuring plan. It negotiates an exit financing facility from a major lender, which it uses to pay off certain creditors' claims and to fund its ongoing operations after bankruptcy. This exit financing will enable the new company to emerge from bankruptcy in a strong, competitive state.
- J. Once Sample Company completes its restructuring plan, it returns to court and applies for a "final decree" which certifies consummation of the plan. This enables the newly restructured, recapitalized Sample Company to emerge from bankruptcy.
- K. The "new" Sample Company begins operating, and uses its new financial health to operate more competitively in its market.

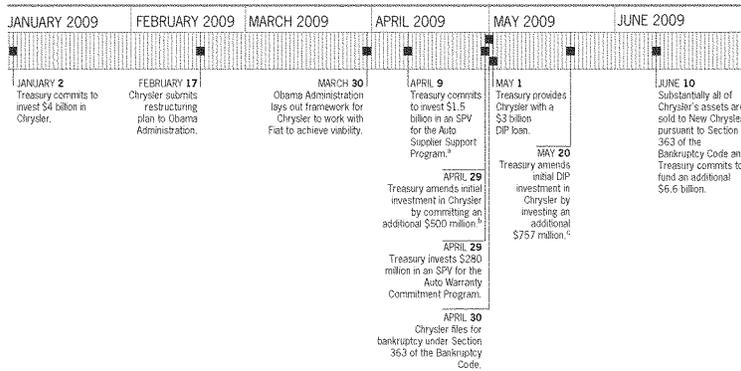
DIP Financing: A credit line used during Chapter 11 proceedings to maintain the value of a company's asset base.

New Chrysler: The entity that purchased substantially all of Chrysler's assets during bankruptcy.

**Chrysler**

Chrysler filed for Chapter 11 bankruptcy on April 30, 2009, and the transaction in which substantially all of its assets were sold to the newly formed entity ("New Chrysler") closed on June 10, 2009. Chrysler has received \$16.7 billion in commitments from Treasury through AIFP, ASSP, and AWCP, \$10.4 billion of which was provided through DIP or working capital funding after Chrysler's bankruptcy filing.<sup>242</sup> Figure 2.15 shows a timeline of Treasury's investments in Chrysler as well as important milestones regarding Chrysler's bankruptcy.

FIGURE 2.15  
CHRYSLER TIMELINE



Notes:  
<sup>a</sup> Commitment was decreased to \$1 billion on 7/8/2009.  
<sup>b</sup> This \$500 million commitment was never funded.  
<sup>c</sup> \$1.9 billion of the total \$3.8 billion DIP financing was never funded.

Sources: Treasury, *Transactions Report*, 7/2/2009; Treasury, "Obama Administration Auto Restructuring Initiative: Chrysler-Fiat Alliance," 4/30/2009, [www.financialstability.gov](http://www.financialstability.gov), accessed 6/9/2009; Treasury, "Obama Administration New Path to Viability for GM & Chrysler," 3/30/2009, [www.financialstability.gov](http://www.financialstability.gov), accessed 6/9/2009; Treasury, responses to SIGTARP drafts, 7/9/2009 and 7/13/2009.

**Chrysler-Fiat Alliance**

On March 30, 2009, the President's Auto Task Force determined that Chrysler's restructuring plan was not likely to lead to viability on a stand-alone basis as it was structured at the time. The Government stated that Chrysler could only achieve viability by forming a partnership with Fiat.<sup>242</sup> On April 30, 2009, Chrysler filed for bankruptcy under Chapter 11 of the United States Bankruptcy Code. As noted above, New Chrysler emerged from bankruptcy on June 10, 2009, with a new ownership structure including Fiat. See Table 2.31 for a list of the actions taken by each stakeholder and their respective equity stakes in New Chrysler.<sup>243</sup>

*Pro Forma:* In finance, refers to the presentation of hypothetical financial information assuming that certain assumptions will happen. For example, Table 2.31 sets forth the ownership interests in New Chrysler based on the assumption that Fiat will meet its performance goals and obtain an additional 15% of equity from the other equity holders. If the new equity stakes were not reported *pro forma*, the equity interest of the other equity participants would be higher to account for Fiat's additional 15%.

TABLE 2.31

| CHRYSLER-FIAT ALLIANCE STAKEHOLDERS ACTIONS AND EQUITY STAKE |  |  |
|--|--|--|
| Stakeholders   | Action   | Equity Stakes with New Chrysler-Fiat Alliance <sup>a</sup>   |
| Fiat   | <ul style="list-style-type: none"> <li>Contribute billions of dollars in technology and intellectual property</li> <li>Offer access to global distribution network</li> </ul>  | <ul style="list-style-type: none"> <li>20% equity in New Chrysler</li> <li>15% additional equity based on performance metrics<sup>b</sup></li> <li>Selection of three directors</li> </ul> |
| Secured Lenders  | <ul style="list-style-type: none"> <li>Exchange \$6.9 billion secured claim</li> </ul>   | <ul style="list-style-type: none"> <li>Receive \$2 billion cash</li> </ul>   |
| UAW (VEBA)   | <ul style="list-style-type: none"> <li>Make concessions on wages, benefits, and retiree health care</li> </ul>   | <ul style="list-style-type: none"> <li>55% equity in New Chrysler, <i>pro forma</i> for Fiat additional equity</li> <li>Selection of one director</li> </ul>                               |
| United States Treasury                                       | <ul style="list-style-type: none"> <li>Waive repayment of \$1.9 billion DP financing provided during bankruptcy<sup>c</sup></li> <li>Provide \$4.7 billion in working capital<sup>d</sup></li> <li>Waive \$3.5 billion of the \$4 billion pre-bankruptcy loan, with the remaining \$500 million carried over to the new financing<sup>e</sup></li> </ul> | <ul style="list-style-type: none"> <li>8% equity in New Chrysler, <i>pro forma</i></li> <li>Selection of four directors</li> </ul>   |
| Canadian Government  | <ul style="list-style-type: none"> <li>Lend money alongside the U.S. Treasury based on a 3:1 formula</li> </ul>  | <ul style="list-style-type: none"> <li>2% equity in New Chrysler, <i>pro forma</i></li> <li>Selection of one director</li> </ul>   |
| Daimler  | <ul style="list-style-type: none"> <li>Waive its share of Chrysler's \$2 billion second-lien debt</li> <li>Waive 19% equity in Chrysler's parent</li> <li>Pay \$600 million to Chrysler's Pension Plan to settle PBGC obligation</li> </ul>  | <ul style="list-style-type: none"> <li>None</li> </ul>   |
| Cerberus   | <ul style="list-style-type: none"> <li>Waive its share of Chrysler's \$2 billion second-lien debt</li> <li>Forfeit its entire equity stake in Chrysler</li> <li>Transfer ownership of old Chrysler headquarters building to the New Chrysler-Fiat alliance</li> <li>Contribute to a claim against Daimler to help settle with PBGC</li> </ul>            | <ul style="list-style-type: none"> <li>None</li> </ul>   |
| PBGC   | <ul style="list-style-type: none"> <li>Settle claim with Daimler</li> </ul>  | <ul style="list-style-type: none"> <li>None</li> </ul>   |

Notes: Numbers affected by rounding.  
<sup>a</sup>The listed ownership percentages are based on the assumption that Fiat will achieve all three performance metrics.  
<sup>b</sup>Fiat can earn this 15% equity by achieving certain performance metrics. It would receive 5% for meeting each of three performance goals: produce a vehicle at a Chrysler factory in the United States that performs at 40 mpg or better; provide Chrysler with a distribution network in numerous foreign jurisdictions; manufacture state-of-the-art, next generation engines at a U.S. Chrysler facility.  
<sup>c</sup>\$2.8 billion DP financing was initially committed but \$1.9 billion of that commitment was never funded.  
<sup>d</sup>A total of \$6.6 billion is committed; \$3 billion is used to pay senior secured lenders.  
<sup>e</sup>\$4.5 billion was originally committed, but \$500 million of that commitment was never funded.  
 Sources: Treasury, "Obama Administration Auto Restructuring Initiative: Chrysler-Fiat Alliance," 4/30/2009, www.financialstability.gov/docs/AFIP/Chrysler-restructuring/factsheet\_043009.pdf, accessed 6/9/2009; Treasury, responses to SICR/AFIP draft reports, 7/9/2009 and 7/13/2009.

**TARP Support for Chrysler**

As shown in Table 2.26, Treasury is using a number of different TARP investment vehicles to support Chrysler. Treasury has stated that its intention is to maximize taxpayer return, while at the same time maximizing the likelihood of the New Chrysler succeeding.<sup>244</sup> Prior to Chrysler's bankruptcy, Treasury increased its initial \$4.5 billion loan by \$280.1 million, which was set aside for the Auto Warranty Commitment Program ("AWCP") and which will be returned to Treasury. While Chrysler was in bankruptcy, Treasury committed to provide a loan of \$3.8 billion in DIP financing. On June 10, 2009, Treasury committed \$6.6 billion in new debt obligations. Treasury does not expect to receive repayment for its DIP investments but expects repayment of \$6.6 billion in loans and has received an 8% *pro forma* equity share in New Chrysler.<sup>245</sup> Treasury will also select four of the initial independent directors, but has claimed that it will play no other role in management or governance of the company.<sup>246</sup> Treasury anticipates having quarterly meetings with Chrysler leadership that focus solely on financial reporting and key operating metrics.

**Financing**

Chrysler entered into an agreement with GMAC, pursuant to which GMAC agreed to provide certain dealer and retail financing. GMAC will have financing agreements with both Chrysler and GM post-bankruptcy. Treasury has provided GMAC with additional capital to support its anticipated growth in Chrysler dealer and retail loans.<sup>247</sup>

TABLE 2.32

| IMPACT OF THE CHRYSLER-FIAT ALLIANCE ON STAKEHOLDERS |  |
|--|--|
| Stakeholders   | Impact   |
| Employees  | <ul style="list-style-type: none"> <li>Chrysler's insurers will continue to pay workers compensation claims.</li> <li>Pension plan and VEBA funding will be transferred to the purchaser.</li> </ul>   |
| Suppliers  | <ul style="list-style-type: none"> <li>Chrysler will continue to pay suppliers.</li> <li>Auto Supplier Support Program will continue to operate.</li> </ul>  |
| Dealers  | <ul style="list-style-type: none"> <li>Chrysler will continue to honor customer warranties.</li> <li>Chrysler will continue to honor dealer incentives for those dealers that will remain operational.</li> <li>Chrysler has identified certain dealers to terminate.</li> </ul> |
| UAW  | <ul style="list-style-type: none"> <li>Modified labor agreement between UAW and Chrysler will be operative.</li> </ul>   |
| Creditors  | <ul style="list-style-type: none"> <li>Majority of senior secured lenders support the transactions.</li> </ul>   |

Source: Treasury, "Obama Administration Auto Restructuring Initiative: Chrysler-Fiat Alliance," 4/30/2009, [www.financialstability.gov/docs/AIFP/ChryslerRestructuringfactsheet\\_043009.pdf](http://www.financialstability.gov/docs/AIFP/ChryslerRestructuringfactsheet_043009.pdf), accessed 6/9/2009.

FIGURE 2.16

GM TIMELINE



Note:  
\* Commitment was decreased to \$2.5 billion on 7/8/2009.

Sources: Treasury, *Transactions Report*, 7/2/2009; Treasury, "Obama Administration Auto Restructuring Initiative: General Motors Restructuring," 6/1/2009, [www.financialstability.gov](http://www.financialstability.gov), accessed 6/9/2009; Treasury, "Obama Administration New Path to Viability for GM & Chrysler," 3/30/2009, [www.financialstability.gov](http://www.financialstability.gov), accessed 6/9/2009; Treasury, responses to SIGTARP draft, 7/9/2009 and 7/13/2009.

**Execution of the Chrysler-Fiat Alliance**

Chrysler entered bankruptcy on April 30, 2009, and substantially all of its assets were sold to New Chrysler on June 10, 2009, with a new alliance with Fiat.<sup>248</sup> The impact of the alliance on the specific stakeholders is listed in Table 2.32.

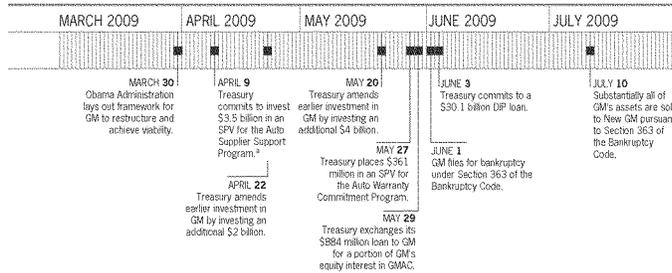
**General Motors**

General Motors ("GM") filed for Chapter 11 bankruptcy on June 1, 2009, and the transaction in which substantially all of its assets were sold to the newly formed entity ("New GM") closed on July 10, 2009. Treasury has committed \$53.4 billion to GM, of which \$30.1 billion is DIP financing.<sup>249</sup> Figure 2.16 shows a timeline of Treasury's investments in GM as well as important milestones regarding GM's bankruptcy.

**Restructured General Motors**

In accordance with the March 31, 2009, deadline, the Obama Administration determined that GM's restructuring plan was not likely to lead to viability on a stand-alone basis. The Government laid out the framework for GM to achieve viability through a substantially more aggressive restructuring plan.<sup>250</sup> On June 1, 2009, GM filed for bankruptcy under Chapter 11 of the United States Bankruptcy Code. Under its reorganization plan, New GM will purchase from GM the assets needed to implement the plan for viability. In exchange for this purchase, Treasury will waive the majority of its loans to GM and obtain a controlling equity stake in the new company. See Table 2.33 for a list of the actions taken by each stakeholder and their respective role with New GM.<sup>251</sup>

New GM: The entity that purchased substantially all of GM's assets during bankruptcy.



**TARP Support for GM**

As shown in Table 2.26, Treasury has made a number of investments in GM. In December 2008, Treasury made two initial investments in GM: one that provided \$884 million and one that committed to provide GM an additional \$13.4 billion in financing. Treasury made three amendments to the \$13.4 billion loan bringing the total of that loan, as of May 27, 2009, to \$19.8 billion, which includes \$361 million used to capitalize an SPV for the Auto Warranty Commitment Program.<sup>252</sup>

On May 29, 2009, Treasury exchanged its \$884 million loan in GM for a portion of GM's common equity in GMAC. This transaction raised Treasury's ownership of GMAC's common equity to 35.4%.<sup>253</sup>

GM filed for bankruptcy on June 1, 2009. On June 3, 2009, Treasury committed to loan GM \$30.1 billion, under the terms of the DIP financing agreement.<sup>254</sup>

According to Treasury, the Government is taking steps to limit its involvement in the day-to-day management of GM. The Obama Administration has published four core principles to guide the Government's management of ownership interests

TABLE 2.33

| NEW GM STAKEHOLDERS ACTIONS AND ROLES |   |  |
|---------------------------------------|---|--|
| Stakeholders                          | Restructuring Actions   | Role with New GM   |
| UAW (VEBA)                            | <ul style="list-style-type: none"> <li>Make concessions on compensation and retiree health care</li> </ul>  | <ul style="list-style-type: none"> <li>17.5% equity share of New GM</li> <li>Warrants to purchase an additional 2.5% share of New GM</li> <li>Select one initial director</li> </ul>                                   |
| Bondholders                           | <ul style="list-style-type: none"> <li>Give up \$27.1 billion of unsecured debt</li> </ul>  | <ul style="list-style-type: none"> <li>10% equity share of New GM</li> <li>Warrants to purchase an additional 15% share of New GM</li> </ul>   |
| GM Pension Plans                      | <ul style="list-style-type: none"> <li>None</li> </ul>  | <ul style="list-style-type: none"> <li>Transferred to New GM</li> </ul>  |
| United States Treasury                | <ul style="list-style-type: none"> <li>Provide \$30.1 billion in DIP financing to support GM through bankruptcy</li> <li>Contribute the \$19.4 billion pre-bankruptcy loan</li> </ul> | <ul style="list-style-type: none"> <li>\$7.1 billion in debt assumed by New GM</li> <li>\$2.1 billion of preferred stock in New GM</li> <li>61% equity share of New GM</li> <li>Select 10 initial directors</li> </ul> |
| Governments of Canada and Ontario     | <ul style="list-style-type: none"> <li>Lend \$9.5 billion</li> </ul>  | <ul style="list-style-type: none"> <li>\$1.7 billion in debt and preferred stock in New GM</li> <li>12% equity share of the New GM</li> <li>Select one initial director</li> </ul>                                     |

Notes: Numbers affected by rounding. Treasury did not publish pro forma data on equity ownership.

Sources: Treasury, "Obama Administration Auto Restructuring Initiative: General Motors Restructuring," 6/1/2009, [www.financialstability.gov/ohs/05112009\\_gmstructure.html](http://www.financialstability.gov/ohs/05112009_gmstructure.html), accessed 6/10/2009; Treasury, responses to SGI TARP draft reports, 7/9/2009 and 7/13/2009.

in private firms such as GM. According to Treasury, the Government will attempt to do the following:<sup>255</sup>

- seek to dispose of its ownership interest as soon as practicable
- reserve the right to set upfront conditions to protect taxpayers, promote financial stability, and encourage growth
- protect the taxpayers' investment by managing its ownership stake in a hands-off, commercial manner
- vote on core governance issues, including the selection of a company's board of directors and major corporate events or transactions

OFS has not publicly released the details of its exit strategy for GM.

#### Execution of the GM Restructuring

GM entered bankruptcy on June 1, 2009. The impact of the restructuring on the specific stakeholders is described in Table 2.34.

TABLE 2.34

| EXECUTION IMPACT OF THE GENERAL MOTORS RESTRUCTURING ON STAKEHOLDERS |   |
|--|---|
| Stakeholders   | Impact  |
| Employees  | <ul style="list-style-type: none"> <li>• Pension Plan and VEBA funding will be transferred to New GM</li> </ul>   |
| Suppliers  | <ul style="list-style-type: none"> <li>• GM will continue to pay suppliers</li> <li>• Auto Supplier Support Program will continue to operate</li> </ul>   |
| Dealers  | <ul style="list-style-type: none"> <li>• GM will continue to honor customer warranties</li> <li>• GM will attempt to honor dealer incentives for those dealers that will remain operational</li> <li>• GM will identify certain dealers to terminate</li> </ul> |
| UAW  | <ul style="list-style-type: none"> <li>• Modified labor agreement between UAW and GM will be operative</li> </ul>   |

Source: Treasury, "Obama Administration Auto Restructuring Initiative: General Motors Restructuring," 6/1/2009, [www.financialstability.gov/facts/05312009\\_gm-factsheet.html](http://www.financialstability.gov/facts/05312009_gm-factsheet.html), accessed 6/10/2009.

**GMAC**

The majority of automobile purchases in the United States are financed, including an estimated 80% – 90% of consumer purchases and substantially all dealer inventory purchases.<sup>256</sup> In fall 2008, credit began to tighten and it became increasingly difficult for both dealers and customers to obtain credit for automobile purchases. It has been estimated that 2 million to 2.5 million vehicle sales were lost because either dealers or customers could not obtain credit.<sup>257</sup> Treasury has stated that it believes its investment in GMAC will help provide a reliable source of financing to both auto dealers and customers seeking to buy cars, and that a recapitalized GMAC will offer strong credit opportunities, help stabilize the auto financing market, and contribute to the overall economic recovery.<sup>258</sup> Under AIFR, Treasury has invested \$13.4 billion in GMAC.<sup>259</sup>

GMAC has entered a master financing agreement with Chrysler to provide certain dealer and retail financing.<sup>260</sup>

**Status of Funding**

On December 29, 2008, Treasury invested \$5 billion in GMAC. At the time of this investment, GMAC reorganized into a bank holding company and thus became eligible to receive TARP funds and participate in other Government support programs.<sup>261</sup> On May 21, 2009, Treasury purchased an additional \$7.5 billion of mandatorily convertible preferred equity in GMAC.<sup>262</sup> Of this \$7.5 billion investment, \$4 billion will support GMAC's anticipated growth in Chrysler dealer and retail loans.<sup>263</sup> The additional \$3.5 billion will help GMAC address its capital needs as identified through the SCAP stress test completed with the Federal Reserve.<sup>264</sup>

At the time of the initial Treasury investment, the Federal Reserve required GMAC to raise \$2 billion of new equity. GMAC raised \$1.1 billion through private investments, and Treasury loaned GM the remaining \$884 million to purchase GMAC equity.<sup>265</sup> On May 29, 2009, Treasury exchanged this \$884 million loan to GM for a portion of GM's common equity interests in GMAC. As a result of that exchange, Treasury now holds 35.4% of GMAC's common shares.<sup>266</sup> Treasury's mandatorily convertible preferred shares may be converted to common shares at GMAC's option with the approval of the Federal Reserve, though any conversion by GMAC must not result in Treasury owning in excess of 49% of GMAC's common shares except under the following circumstances:<sup>267</sup>

- with the prior written consent of Treasury
- pursuant to GMAC's capital plan, as agreed upon by the Federal Reserve
- pursuant to an order of the Federal Reserve compelling such a conversion

**Supervisory Capital Assessment Program ("SCAP")**

As detailed in the "Capital Assessment Program" discussion earlier in this section, U.S. bank supervisors recently created SCAP to determine if BHCs have a sufficient capital buffer to operate in worse-than-expected future economic conditions.<sup>268</sup> As a result of the stress test, GMAC is required to raise a SCAP buffer of \$1.5 billion. As noted previously, \$3.5 billion of Treasury's recent investment will be applied to meet this capital shortfall.<sup>269</sup>

**Chrysler Financial**

In January 2009, Treasury loaned \$1.5 billion to a bankruptcy-remote SPV to support Chrysler Financial retail loan originations. Treasury's loan forms the senior portion of the capital structure of the SPV, with Chrysler Financial providing the junior capital. Treasury's loan is collateralized by retail auto loans with stronger credit characteristics (higher credit scores, lower loan-to-value, shorter maturity) than Chrysler Financial's broader retail loan portfolio.<sup>270</sup>

Chrysler Financial has essentially ceased ordinary operations and is winding down its business.<sup>271</sup> Due to the nature of the collateral, Treasury expects to recover fully the \$1.5 billion loan to Chrysler Financial.

*For more information on the Supervisory Capital Assessment Program, see "Financial Institution Support Programs" earlier in this section.*

**Servicer:** Administrative party that collects payments and generates reports regarding mortgage payments.

**Private-Label Mortgages:** Loans that are not owned or guaranteed by Fannie Mae, Freddie Mac, or another Federal agency.

**Government-Sponsored Enterprises ("GSEs"):** Private corporations created by the Government to reduce borrowing costs. They are chartered by the U.S. Government but are not considered to be direct obligations.

*For more information regarding HAMP eligibility, modifications, and incentive payments, see SIGTARP's April Quarterly Report, Section 2: "TARP Overview."*

## HOMEOWNER SUPPORT PROGRAMS

### Making Home Affordable Program

The Making Home Affordable ("MHA") program was introduced by the Administration on February 18, 2009, and was intended to assist homeowners who are facing foreclosure or struggling to make their monthly mortgage payments.

Two weeks later, on March 4, 2009, Treasury released detailed program guidelines, which allowed mortgage servicers to begin to refinance and issue modifications.<sup>272</sup> MHA comprises three major initiatives: a loan modification program, a loan refinancing program, and additional support to lower mortgage interest rates. Only the loan modification program, known as the Home Affordable Modification Program ("HAMP") currently involves TARP funds.<sup>273</sup>

According to Treasury, HAMP is a \$75 billion program that will lower monthly mortgage payments for homeowners facing foreclosure by providing loan modifications and incentive payments for the loan servicers, loan holders, and homeowners. Under HAMP, \$50 billion from TARP will be used to modify private-label mortgages. An additional \$25 billion, funded under the Housing and Economic Recovery Act of 2008 ("HERA"), will be used to modify mortgages that are owned or guaranteed before January 1, 2009, by Government-sponsored enterprises ("GSEs"), particularly Fannie Mae and Freddie Mac.<sup>274</sup>

HAMP has several key components:<sup>275</sup>

- The lender will reduce monthly payments so that the borrower's monthly mortgage is no greater than 38% of the borrower's monthly income.
- Treasury and the lender will split the cost of reducing the monthly payments from 38% to 31% of the borrower's monthly income.
- The borrower will enter a 90-day trial period of reduced payments before entering program; if successful (*i.e.*, borrower makes payments), the borrower will maintain new, lower mortgage payments for five years.
- Treasury will make incentive payments to servicers, lenders/investors, and (to servicers) on behalf of borrowers.

### Status of Funds

As of June 30, 2009, Treasury had signed agreements with loan servicers allocating up to \$18 billion under HAMP.<sup>276</sup>

Countrywide Home Loans Servicing, LLP, will receive up to \$5.2 billion — the largest allocation under the program. The average allocation to each servicer

through HAMP is \$781.8 million. These funds can be used to modify both first and second lien mortgages.<sup>277</sup> Table 2.35 provides a detailed list of allocations made under the HAMP program as of June 30, 2009.

TABLE 2.35

| HOME AFFORDABLE MODIFICATION PROGRAM FUNDING |   |                                    |  |
|--|---|------------------------------------|--|
| Date of Initial Transaction                  | Institution                               | Ultimate Parent Company            | Adjusted Cap as of 6/30/2009 (\$ Millions) |
| 4/13/2009                                    | Select Portfolio Servicing                | Credit Suisse Group AG             | \$660.59                                   |
| 4/13/2009                                    | CitiMortgage, Inc.                        | Citigroup, Inc.                    | 1,079.42                                   |
| 4/13/2009                                    | Wells Fargo Bank, NA                      | Wells Fargo & Company              | 2,410.01                                   |
| 4/13/2009                                    | GMAC Mortgage, Inc.                       | GMAC                               | 1,017.65                                   |
| 4/13/2009                                    | Saxon Mortgage Services, Inc.             | Morgan Stanley                     | 632.04                                     |
| 4/13/2009                                    | Chase Home Finance, LLC                   | JPMorgan Chase & Co.               | 3,552.0                                    |
| 4/16/2009                                    | Ocwen Financial Corporation, Inc.         | N/A                                | 553.38                                     |
| 4/17/2009                                    | Bank of America, N.A.                     | Bank of America Corporation        | 804.44                                     |
| 4/17/2009                                    | Countrywide Home Loans Servicing, LP      | Bank of America Corporation        | 5,182.84                                   |
| 4/20/2009                                    | Home Loan Services, Inc.                  | Bank of America Corporation        | 447.30                                     |
| 4/20/2009                                    | Wilshire Credit Corporation               | Bank of America Corporation        | 453.13                                     |
| 4/24/2009                                    | Green Tree Servicing, LLC                 | N/A                                | 91.01                                      |
| 4/27/2009                                    | Carrington Mortgage Services, LLC         | N/A                                | 131.02                                     |
| 5/1/2009                                     | Aurora Loan Services, LLC                 | Lehman Brothers Holding, Inc.      | 459.55                                     |
| 5/28/2009                                    | Nationstar Mortgage LLC                   | N/A                                | 117.14                                     |
| 6/12/2009                                    | Residential Credit Solutions              | Residential Credit Holdings, LLC   | 19.40                                      |
| 6/17/2009                                    | CCO Mortgage                              | The Royal Bank of Scotland, PLC    | 16.52                                      |
| 6/17/2009                                    | RG Mortgage Corporation                   | R&G Financial Corporation          | 57.00                                      |
| 6/19/2009                                    | First Federal Savings and Loan            | N/A                                | 0.77                                       |
| 6/19/2009                                    | Wescom Central Credit Union               | N/A                                | 0.54                                       |
| 6/26/2009                                    | Citizens First Wholesale Mortgage Company | N/A                                | 0.03                                       |
| 6/26/2009                                    | Technology Credit Union                   | N/A                                | 0.07                                       |
| 6/26/2009                                    | National City Bank                        | PNC Financial Services Group, Inc. | 294.98                                     |
| <b>Total</b>                                 |   |                                    | <b>\$17,980.83</b>                         |

Notes: Numbers may be affected by rounding. Data as of 6/30/2009.

Sources: Treasury, Transactions Report, 7/2/2009; Factiva website, <http://fcs.factiva.com/fcs/default.aspx>, accessed 6/24/2009; CDS Loan Servicing, <https://mybar.com/regimens.com>, accessed 6/24/2009; "Nationstar Mortgage, About Us," <https://www.nationstarimg.com>, accessed 6/24/2009; "RCS, Corporate Information," <https://www.residentialcredit.com>, accessed 6/24/2009; "About CCO Mortgage," <https://www.ccomortgage.com>, accessed 6/24/2009; "First Federal, About Us," <http://www.ourfirstfed.com>, accessed 6/24/2009; GMAC Investor FAQ, [www.gmacfs.com](http://www.gmacfs.com), accessed 6/24/2009.

**Second-Lien Debt:** Debt that is ranked lower than senior debt in the event of a liquidation or bankruptcy restructuring.

**Loan-to-Value ("LTV") Ratio:** In real estate lending, the outstanding principal amount of the loan divided by the appraised value of the property underlying the loan.

**Back-End Debt-to-Income ("DTI") Ratio:** Indicates the percentage of an income that is used to pay debts.

**Back-End DTI Ratio = Total Monthly Debt Expense / Gross Monthly Income**

**Unpaid Principal Balance ("UPB"):** Amount of a loan that is unpaid. This does not include additional charges, such as interest.

*For more information regarding Loan-to-Value ratios and Debt-to-Income ratios, see SIGTARP's April Quarterly Report, Section 2: "TARP Overview."*

### Second Lien Program

On April 28, 2009, Treasury released guidelines regarding the Second Lien Program within HAMP. A significant portion of delinquent borrowers carry both senior- and second-lien debt and therefore may need assistance with both loans to remain in their homes. In other cases, homeowners may be able to pay their first mortgage, but the second mortgage increases the monthly payments to a level that is no longer affordable. According to Treasury, the Second Lien Program was designed to create substantially affordable mortgage payments for homeowners who qualify for a first-mortgage modification but still struggle to make their monthly payments because of a second mortgage. According to Treasury, the Second Lien Program could potentially reduce payments for 1 million–1.5 million homeowners, which could account for up to half of all HAMP participants.<sup>278</sup>

Second-lien debt is subordinate to a senior claim. Both claims use the same asset as collateral. For example, in addition to a mortgage on a home, borrowers may take out a second mortgage or a home-equity loan to pay for higher education. Homeowners can use their house as collateral for both loans. The home mortgage is considered to be senior to the second loan. In the event of a first-lien foreclosure, personal bankruptcy, or liquidation, the second-lien investor only gets paid after the initial mortgage holder has been paid in full.<sup>279</sup>

### Reducing Second Mortgage Payments

To reduce the number of foreclosures initiated by second-lien holders, Treasury will make an offer to the second mortgage holder that Treasury will share in both the write-down of the mortgage and the refinancing of the loan. Treasury will also deliver "Pay for Success" incentive payments to servicers, lenders/investors, and (to servicers) on behalf of borrowers. Since the bank holding the second mortgage may not receive any money if the borrower defaults on the loan, it is incentivized to work with the Government to refinance the second mortgage and recoup at least part of its investment.<sup>280</sup>

Lenders may decide that rather than modify a loan, they would like to terminate the loan in exchange for a one-time payment from the borrower. This is called extinguishing a loan. The one-time payment is determined through a set payment schedule based on four factors: the loan-to-value ("LTV") ratio, the back-end debt-to-income ("DTI") ratio, the unpaid principal balance ("UPB"), and the duration of the delinquency (the length of time the loan has been overdue).<sup>281</sup>

**Second Lien Guidelines**

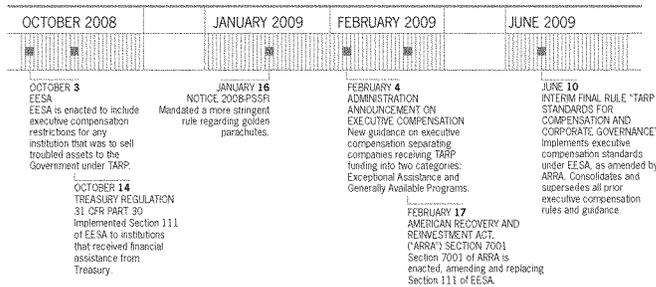
According to Treasury, prior to the MHA program, mortgage servicers often refrained from completing loan modifications due to a lack of common standards. In addition to the guidelines in the original modification program, on April 28, 2009, Treasury issued guidelines on second-lien modifications. These guidelines include the following:<sup>182</sup>

- The second lien is automatically modified when a first lien is modified.
- The second-lien modification may not delay first-lien modification.
- Borrower, servicer, and lender incentives have been aligned to complete modifications at an affordable and sustainable level.
- Payments are designed under the principle of "pay for success," which aligns incentives to reduce payments in a way that is most cost-effective for taxpayers.

### EXECUTIVE COMPENSATION

As discussed in SIGTARP's previous reports, the executive compensation restrictions set forth in EESA have been changed over time by regulations, amendments, and notices. On February 17, 2009, Section 111 of EESA was amended by Section 7001 of the American Recovery and Reinvestment Act of 2009 ("ARRA"), which further required that Treasury promulgate regulations to implement ARRA amendments.<sup>283</sup> On June 10, 2009, Treasury released its Interim Final Rule on TARP Standards for Compensation and Corporate Governance (the "Rule"), which implements EESA as amended by ARRA. The Rule is an "Interim Final Rule" — meaning it took effect upon its publication in the *Federal Register* on June 15, 2009, but there is a 60-day public comment period after which it may be changed. The Rule "implement[s] ARRA provisions, consolidates all of the executive-compensation-related provisions that are specifically directed at TARP recipients into a single rule (superseding all prior rules and guidance), and utilizes the discretion granted to the [Treasury] Secretary under ARRA to adopt additional standards, some of which are adapted from principles set forth" in guidance previously provided by Treasury in February 2009.<sup>284</sup> Figure 2.17 describes the changes in executive compensation restrictions set forth by Congress and included in Treasury regulations over time. For more information on the guidelines in the figure, see Section 2: "TARP Overview" in SIGTARP's April Quarterly Report.

FIGURE 2.17  
EXECUTIVE COMPENSATION RESTRICTIONS TIMELINE



Sources: EESA, P.L. 110-343, 10/3/2008; Treasury, "Treasury Regulation 31 CFR Part 30," 10/14/2008; Treasury, "Notice 2008 - PSSR1," 1/16/2009, www.treas.gov, accessed 1/19/2009; Treasury, "Treasury Announces New Restrictions on Executive Compensation," 2/4/2009, www.treas.gov, accessed 3/20/2009; ARRA, P.L. 111-5, 2/17/2009; Treasury, "TARP Standards for Compensation and Corporate Governance," 6/10/2009, www.fraudcalability.gov, accessed 6/10/2009.

The Rule applies to all TARP recipients, defined in the Rule to include “any entity that has received or holds a commitment to receive financial assistance” provided under TARP or any entity that owns 50% or more, or is 50% or more owned by such an entity.<sup>285</sup> In general, the executive compensation restrictions in the Rule apply only so long as the TARP recipient has an “obligation” to Treasury; an “obligation” does not include Treasury holding warrants to purchase common stock of the TARP recipient.<sup>286</sup>

In general, the Rule defines financial assistance as “any funds or fund commitment provided through the purchase of troubled assets” by Treasury through a direct financial transaction between Treasury and the TARP participant.<sup>287</sup> For example, CPP participants that directly sell preferred stock to Treasury generally have received financial assistance under the Rule. However, those institutions that post collateral to and receive loans from TALF are considered to have not “received financial assistance provided under TARP” and therefore are not subject to the Rule.<sup>288</sup> Table 2.36 shows a breakdown of how the compensation and governance standards set forth in the Rule apply to all TARP programs.

TABLE 2.36

| INTERIM RULE EXECUTIVE COMPENSATION RESTRICTIONS AS THEY APPLY TO TARP PROGRAMS |            |  |
|---|------------|--|
| TARP Program  | Applicable | Notes  |
| CPP   | X          | All participating institutions are subject to the executive compensation restrictions.   |
| CAP   | X          | All participating institutions are subject to the executive compensation restrictions.   |
| SSFI  | X          | Restrictions apply to AIG.   |
| TIP   | X          | Restrictions apply to Citigroup and Bank of America.   |
| AGP   | X          | Restrictions apply to Citigroup.   |
| AFP   | X          | Restrictions apply to GM, GMAC, Chrysler, Chrysler Financial.  |
| ASSP  | X          | Executive compensation restrictions apply only to auto companies, not the suppliers.   |
| AWCP  | X          | Executive compensation restrictions apply only to auto companies, not automobile purchasers.   |
| TALF  |            | Program is not applicable to TALF participants.  |
| PPIF  |            | Would apply only if there was a majority owner of the Public-Private Investment Fund (“PPIF”). Since PPIF will be structured so that no entity can invest in more than 9.9% of the fund, executive compensation restrictions will not apply. According to OFS, the luxury expenditure policy will apply to the recipient. <sup>a</sup> |
| MHA   |            | Program is exempted by statute. <sup>b</sup>   |
| UCSB  | X          | Restrictions apply only to the institution selling the eligible assets to Treasury.  |

Notes:

<sup>a</sup> Treasury response to SIGTARP draft report, 7/9/2009.<sup>b</sup> The Making Home Affordable program is exempted by statute from the executive compensation and corporate governance standards set forth in the ARRA amendments. See Section 7002 of the American Recovery and Reinvestment Act of 2009, P.L. 111-5, 2/13/2009.Source: Treasury, “TARP Standards for Compensation and Corporate Governance,” 6/10/2009, [www.financialstability.gov](http://www.financialstability.gov), accessed 6/10/2009.

**Senior Executive Officers ("SEOs"):** A "named executive officer" of a TARP recipient as defined under Federal securities law, which generally includes the principal executive officer ("PEO"), principal financial officer ("PFO"), and the next three most highly compensated employees.

**Most Highly Compensated Employee:** The employee of a TARP recipient whose total annual compensation is determined to be the highest among all employees, where "annual compensation" includes the dollar value for total compensation as determined pursuant to Federal securities laws reduced by the amount required by the employee's defined benefit and pension plans.

**Compensation Limits**

The Rule establishes certain compensation requirements by which all TARP recipients must abide. The number of employees to whom the requirements apply varies; in general, however, the compensation limitations in the Rule apply to the TARP recipient's senior executive officers (SEOs) and most highly compensated employees, determined by reference to annual compensation. The Rule defines annual compensation as the dollar value for total compensation as determined pursuant to applicable Federal securities laws.<sup>289</sup>

Different types of compensation are addressed differently in the Rule. For example, the number of employees for whom bonus payments are limited is based upon the amount of TARP funding received by the institution.<sup>290</sup> The Rule did not include the annual compensation limit of \$500,000 that had been set forth in the February 2009 Administration guidance.<sup>291</sup> Table 2.37 shows how bonus payments are applied to each TARP recipient based on funding levels. The specific compensation requirements set forth in the Rule, and how each requirement applies to TARP recipients, are detailed in Table 2.38.

TABLE 2.37

| EMPLOYEES SUBJECT TO BONUS LIMITATIONS, BY AMOUNT OF TARP FUNDING |  |
|---|--|
| Amount of TARP Funding  | Applicable Employees                               |
| < \$25,000,000  | most highly compensated employee                   |
| ≥\$25,000,000 < \$250,000,000                                     | at least the 5 most highly compensated employees   |
| ≥\$250,000,000 < \$500,000,000                                    | SEOs and 10 next most highly compensated employees |
| ≥\$500,000,000  | SEOs and 20 next most highly compensated employees |

Note: The ARRA amendments provide that, with respect to financial institutions that have received greater than \$25,000,000 in TARP assistance, the Secretary may apply the bonus limitations to a higher number of employees as the Secretary may determine is in the public interest.

Source: Treasury, "TARP Standards for Compensation and Corporate Governance," 6/10/2009, [www.financialstability.gov](http://www.financialstability.gov), accessed 6/10/2009.

TABLE 2.38

| COMPENSATION LIMIT REQUIREMENTS |  |   |  |
|---------------------------------|--|---|--|
| Requirement                     | Definition   | How Requirement Is Applied  | To Whom the Requirement Applies  |
| Bonus Payments                  | Bonus, retention award, or incentive compensation  | Bonus payments are prohibited — except for payments made in the form of restricted stock (which cannot have a value greater than 1/3 of the employee's total compensation and must be forfeitable if the employee does not continue providing services for the TARP recipient for at least two years from the date of grant). | Employees identified in Table 2.37 (based on the level of TARP assistance) |
| Commissions                     | Payment earned by an employee consistent with a program in existence for that type of employee as of February 17, 2009, if a substantial portion of the services provided by the employee consists of the direct sale of a product or service to an unrelated customer | Commissions meeting the definition in the Rule are exempt from the limitations on bonuses, retention awards, and incentive compensation; however, fees earned in connection with a specified transaction (e.g., an initial public offering) are not commissions for purposes of the Rule.                                     | Employees identified in Table 2.37 (based on the level of TARP assistance) |
| Excessive Risk                  | Unnecessary risk taking encouraged by employee compensation plans  | Review of employee compensation plans by the compensation committee, a narrative explanation of the committee's analysis with respect to risk, and certification that the compensation committee has completed the review.  | All TARP recipients  |
| Clawback                        | Recovery by the company of amounts paid to an employee based on materially inaccurate performance criteria   | All bonuses, retention awards, and incentive compensation must be subject to clawback if the payments were based on materially inaccurate performance criteria; the TARP recipient must actually exercise its clawback rights unless it can demonstrate that it would be unreasonable to do so.                               | SEOs and the next 20 most highly compensated employees                     |
| Golden Parachute                | Any payment to an employee for departure for any reason, or any payment due to a change in control   | Prohibits any and all golden parachute payments to the applicable employees made at the time of departure or upon a change in control.  | SEOs and the next 5 most highly compensated employees                      |
| Perquisite                      | Personal benefit, including a privilege or profit incidental to regular salary or wages  | Must disclose the amount, nature, and justification for the perquisite whose value exceeds \$25,000.  | Employees identified in Table 2.37 (based on the level of TARP assistance) |

Source: Treasury, "TARP Standards for Compensation and Corporate Governance," 6/10/2009. [www.financialstability.gov](http://www.financialstability.gov), accessed 6/10/2009.

### Office of the Special Master for TARP Executive Compensation

Under the Rule, Treasury has created a new Office of the Special Master for TARP Executive Compensation (“Special Master”) which will be responsible for the review and analysis of executive compensation at TARP recipients.<sup>292</sup> Treasury has appointed Kenneth R. Feinberg, a “highly respected mediator widely praised for his leadership of the September 11<sup>th</sup> Victim Compensation Fund,” as Special Master, and he will report to the Assistant Secretary of the Treasury for Financial Stability.<sup>293</sup> The Special Master’s scope is limited to executive compensation and corporate governance issues under the Rule for TARP recipients. The Special Master has the authority to accomplish these objectives:<sup>294</sup>

- review compensation payments and plans at TARP recipients that have received “exceptional assistance” (for the CEOs and 20 next most highly compensated employees) and compensation structures (for the 100 most highly compensated employees and any executive officers)
- review bonuses, retention awards, and other compensation paid before February 17, 2009, by TARP recipients and, where appropriate, negotiate reimbursements
- provide advisory opinions with respect to the application of the Rule and whether compensation payments and plans are consistent with EESA, TARP, and the public interest

The Rule requires that the Special Master use specific principles when reviewing compensation payments and plans at TARP recipients:<sup>295</sup>

- **Risk** — The compensation structure should avoid incentives for employees to take unnecessary or excessive risks that could threaten the value of the TARP recipient, including incentives that reward employees for short-term or temporary increases in value, performance, or similar measures that may not ultimately be reflected by an increase in the long-term value of the TARP recipient.
- **Taxpayer Return** — The compensation structure, and amount payable where applicable, should reflect the need for the TARP recipient to remain a competitive enterprise, to retain and recruit talented employees who will contribute to the TARP recipient’s future success, and ultimately to be able to repay TARP obligations.
- **Appropriate Allocation** — The compensation structure should appropriately allocate the components of compensation (e.g., salary, executive pensions, bonus payments, and incentives). The appropriate allocation may be different for different positions and for different employees, but generally, in the case of an executive or other senior-level position, a significant portion of the overall compensation should be long-term compensation that aligns the interest of the employee with the interests of shareholders and taxpayers.

- **Performance-Based Compensation** — An appropriate portion of the compensation should be performance-based over a relevant performance period. Performance-based compensation should be determined through tailored metrics that encompass individual performance and/or the performance of the TARP recipient or a relevant business unit, taking into consideration specific business objectives.
- **Comparable Structures and Payments** — The compensation structure and pay should be consistent with pay for those in similar positions at similar entities.
- **Employee Contribution to TARP Recipient Value** — The compensation structure should reflect the current or prospective contributions of an employee to the value of the TARP recipient, taking into account multiple factors.

#### **Exceptional Assistance Authority**

Under the Rule, the Special Master has specific duties regarding payments and compensation plans for executives of TARP recipients that have received exceptional assistance. For companies receiving exceptional assistance, the Special Master will review compensation payments for the CEOs and the 20 most highly compensated employees at each institution. In addition, he will be reviewing compensation plans for CEOs and the 100 most highly compensated employees (and the executive officers) of a TARP recipient receiving exceptional assistance. According to Treasury, this is to ensure that compensation is fair and structured, to protect taxpayer interests and to promote long-term shareholder value.<sup>296</sup>

#### **"Look-Back" Authority**

The Special Master will also be conducting a "look-back" review of certain payments at all TARP recipients made prior to February 17, 2009 (*i.e.*, the date of ARRA's enactment). The review will cover all bonuses, retention awards, and other compensation paid to the 5 CEOs and the next 20 most highly paid employees.<sup>297</sup> This review will encompass approximately 436 institutions and 10,900 individuals.<sup>298</sup> Should the Special Master determine that payments were made inappropriately or contrary to the public interest, he will have responsibility for negotiations with the TARP recipient and the applicable employee for appropriate reimbursement to the Federal Government.<sup>299</sup>

**Exceptional Assistance:** Companies receiving assistance under the programs for SSFI, TIP, AGP, AIFP, and any future Treasury program designated by the Treasury Secretary as providing exceptional assistance. Currently includes AIG, Citigroup, Bank of America, GM, GMAC, Chrysler, and Chrysler Financial.

### The American Recovery and Reinvestment Act of 2009 — Expanded Provisions

The Rule expanded upon three provisions set forth in ARRA. They include review by the Board Compensation Committee of all employee compensation plans, the “Say on Pay” requirement, and enhanced luxury expenditure requirements.<sup>300</sup>

#### Board Compensation Committee

Under the Rule, each TARP recipient must establish a Board Compensation Committee (the “Committee”). The Committee must include independent directors from the company’s board and will convene for the purpose of reviewing all employee compensation plans. An exception to this requirement is made for TARP recipients that are not registered under the Securities Exchange Act of 1934 and have received \$25 million or less in TARP assistance. These institutions may have their boards of directors carry out the duties of the Board Compensation Committee.<sup>301</sup>

The Committee is required to meet at least semiannually to review with senior risk officers the proposed compensation plans of all employees and ensure that the TARP recipient is not unnecessarily exposed to risks. In addition, the Committee will evaluate CEO compensation plans to ensure that the plans do not encourage CEOs to take unnecessary and excessive risks that could threaten the value of the TARP recipient. The Rule requires that the Committee submit an annual report to Treasury providing a narrative description of how it limited any features of compensation plans that would encourage CEOs to take unnecessary and excessive risks and any features of compensation plans that could encourage the manipulation of reported earnings to enhance the compensation of an employee.<sup>302</sup>

#### “Say on Pay”

The Rule provides a provision for a non-binding vote by shareholders on executive compensation, sometimes referred to as “Say on Pay.” This provision requires all TARP recipients to permit an annual non-binding vote by shareholders on executive compensation as required by SEC regulations.<sup>303</sup>

#### Luxury Expenditures

The Rule also addresses corporate luxury expenses; the Rule states that the board of directors of any institution receiving TARP funds must have a company-wide policy to define and prevent excessive expenditure on entertainment or events, office and facility renovations, aviation or other transportation services, and other activities or events that are not reasonable expenditures for the following activities:<sup>304</sup>

- staff development
- reasonable performance incentives
- other activities conducted in the normal course of business operations

**Say on Pay:** A non-binding vote by shareholders with respect to the company’s executive compensation, as disclosed pursuant to SEC regulations.

The company must file this policy with Treasury and post it to the company website no later than (i) 90 days after the closing of the transaction between Treasury and the TARP recipient or (ii) 90 days following publication of the Rule.<sup>305</sup> The Rule also requires that the PEO and PFO of each institution provide certification that any expenditures needing approval by a senior executive or the board of directors have been properly approved.<sup>306</sup>

#### **Additional Compensation and Governance Standards**

According to Treasury, the Rule provides additional requirements that will further protect shareholder value and increase transparency by all TARP recipients. In addition to the compensation and corporate governance standards explicitly required by Congress, the Rule includes three additional requirements: a prohibition on tax gross-ups, a requirement that TARP recipients provide additional disclosure of perquisites, and a requirement that TARP recipients provide disclosure with respect to compensation consultants.<sup>307</sup>

#### **Tax Gross-Up**

A tax gross-up is typically a specific payment to cover taxes due on certain compensation. According to Treasury, studies have shown that these payments cost the companies that provide them far more than the benefits the payments provide to executives. The Rule prohibits TARP recipients from providing any tax gross-up payments to senior executives and to the next 20 highest-compensated employees.<sup>308</sup>

#### **Perquisites**

In addition to disclosure requirements applicable to perquisites that are already enforced by the SEC, the Rule subjects TARP recipients to more stringent requirements. SEC rules require disclosure of perquisites given to the top five executive officers. The Rule expands this requirement to include perquisites over \$25,000 given to any employees of TARP recipients subject to the bonus limitations described in Table 2.37. Additionally, firms must provide a narrative description and justification for these benefits.<sup>309</sup>

#### **Compensation Consultants**

Many firms hire compensation consultants to determine appropriate pay levels for top executives. According to Treasury, these consultants may have influence over the setting of compensation, and it may be helpful for shareholders to know whether TARP recipients have hired an outside consultant. More specifically, the Rule requires all TARP recipients to provide a narrative description of the services provided by such consultants and a description of any benchmarking analysis performed by the consultants.<sup>310</sup>

Tax Gross-Up: A reimbursement of taxes owed with respect to any compensation.

### Certifications

As recommended by SIGTARP, the Rule provides certification and reporting requirements on the compensation and corporate governance guidelines that apply to TARP recipients. All certifications provided by TARP recipients must name the CEOs and the 20 most highly compensated employees for the current fiscal year. Under the Rule, this determination is based on their prior fiscal year's total annual compensation. Each certification must also provide a statement by the officer certifying that they "understand that a knowing and willful false or fraudulent statement made in connection with the certification may be punished by fine, imprisonment, or both."<sup>111</sup> Table 2.39 describes the reporting and certification requirements and the frequency with which the institution must provide the certifications.

In addition to the requirements in Table 2.39, those TARP recipients classified as receiving exceptional assistance must certify to Treasury that they have had their compensation payments and structures approved by the Special Master as required by the Rule.<sup>112</sup>

TABLE 2.39

| EXECUTIVE COMPENSATION REPORTING AND CERTIFICATION REQUIREMENTS |  |   |
|---|--|---|
| Compliance Category   | Action Requiring Certification   | Certification Frequency   |
| Board Compensation Committee                                    | TARP recipient has created a Board Compensation Committee that meets the requirements of the Rule.   | <ul style="list-style-type: none"> <li>• Later of 90 days after the closing of the transaction or 90 days after publication of the Rule</li> </ul>  |
| Compensation Plans Excessive Risk                               | The Committee has evaluated CEO compensation plans and has identified and limited features of plans that could lead to unnecessary risks. The committee has also reviewed employee compensation plans for features that could encourage the manipulation of reported earnings. | <ul style="list-style-type: none"> <li>• Evaluate every 6 months</li> <li>• 90 days after the end of each fiscal year — must submit narrative description and certification</li> </ul>                  |
| Bonus Payments  | TARP recipient has limited bonus payments to applicable employees in accordance with Section 111 of EESA and guidance thereunder.  | <ul style="list-style-type: none"> <li>• 90 days after the end of each fiscal year</li> </ul>   |
| Luxury Expenditures   | TARP recipient has established an excessive or luxury expenditures policy, and has posted it to the company website, and its employees have complied with the policy.  | <ul style="list-style-type: none"> <li>• Later of 90 days after the closing of the transaction or 90 days after publication of the Rule</li> <li>• 90 days after the end of each fiscal year</li> </ul> |
| Say on Pay  | TARP recipient has permitted a non-binding shareholder resolution on executive compensation (publicly traded TARP recipients only) in accordance with applicable SEC regulations.  | <ul style="list-style-type: none"> <li>• 90 days after the end of each fiscal year</li> </ul>   |
| Compensation Consultants  | TARP recipient has disclosed whether an executive compensation consultant was hired and a description of services provided.  | <ul style="list-style-type: none"> <li>• 90 days after the end of each fiscal year</li> </ul>   |
| Perquisite  | TARP recipient has disclosed the amount, nature, and justification for offering any perquisites greater than \$25,000 to each of its employees subject to bonus limitations (as identified in Table 2.37).   | <ul style="list-style-type: none"> <li>• 90 days after the end of each fiscal year</li> </ul>   |
| Clawback  | TARP recipient has required that all bonus payments are subject to recovery if the payments were based on materially inaccurate performance metrics.   | <ul style="list-style-type: none"> <li>• 90 days after the end of each fiscal year</li> </ul>   |

Source: Treasury, "TARP Standards for Compensation and Corporate Governance," 6/10/2009, [www.financialstability.gov](http://www.financialstability.gov), accessed 6/10/2009.

SECTION 3

TARP IN CONTEXT:  
FINANCIAL INSTITUTION  
SUPPORT AND POLICIES  
OUTSIDE OF TARP



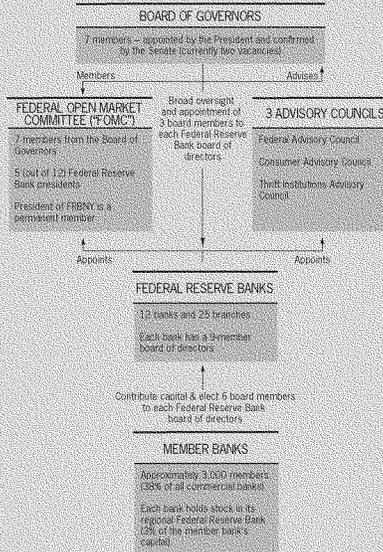
This section provides some background on the Federal agencies and financial rescue initiatives that have been implemented as part of the Government's response to the financial crisis. TARP programs must work in concert with these other agencies and their initiatives — either as a direct partner, as in the case of the Term Asset-Backed Securities Loan Facility (“TALF”), or as a potentially overlapping business alternative for banks requiring funds. Though a huge sum in its own right, the \$700 billion in TARP funding represents only a portion of a much larger sum — estimated to be as large as \$23.7 trillion — of potential Federal Government support to the financial system. This support is spread among numerous Federal agencies, with the Federal Reserve System (“Federal Reserve”), providing one of the largest support packages (\$6.8 trillion if each initiative were implemented to its maximum authorized level).

In an effort to provide context to the environment within which the TARP programs are operating, this section provides an overview of the Federal Reserve System and a description of the multiple financial-crisis-response programs throughout the Federal Government. This section is intended to provide perspective for understanding TARP. SIGTARP has no oversight responsibility for any of the programs set forth in this section that do not involve TARP funds. Additionally, throughout this section, SIGTARP uses the term “potential support” to represent the maximum amount of support a Government agency has specified that it could provide under a specific program. In those cases in which there are no specified maximum thresholds, SIGTARP has used the high-water mark of the program (the maximum amount actually expended or guaranteed) through June 30, 2009. Further, some of the programs have been discontinued or even, in some cases, not utilized. As such, these total potential support figures do not represent a current total, but the sum total of all support programs announced since the onset of the financial crisis in 2007.

TARP TUTORIAL: THE FEDERAL RESERVE SYSTEM

The Federal Reserve System is the central bank of the United States and is structured as a collection of quasigovernmental financial entities. It comprises a Board of Governors, 12 Federal Reserve District Banks, a Federal Open Market Committee, and a number of advisory councils. Established by the Federal Reserve Act of 1913, the Federal Reserve oversees monetary policy, supervises and regulates various banking institutions, contains systemic risk in financial markets, and provides banking services to depository institutions. For an outline of the Federal Reserve System organization, see Figure 3.1.

FIGURE 3.1  
THE FEDERAL RESERVE SYSTEM ORGANIZATION



Source: Federal Reserve, "FED 101," no date, [www.federalreserveeducation.org/FED101/HTML/structure/](http://www.federalreserveeducation.org/FED101/HTML/structure/), accessed 7/8/2009

### The Federal Reserve System: Structure and Key Individuals The Chairman and Board of Governors

The Board of Governors of the Federal Reserve is a group of seven Members ("Governors"), nominated by the President and confirmed by the Senate. The Banking Act of 1935 states that the Board of Governors should have a "fair representation of the financial, agricultural, industrial, and commercial interests and geographical divisions of the country," and no two Governors may come from the same Federal Reserve District.<sup>313</sup> Each Governor's term is 14 years, and those who have served full terms cannot be reappointed; however, those appointed to complete an unexpired term may be appointed for the following full term. Appointments are staggered so that one term expires on January 31 of each even-numbered year.<sup>314</sup> Currently, there are two vacant seats on the Board of Governors.

The Chairman of the Board is chosen by the President and must be confirmed by the Senate. The Chairman serves terms of four years and may be reappointed as Chairman until his or her terms as a Governor expire. Currently, the Chairman of the Board of Governors is Ben Bernanke. Sworn in as Chairman on February 1, 2006, his term on the Board of Governors will expire in 2020,<sup>315</sup> although his term as Chairman will expire on January 31, 2010, unless reappointed.

#### Federal Open Market Committee

The Federal Open Market Committee ("FOMC") is the other primary policymaking body of the Federal Reserve System, responsible for Open Market Operations ("OMOs"). These OMOs are the principal tool of monetary policy, comprising purchases and sales of U.S. Government and Federal agency securities that are used to affect bank reserves and, in turn, the cost and availability of money and credit in the U.S. economy. The FOMC specifies a short-term objective for the OMOs. These policy targets change from time to time, but the current objective of the FOMC is to stabilize the federal funds rate around a target interest rate. The FOMC instructs the Federal Reserve Bank of New York ("FRBNY") to engage in OMOs as appropriate to keep the federal funds rate near the target. Such activity either contracts or expands the supply of bank reserves until the federal funds rate nears the target, directly affecting interest rates. Of the Federal Reserve banks, FRBNY has a preeminent role in executing monetary policy, particularly in its role as the executing institution of FOMC directives.

Traditionally, monetary policy has been conducted by changing the target federal funds rate. Lower interest rates tend to stimulate the economy, while higher interest rates tend to temper growth and inflationary pressures.

**Federal Funds Rate:** The rate at which depository institutions lend to each other overnight to fill immediate shortages.

## TARP TUTORIAL: THE FEDERAL RESERVE SYSTEM

TABLE 3.1

**2009 FOMC MEMBERS**

| Member             | Title(s)   |
|--------------------|--|
| Ben S. Bernanke    | Chairman, Board of Governors   |
| William C. Dudley  | Vice Chairman, Board of Governors; President, Federal Reserve Bank of New York |
| Elizabeth A. Duke  | Member, Board of Governors   |
| Charles L. Evans   | President, Federal Reserve Bank of Chicago                                     |
| Donald L. Kohn     | Member, Board of Governors   |
| Jeffrey M. Lacker  | President, Federal Reserve Bank of Richmond                                    |
| Dennis F. Lockhart | President, Federal Reserve Bank of Atlanta                                     |
| Daniel K. Tarullo  | Member, Board of Governors   |
| Kevin M. Warsh     | Member, Board of Governors   |
| Janet L. Yellen    | President, Federal Reserve Bank of San Francisco                               |

Note: As of 6/30/2009 two board member positions are currently vacant.

Source: Board of Governors of the Federal Reserve System; [www.federalreserve.gov/monetarypolicy/fomc.htm](http://www.federalreserve.gov/monetarypolicy/fomc.htm), accessed 6/20/2009.

The FOMC comprises 12 voting members: the 7 members of the Board of Governors, the president of FRBNY, and 4 of the other 11 Federal Reserve Bank presidents, who serve one-year terms on a rotating basis. Table 3.1 details the current members of the FOMC.

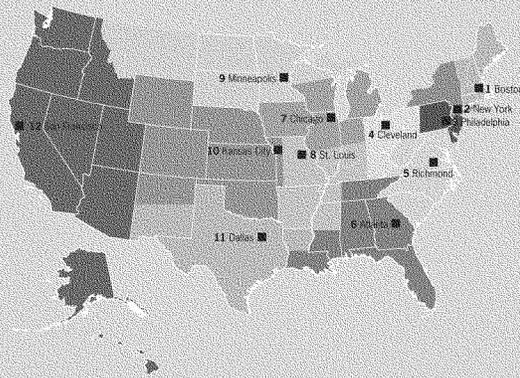
FOMC meetings are held at regular intervals of five to eight weeks. The staff prepares policy papers for discussion and committee members discuss options in detail. Decisions may only be implemented, however, after reaching consensus. FOMC policy directives are then referred to FRBNY for execution.

#### Federal Reserve Banks

There are 12 Federal Reserve Banks, one in every Federal Reserve District, each of which is headed by a President. For a map detailing the 12 Federal districts and the location of the Federal Reserve Banks, see Figure 3.2. For a listing of the current Presidents of the Federal Reserve Banks, see Table 3.2.

The individual Federal Reserve Banks are "owned" by the private, commercial banks in their districts. This ownership is, however, very different from the private-sector concept of stock ownership; the shareholders cannot sell their stock, they cannot vote, and they cannot receive dividends.

FIGURE 3.2  
MAP OF FEDERAL RESERVE BANKS AND THEIR DISTRICT BOUNDARIES



Note: Alaska and Hawaii are part of the San Francisco District.  
Source: Federal Reserve, [www.federalreserve.gov/otairchb.htm](http://www.federalreserve.gov/otairchb.htm), accessed 6/30/2009

TABLE 3.2

**FEDERAL RESERVE BANKS AND THEIR LEADERSHIP**

| District                      | President          |
|-------------------------------|--------------------|
| 1st District — Boston         | Eric S. Rosengren  |
| 2nd District — New York       | William C. Dudley  |
| 3rd District — Philadelphia   | Charles I. Plosser |
| 4th District — Cleveland      | Sandra Pianalto    |
| 5th District — Richmond       | Jeffrey M. Lacker  |
| 6th District — Atlanta        | Dennis P. Lockhart |
| 7th District — Chicago        | Charles L. Evans   |
| 8th District — St. Louis      | James B. Bullard   |
| 9th District — Minneapolis    | Gary H. Stern      |
| 10th District — Kansas City   | Thomas M. Hoeng    |
| 11th District — Dallas        | Richard W. Fisher  |
| 12th District — San Francisco | Janet L. Yellen    |

Source: Federal Reserve, "Federal Reserve Presidents," [www.federalreserve.gov](http://www.federalreserve.gov), accessed 6/30/2009.

**Independence of the Federal Reserve System**

The Federal Reserve Board of Governors is an independent agency of the Federal Government. The individual Federal Reserve banks are not agencies of the Federal Government.<sup>114</sup> Congressional oversight requires that the Chairman of the Board of Governors of the Federal Reserve appear twice before Congress each year to testify on the subject of the Federal Reserve's monetary policy. Congress may also enact changes in the Federal Reserve Act to affect long-term Federal Reserve policies and priorities. The Federal Reserve is a hybrid entity with characteristics of both public and private organizations. Its independence is an important feature, designed to protect the monetary base and the financial system oversight from "politicization."

**Taxpayer Exposure to the Federal Reserve**

As the Federal Reserve has been providing liquidity to financial institutions during the current crisis, it has increased its exposure to potential for losses, such as if the value of

the collateral posted for non-recourse loans were to fall below the loan amount. Although taxpayers are not directly liable to make up any losses of the Federal Reserve, in practice, the American public is exposed in many ways to the effects of Federal Reserve actions.

To a certain extent, losses can be absorbed by the Federal Reserve in the course of its ongoing business. The Federal Reserve derives revenues from interest on outstanding loans to banks and from fees for services. In 2008, the Federal Reserve had a surplus of \$35 billion, which it remitted to Treasury.<sup>37</sup> If Federal Reserve losses exceeded a certain level — for example, the amount of the Federal Reserve's annual revenues — further funds would be required to meet those losses.

As a central bank, however, the Federal Reserve has other options that are not open to the typical private-sector business. Losses up to a point can be covered by such means as assessments on member banks, increases in interest rates on Federal Reserve loans, or fee increases. These efforts would indirectly affect taxpayers, however, because the banks could increase consumer fees or interest rates to compensate for the Federal Reserve assessments.

A major financial shortfall at the Federal Reserve could lead to either an appropriation by Congress of taxpayer funds for a bailout or an expansion of the money supply ("running the printing press") to cover Federal Reserve losses, which could lead to inflation.

#### **The Federal Reserve's Role in Addressing the Current Financial Crisis**

In the current financial crisis, the Federal Reserve has initiated a number of programs to provide liquidity to the financial system, including engaging in large-scale asset purchases, which has resulted, since January 2007, in a \$1.2 trillion expansion of its balance sheet and a number of regulatory changes intended to reduce stress on the financial system.<sup>38</sup> The Federal Reserve has also created new standby credit facilities and loan guarantees, and has engaged in "quantitative easing" (lowering interest rates to provide banks with additional profits through larger spreads). The role of the Federal Reserve in the Government's response to the financial crisis is covered in more detail in the "TARP in Context: Other Government Programs To Assist the Financial Sector" discussion following this section of the report.

### Oversight and Authority

The legal authority to undertake efforts to stabilize the economy was provided by Congress in the Federal Reserve Act of 1913. A certain level of balance sheet activity will always be occurring during the Federal Reserve's normal operations, but the activity in 2008 was extraordinary by any measure. Congress receives regular reports from the Federal Reserve and has occasionally enacted legislation designed to accomplish certain economic and financial policy goals.

Section 13 of the Federal Reserve Act ("Section 13") details the powers of the Federal Reserve Banks. In 1932, the Emergency Relief and Construction Act added paragraph 3 to Section 13, opening the Federal Reserve's discount window to nonbanks "in unusual and exigent circumstances."<sup>49</sup> Section 13(3) of the Federal Reserve Act is an "emergency clause," which provides the Federal Reserve with broad powers to take actions necessary to protect the U.S. financial system. Portions of Section 13 were used during the Great Depression and for almost 20 years thereafter to provide credit from the Federal Reserve to nonbanking businesses. In 1991, Section 13(3) was invoked to provide a \$25 billion direct loan from the Federal Reserve to the FDIC's Bank Insurance Fund as a response to the Savings and Loan Crisis of the 1980s and 1990s. Section 13(3) was amended in 1991, allowing the Federal Reserve to lend directly to securities firms during financial emergencies. Between 1991 and 2008 Section 13(3) was not invoked.<sup>50</sup> Since 2008, the Federal Reserve's lending under Section 13(3) includes: loans to JPMorgan Chase & Co. ("JPMorgan") to facilitate the acquisition of Bear Stearns Companies Inc. ("Bear Stearns"); a loan to American International Group, Inc. ("AIG"), a diversified financial company, which is not normally under the Federal Reserve's discount window authority; and the creation of the TALF. For a complete list of recent, known Section 13(3)-related Federal Reserve lending, see Table 3.3.

Exact Language of Section 13(3) of the Federal Reserve Act:

**13(3) Discounts for Individuals, Partnerships, and Corporations.**  
In unusual and exigent circumstances, the Board of Governors of the Federal Reserve System, by the affirmative vote of not less than five members, may authorize any Federal reserve bank, during such periods as the said board may determine, at rates established in accordance with the provisions of section 14, subdivision (d), of this Act, to discount for any individual, partnership, or corporation, notes, drafts, and bills of exchange when such notes, drafts, and bills of exchange are endorsed or otherwise secured to the satisfaction of the Federal Reserve bank: Provided, that before discounting any such note, draft, or bill of exchange for an individual, partnership, or corporation the Federal reserve bank shall obtain evidence that such individual, partnership, or corporation is unable to secure adequate credit accommodations from other banking institutions. All such discounts for individuals, partnerships, or corporations shall be subject to such limitations, restrictions, and regulations as the Board of Governors of the Federal Reserve System may prescribe.

**Discount Window:** Federal Reserve facility that lends short-term money directly to eligible institutions.

TABLE 3.3  
RECENT KNOWN AUTHORIZATIONS UNDER SECTION 13(3) (S BILLIONS)

| Date                   | Program   | Authorized Upper Limit <sup>a</sup> | End Date         | Comments  |
|------------------------|---|-------------------------------------|------------------|---|
| 3/11/2008              | TSLF  | \$250.0                             | 2/1/2010         | Subsequently modified to include TSLF TOP (Options Program)   |
| 3/14/2008              | Bear Stearns Bridge Loan  | 12.9                                | Repaid 3/17/2008 |   |
| 3/16/2008              | PDCF  | ≥147.7                              | 2/1/2010         | Covers primary dealers — in September 2008, extended to include broker/dealer subsidiaries of the primary dealers |
| 3/16/2008              | Maiden Lane LLC (Bear Stearns Acquisition Loan)                           | 29.8                                |                  | To facilitate purchase by JPMorgan of Bear Stearns  |
| 9/16/2008              | ALG Revolving Credit Facility   | 85.0                                |                  | For: ALG; reduced to \$60 billion in November 2008  |
| 9/19/2008              | AMLF/Non-depository Institutions  | ≥145.9                              | 2/1/2010         | 13(3) was needed to bring non-depository institutions into program  |
| 10/7/2008              | CPFF  | 1,800.0                             | 2/1/2010         |   |
| 10/8/2008              | ALG Securities Lending Program  | 37.8                                | 12/12/2008       | For: ALG; Paid off and terminated on 12/12/2008   |
| 10/21/2008             | MMFF  | 600.0                               | 10/30/2009       | Eligibility expanded in January 2009 — unused, as of 6/30/2009  |
| 11/10/2008             | Maiden Lane II  | 22.5                                |                  | For: ALG  |
| 11/10/2008             | Maiden Lane III   | 30.0                                |                  | For: ALG  |
| 11/23/2008             | Residual Financing for Citigroup Designated Asset Pool                    | 220.4                               |                  | For Citigroup; "Ring Fence"   |
| 11/24/2008             | TALF  | 1,000.0                             | 12/31/2009       | There have been several expansions  |
| 1/15/2009 <sup>b</sup> | Residual Financing for Bank of America Designated Asset Pool <sup>b</sup> |                                     |                  | For: Bank of America "Ring Fence"   |
| 3/2/2009 <sup>c</sup>  | ALG Securitization of Life Insurance Cash Flows ("SLICF")                 | 8.5 <sup>d</sup>                    |                  | For: ALG; loans secured by life insurance cash flows  |
| <b>Total</b>           |   | <b>\$4,390.5</b>                    |                  |   |

Notes: Numbers affected by rounding. In certain occasions, Section 13(3) was invoked multiple times for a single program.  
<sup>a</sup> Authorized limits do not account for any collateral pledged. "≥" reflects programs that did not specify upper limit — in such cases highwater mark of program is used.  
<sup>b</sup> Based on Original Master Agreement date of 1/15/2009.  
<sup>c</sup> The residual financing arrangement for Bank of America has not been executed as of 6/30/2009.  
<sup>d</sup> Based on press release date of 3/2/2009.  
 The authority for this facility was tested separately from the revolving credit facility for ALG.  
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## TARP IN CONTEXT: OTHER GOVERNMENT PROGRAMS TO ASSIST THE FINANCIAL SECTOR

By itself, the Troubled Asset Relief Program ("TARP") is a huge program at \$700 billion. As discussed in SIGTARP's April Quarterly Report, the total financial exposure of TARP and TARP-related programs may reach approximately \$3 trillion. Although large in its own right, TARP is only a part of the combined efforts of the Federal Government to address the financial crisis. Approximately 50 initiatives or programs have been created by various Federal agencies since 2007 to provide potential support totaling more than \$23.7 trillion.

The Federal Reserve has been one of the lead agencies responding to the financial crisis — increasing its balance sheet to more than \$2 trillion to implement a wide range of programs designed to stimulate liquidity in financial markets, as well as several institution-specific interventions.<sup>121</sup> The Federal Reserve's \$2 trillion balance sheet (which grew from approximately \$900 billion prior to the financial crisis to a peak of nearly \$2.3 trillion in December 2008),<sup>122</sup> however, does not reflect the true potential amount of support the Federal Reserve has provided to those programs, which is estimated to be at least \$6.8 trillion. This is because many of the programs involve guarantees that, although not listed on the balance sheet, expose the Federal Reserve to significant losses if the assets they are backing deteriorate in value.

Other players in the Government's efforts include the Federal Deposit Insurance Corporation ("FDIC"), which has contributed more than \$2 trillion in new gross potential support. The newly created Federal Housing Finance Agency ("FHFA") — under whose auspices fall the Government-Sponsored Enterprises ("GSEs") such as Fannie Mae, Freddie Mac, and Federal Home Loan Banks ("FHLBs") — has effectively provided more than \$6 trillion in gross potential support. Meanwhile, Treasury itself has programs outside of those authorized under the Emergency Economic Stabilization Act ("EESA"), and has supplied potential support beyond TARP of approximately \$4.4 trillion. An overview of the Government's new potential support relating to the financial crisis is listed by Federal agency in Table 3.4.

Of this \$23.7 trillion in assistance to financial institutions, participants in non-TARP programs are not subject to TARP's restrictions and conditions, such as executive compensation, nor do they necessarily require specific Congressional approval. Although SIGTARP's oversight responsibility is for the operations of TARP and directly related programs (such as TALF and the Public-Private Investment Program ("PPIP")), it is necessary to understand the larger context in which TARP operates, the linkages between TARP and the trillions of dollars of other Government initiatives. As noted earlier, SIGTARP has no authority over any of the non-TARP activities of the agencies discussed below.

The Federal Reserve balance sheet represents the assets that the Federal Reserve has acquired as it has put resources into the financial sector. The assets on the Federal Reserve's balance sheet are the tools it employs to manage liquidity in the economy.

TABLE 3.4

| <b>INCREMENTAL FINANCIAL SYSTEM SUPPORT, BY FEDERAL AGENCY<br/>SINCE 2007 (S TRILLIONS)</b> |                            |  |  |
|---|----------------------------|--|--|
|   | <b>Current<br/>Balance</b> | <b>Maximum<br/>Balance as of<br/>6/30/2009</b> | <b>Total Potential<br/>Support<br/>Related to Crisis</b> |
| Federal Reserve   | \$1.4                      | \$3.1  | \$6.8  |
| FDIC  | 0.3                        | 0.3  | 2.3  |
| Treasury — TARP (including<br>Federal Reserve, FDIC<br>components)                          | 0.6                        | 0.6  | 3.0  |
| Treasury — Non-TARP   | 0.3                        | 0.3  | 4.4  |
| Other: FHFA, NCUA, GNMA, FHA, VA  | 0.3                        | 0.3  | 7.2  |
| <b>Total</b>  | <b>\$3.0</b>               | <b>\$4.7</b>                                   | <b>\$23.7</b>  |

Notes: Numbers affected by rounding. Amounts may include overlapping agency liabilities, "implied" guarantees, and unfunded initiatives. Total Potential Support does not account for collateral pledged. See the "Methodology for Estimating Government Financial Exposure" discussion in this section for details on the methodology of this chart. Other agencies include: FHFA, National Credit Union Administration (NCUA), Government National Mortgage Association (GNMA), Federal Housing Administration (FHA), and U.S. Department of Veterans Affairs (VA).

Source: See respective source notes in the agency-specific tables later in this section.

#### Methodology for Estimating Government Financial Exposure

No official financial statements have been prepared for the combined efforts of the Federal Government in its response to the financial crisis. The estimates in this section are designed to suggest the scale and scope of those efforts and not to provide a firm financial statement. These numbers may have some overlap, and have not been evaluated to provide an estimate of likely net costs to the taxpayer. Available data has been broken down into the following categories:

- **Current Balance** — the amount that has been expended on bank rescue efforts and that is currently outstanding.
- **Maximum Balance to Date** — the highest balance a program has reached in its history to date. Many programs reached their peak in December 2008 and are now declining. Comparing the maximum balance to the current balance provides a sense of how far past the high-water mark a program might be. The sum for each Federal agency reflects the sum of the individual high-water marks for each program under its supervision.
- **Total Potential Support** — quantifies the gross, not net, exposure that an agency would face should all eligible program applicants request assistance at once to the maximum permitted under the program guidelines. Note that many of these programs are collateralized or have not been drawn down to their full authorized levels, and as such, the actual potential for losses is likely to be lower. In certain

cases, programs included have been canceled or repaid; however, they are still included in this table (SIGTARP's intent is to represent all support programs created).

The program listings in this section are not comprehensive — there are dozens of smaller programs, regulations, statutes, and procedures of individual agencies that are not captured in the following tables. Also, there is potential for some double-counting of exposure in instances where different Federal agencies provide guarantees for the same financial institutions (such as the overlapping exposure by Treasury, the Federal Reserve, and FHFA to the CSEs).

#### **Other Federal Responses: Beyond TARP**

The Federal Government has undertaken dozens of initiatives, some of them involving specific programs with specific spending limits and others without any specific, quantifiable measurement appearing in the books of the responsible agency. Examples of the latter include the increase in deposit insurance instituted by FDIC, or the action by the Federal Reserve to pay interest on reserves held by banks at the Reserve Banks.<sup>23</sup> To the extent possible, SIGTARP has quantified the total exposure of these programs using publicly available information from the Federal agencies responsible for the programs or initiatives. Following each table are brief descriptions of key programs implemented by the agencies. The descriptions reflect the agencies' own descriptions of their programs. Note that the TARP-related programs, such as TALE and PPIP, are not included as they are addressed in other sections of this report.

#### **Federal Reserve System**

As the central bank of the United States, the Federal Reserve has exceptional responsibilities and powers to deal with systemic financial crises. See the previous discussion "TARP Tutorial: The Federal Reserve System" in this report. The Federal Reserve has created 18 financial support programs outside of its TARP-related programs, as listed in Table 3.5.

TABLE 3.5

| NON-TARP GOVERNMENT SUPPORT OF THE FINANCIAL SECTOR — FEDERAL RESERVE SYSTEM (IN BILLIONS)        |                           |                   |                                 |  |
|---|---------------------------|-------------------|---------------------------------|--|
| Program   | Coverage                  | Current Balance   | Maximum Balance as of 6/30/2009 | Total Potential Support Related to Crisis* |
| Term Auction Facility ("TAF")   | Banks                     | \$282.8           | \$493.1 <sup>a</sup>            | \$900.0 <sup>b</sup>                       |
| Primary Credit ("Discount Program Modification")  | Banks                     | 39.1              | 111.9                           | ≥ 111.9                                    |
| TriParty Repurchase Agreements  | Banks                     | —                 | 124.6 <sup>d</sup>              | ≥ 124.6                                    |
| Commercial Paper Funding Facility ("CPFF") <sup>***</sup>   | Corporate Debt Markets    | 128.1             | 349.9 <sup>a</sup>              | 1,800.0 <sup>b</sup>                       |
| Money Market Investor Funding Facility ("MMIFF")  | Money Market Mutual Funds | —                 | —                               | 600.0 <sup>b</sup>                         |
| Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility ("AMLF") <sup>***</sup> | Money Market Mutual Funds | 16.7              | 145.9 <sup>a</sup>              | ≥ 145.9                                    |
| Term Securities Lending Facility ("TSLF"), TSLF Options Program ("TOP") <sup>**</sup>             | Primary Dealers           | 8.0               | 233.6 <sup>c</sup>              | 250.0                                      |
| Expansion of System Open Market Account ("SOMA") Securities Lending <sup>b</sup>                  | Primary Dealers           | 14.7 <sup>i</sup> | 25.9 <sup>a</sup>               | 32.0 <sup>b</sup>                          |
| Primary Dealer Credit Facility ("PDCF"), credit to other primary dealers <sup>***</sup>           | Primary Dealers           | —                 | 147.7 <sup>a</sup>              | ≥ 147.7                                    |
| Purchase of Direct Obligations of GSEs  | GSEs                      | 92.1              | 92.1 <sup>a</sup>               | 200.0 <sup>b</sup>                         |
| Purchase of GSE Guaranteed Mortgage-Backed Securities <sup>c</sup>                                | GSEs                      | 467.1             | 467.1 <sup>a</sup>              | 1,250.0 <sup>b</sup>                       |
| Foreign Central Bank Currency Liquidity Swaps   | U.S. Markets              | 121.6             | 582.8 <sup>a</sup>              | 755.0 <sup>b</sup>                         |
| Treasuries Purchase Program   | Private Credit Markets    | 174.5             | 174.5 <sup>a</sup>              | 300.0 <sup>b</sup>                         |
| Credit to AIG   | Specific Institution      | 42.6              | 89.5 <sup>a</sup>               | 122.8 <sup>b</sup>                         |
| Maiden Lane LLC (Bear Stearns) <sup>***</sup>   | Specific Institution      | 25.9              | 29.8 <sup>a</sup>               | 29.8                                       |
| Maiden Lane II LLC (AIG) <sup>***</sup>   | Specific Institution      | 16.0              | 20.1 <sup>a</sup>               | 22.5 <sup>b</sup>                          |
| Maiden Lane III LLC (AIG) <sup>***</sup>  | Specific Institution      | 20.1              | 28.1 <sup>a</sup>               | 30.0 <sup>b</sup>                          |
| Other Credit Extensions (JPMorgan, Bear Stearns bridge loan) <sup>**</sup>                        | Specific Institution      | —                 | 12.9 <sup>a</sup>               | 12.9                                       |
| <b>Total</b>  |                           | <b>\$1,449.3</b>  | <b>\$3,129.5</b>                | <b>≥\$6,835.1</b>                          |

Notes: Numbers affected by rounding; if only one source is given for "Current Balance" and "Maximum Balance," it is the same source for both.

\*Total Potential Support does not account for any collateral pledged; "≥" reflects programs that did not specify upper limit — in such cases high-water mark of program is used as total potential support.

\*\* Denies program that has been cancelled or completed.

\*\*\* Current and maximum balances for CPFF, AMLF, PDCF, and Maiden Lane LLCs are derived from value of collateral held, which is approximately the loan amounts outstanding.

(Sources on next page)

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- <sup>6</sup> FDIC, Supervisory Insights, Summer 2009, p. 4.
- <sup>7</sup> Congressional Budget Office, "The Budget and Economic Outlook: Fiscal Years 2009-2019," p. 36; FDIC, Supervisory Insights, Summer 2009, p. 4.
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- <sup>10</sup> Congressional Budget Office, "The Budget and Economic Outlook: Fiscal Years 2009-2019," p. 37.
- <sup>11</sup> Maximum \$5 billion per primary dealer; Fed's primary dealer bid shows 16 dealers lower newprimarydealer.org/markets/primarydealer.html. Limit was increased from \$3 billion to \$5 billion per dealer in 2008 ([www.newyorkfed.org/markets/primarydealer.html](http://www.newyorkfed.org/markets/primarydealer.html), increasing maximum amount to \$80 billion from \$48 billion).
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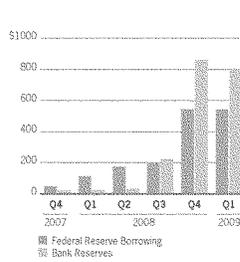
### Term Auction Facility ("TAF") — Total Potential Support: Approximately \$900 Billion

The Term Auction Facility ("TAF") allows banks to borrow funds simply by putting up collateral. It is an alternative to the Federal Reserve's discount window, which is the means by which banks have historically raised funds in an emergency. Because of its association with emergencies, borrowing at the discount window in the past has carried a certain stigma. TAF, by contrast, is an ordinary lending program, and its use is perceived less as a sign of weakness.

TAF was created in December 2007 by the Federal Reserve Board of Governors to meet the short-term liquidity needs of banks. The Federal Reserve claimed that "by increasing the access of depository institutions to funding, the TAF has supported the ability of such institutions to meet the credit needs of their customers."

Technically, the funds are borrowed by banks in an auction that sets the interest rate. The bank must be in "generally sound financial condition," and it must post collateral — such as high-quality notes — that are subject to certain haircuts. Thus, a bank may borrow, for example, \$0.92 after posting \$1.00 worth of securities. The minimum interest rate a bank may bid is the interest rate paid by the Federal Reserve on excess reserve balances. Typically, the Federal Reserve conducts

**FIGURE 3.3**  
BANKS HAVE BORROWED FROM THE FEDERAL RESERVE — AND INCREASED THEIR RESERVES AT THE SAME TIME



Source: Federal Reserve Board, Statistical Release Z.1, "Flow of Funds Accounts of the United States," Table L.108, 6/11/2009.

regular auctions of 28- and 84-day funds for \$150 billion at a time.<sup>724</sup> Banks may not necessarily have been using the funds they have borrowed from TAF to make new loans to consumers. According to the Federal Reserve's weekly statistical releases (Table Z.1 - Flow of Funds Accounts), the banks have, in aggregate, been adding the cash to their reserves at the Federal Reserve. See Figure 3.3 for a comparison of bank borrowings from the Federal Reserve (which are predominantly through TAF), versus the cash that the banks have placed as reserves at the Federal Reserve.

**Primary Credit Program (the "Discount Program Modification") — Total Potential Support: At Least \$111.9 Billion**

Primary credit loans are taken by banks at the Federal Reserve's discount window when they require short-term funds to meet the needs of their customers and creditors. Normally, the Federal Reserve lends at a fixed rate and the bank must post suitable collateral, subject to a haircut. In August 2007, the Federal Reserve set the term at 30 days and approved a 50-basis-point reduction in the primary credit rate to narrow the spread to 50 basis points, or 0.5%, in response to the liquidity crisis in the banking system. Accessibility was broadened in March 2008, as the interest rate was lowered to 25 basis points over the FOMC target federal funds rate, and the term has been lengthened from 30 to 90 days, renewable by the borrower.<sup>725</sup>

**Tri-Party Repurchase Agreements ("Repo's") — Total Potential Support: At Least \$124.6 Billion**

According to the Federal Reserve, "repurchase agreements reflect some of the Federal Reserve's temporary OMOs. Repurchase agreements are transactions in which securities are purchased from a primary dealer under an agreement to sell them back to the dealer on a specified date in the future. The difference between the purchase price and the repurchase price reflects an interest payment. The Federal Reserve may enter into repurchase agreements for up to 65 business days, but the typical maturity is between one and 14 days. Federal Reserve repurchase agreements supply reserve balances to the banking system for the length of the agreement. The Federal Reserve employs a naming convention for these transactions based on the perspective of the primary dealers: the dealers receive cash while the Federal Reserve receives the collateral."<sup>726</sup> In an effort to mitigate problems in certain Repo markets, on September 14, 2008, the Federal Reserve Board announced that it would provide a "temporary exception to the limitations in section 23A of the Federal Reserve Act" (which limits a bank's credit exposure to its affiliates).<sup>727</sup> This exception "allows all insured depository institutions to provide liquidity to their affiliates for assets typically funded in the tri-party repo market."<sup>728</sup>

**Commercial Paper Funding Facility ("CPFF") — Total Potential Support:  
\$1.8 Trillion**

The Commercial Paper Funding Facility ("CPFF") was created in October 2008 to provide an emergency source of funds (in the Federal Reserve's terms, a "liquidity backstop")<sup>229</sup> to U.S. corporations that borrow short-term funds by issuing Commercial Paper ("CP"). CP is a short-term debt security used by corporations to raise funds in what has historically been a liquid market. This market ceased to function well in the fall of 2008, and the CPFF has played a role in assuring issuers and investors in CP that they have a "buyer of last resort." The CPFF, according to the Federal Reserve Board's February 24, 2009, Monetary Report to Congress, "is intended to improve liquidity in short-term funding markets and thereby increase the availability of credit for businesses and households."<sup>230</sup> Under CPFF, the Federal Reserve Bank of New York ("FRBNY") is committed to lending funds as needed to a special purpose vehicle ("SPV") that buys eligible CP from eligible issuers. Eligible CP is U.S.-dollar-denominated CP or asset-backed CP rated at least A-1/P-1/F1 (these are the top ratings of the different rating agencies). Eligible issuers are U.S. corporations, including those with a foreign parent company. For any given issuer, the SPV is limited to the maximum amount of CP that issuer had outstanding between January 1 and August 31, 2008. Issuers must pay a fee to FRBNY of 0.1% of the maximum amount of its CP the SPV could own. The CPFF is scheduled to expire on February 1, 2010.<sup>231</sup>

**Money Market Investor Funding Facility ("MMIFF") — Total Potential Support:  
\$600 Billion**

Money market funds are large investment funds that buy high-quality, short-term debt instruments such as Treasury securities and high-quality bank and corporate notes. Investors in money market funds want absolute safety for their principal and fast access to funds. In turn, banks and other financial intermediaries depend on the money market as a source of funds for their business and household customers. In 2008, this market experienced the same liquidity problems as other markets — that is, investors could not find buyers for securities they were seeking to sell when needed.

To meet this liquidity need, the Federal Reserve created the Money Market Investor Funding Facility ("MMIFF") on October 21, 2008. According to the Federal Reserve Board's Monetary Report to Congress, "the Federal Reserve Bank of New York will provide senior secured funding to a series of SPVs to facilitate an industry-supported private-sector initiative to finance the purchase of eligible assets from eligible investors. Eligible assets include U.S. dollar-denominated certificates of deposit and commercial paper issued by highly rated financial institutions and having remaining maturities of 90 days or less."<sup>232</sup> The SPVs for the MMIFF are similar to the SPV for CPFF in that they purchase eligible money market paper

using funds from MMIFF and asset-backed CP. FRBNY is committed to lending the SPVs 90% of the purchase price of eligible assets; sellers of assets to the SPV will receive that much in cash and the remaining 10% in asset-backed securities from the SPV.<sup>233</sup> The MMIFF has not yet funded any purchases of money market instruments. Even without having advanced funds to the market, the program may be considered by the market to be working merely by its existence; investors are given the comfort that if they need it, it is available. The MMIFF SPVs are authorized through October 30, 2009.<sup>234</sup>

**Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility ("AMLF") — Total Potential Support: At Least \$145.9 Billion**

The Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility ("AMLF") is designed to assist money market funds that hold asset-backed commercial paper ("ABCP"). Through the facility, the Federal Reserve provides non-recourse loans at the primary credit rate to U.S. depository institutions and bank holding companies to finance their purchases of high-quality ABCP from money market mutual funds. According to the Federal Reserve, AMLF is intended "to assist money funds that hold such paper in meeting demands for redemptions by investors and to foster liquidity in the ABCP markets and broader money markets."<sup>235</sup> The AMLF was initially authorized on September 19, 2008, and although originally scheduled to terminate in January 2009, has been subsequently extended by the Federal Reserve Board to February 1, 2010.<sup>236</sup>

**Term Securities Lending Facility ("TSLF"), and Term Securities Lending Facility Options Program ("TOP") — Total Potential Support: \$250 Billion**

In the securities markets, primary dealers are a group of securities broker-dealers who specialize in Treasury and Federal agency debt, and who have the right to trade directly with the Federal Reserve System. They also participate directly in U.S. Treasury auctions. They are an important conduit for financial interactions between the Federal Government and the private markets. In early 2008, this dealer system was under increasing liquidity pressure, which the Federal Reserve addressed on March 11, 2008, with the establishment of a Term Securities Lending Facility ("TSLF"). According to the Federal Reserve Board's February, 2009 Monetary Report to Congress, "Under the TSLF, the Federal Reserve lends up to \$200 billion of Treasury securities to primary dealers for a term of 28 days (rather than overnight, as in the regular securities lending program); the lending is secured by a pledge of other securities."<sup>237</sup> The other securities that must be posted as collateral were broadened from the traditional eligible assets — Treasury and Federal agency securities, and AAA-rated private-label residential mortgage-backed securities ("RMBS") — to include all investment-grade debt securities. TSLF makes securities available in weekly auctions. The program is scheduled to end on February 1, 2010.<sup>238</sup>

An extension of the TSLF is the TSLF Options Program ("TOP"), described by FRBNY as a program intended to "enhance the effectiveness of TSLF by offering added liquidity over periods of heightened collateral market pressures, such as quarter-end dates."<sup>7338</sup> The program "offers options on a short-term fixed rate of [TSLF] bond-for-bond loan of general Treasury collateral against a pledge of eligible collateral."<sup>7340</sup> FRBNY's Open Market Trading Desk will offer a total of \$50 billion in options for each targeted period.<sup>7341</sup> As of June 25, 2009, the TOP has been suspended, although the Federal Reserve states that it is prepared to resume TOP auctions "if warranted by evolving market conditions."<sup>7342</sup>

**Expansion of System Open Market Account ("SOMA") Securities Lending — Total Potential Support: \$32 Billion Increase in Funding**

The System Open Market Account ("SOMA") was started in 1969, and is managed by FRBNY. The account contains dollar-denominated assets purchased in open market operations,<sup>7343</sup> and is a "store of liquidity in the event an emergency need for liquidity arises."<sup>7344</sup> Borrowing is permitted "for the purpose of covering an expected fail to receive on the part of a dealer. In order to prevent lending activity from affecting reserves, Treasury securities, rather than cash, are posted with the Federal Reserve as collateral."<sup>7345</sup> In response to market pressures, the program was expanded on September 23, 2008, to raise the current dealer aggregate limit from \$3 billion to \$4 billion<sup>7346</sup> and raised again on October 8, 2008, to \$5 billion per dealer.<sup>7347</sup>

**Primary Dealer Credit Facility ("PDCF") — Total Potential Support: At Least \$148 Billion**

The Federal Reserve Board's February 2009 Monetary Report to Congress states that "to bolster market liquidity and promote orderly market functioning, on March 16, 2008, the Federal Reserve Board voted unanimously to authorize the Federal Reserve Bank of New York to create a lending facility — the Primary Dealer Credit Facility ["PDCF"] — to improve the ability of primary dealers to provide financing to participants in securitization markets."<sup>7348</sup> Loans are made to primary dealers, against which they must post eligible collateral — the definition of which has been expanded from all investment-grade securities to now include "all collateral eligible for pledge in tri-party funding arrangements through the major clearing banks. The interest rate charged on such credit is the same as the primary credit rate at the Federal Reserve Bank of New York."<sup>7349</sup> The first participants in the PDCF were Merrill Lynch, Goldman Sachs, and Morgan Stanley; it was later expanded to include other primary dealers. The program is scheduled to terminate on February 1, 2010.<sup>7350</sup>

**Purchases of Direct Obligations of GSEs — Total Potential Support: \$200 Billion**

Government-Sponsored Enterprises (“GSEs”) are private corporations created by Congress to fulfill certain financial policy goals, primarily in the housing finance markets. The most prominent of these are Fannie Mae, Freddie Mac, and the FHLMs. As Fannie Mae and Freddie Mac in particular encountered difficulty raising funds in 2008, their problems affected the housing markets in general, where these two agencies alone accounted for more than half of all financing.

To promote market functioning, the availability of credit, and support for the housing and mortgage markets, the Federal Reserve, on September 19, 2008, announced that it would commence purchasing debt and other instruments of the GSEs through its Open Market Trading Desk; these purchases are made in competitive auctions through primary dealers.

On November 25, 2008, the Federal Reserve announced a program to purchase up to \$100 billion in the GSEs’ direct obligations. Note that GSEs raise funds for mortgage lending in two ways — by direct borrowing or by guaranteeing third-party mortgage-backed securities (“MBS”). On March 18, 2009, the Federal Reserve’s FOMC increased the size of these lines to a total of \$200 billion for direct obligations.<sup>351</sup> Although the direct borrowing line has been focused on fixed-rate, non-callable, senior benchmark securities of the GSEs, the Federal Reserve has stated that it may change the scope of its purchases in the future.

**Purchases of GSE-Guaranteed MBS — Total Potential Support: \$1.25 Trillion**

In addition to purchasing the direct obligations of GSEs, the Federal Reserve is further supporting the mortgage markets by committing to purchase up to \$1.25 trillion of MBS that have been guaranteed by the GSEs. This purchase line was originally announced on November 25, 2008, with a maximum purchase limit of \$500 billion, but this amount was raised by \$750 billion to \$1.25 trillion on March 18, 2009.<sup>352</sup>

**Foreign Central Bank Currency Liquidity Swaps — Total Potential Support: \$755 Billion**

On December 12, 2007, the FOMC announced that it had authorized dollar liquidity swap lines with the European Central Bank and the Swiss National Bank in order to “provide liquidity in U.S. dollars to overseas markets.”<sup>353</sup> Since then, the program has expanded to include additional central banks.

The Federal Reserve describes the transactions as follows: “These swaps involve two transactions. When a foreign central bank draws on its swap line with the Federal Reserve, the foreign central bank sells a specified amount of its currency to the Federal Reserve in exchange for dollars at the prevailing market exchange rate. The Federal Reserve holds the foreign currency in an account at the foreign central bank. The dollars that the Federal Reserve provides are deposited in an

account that the foreign central bank maintains at the Federal Reserve Bank of New York. At the same time, the Federal Reserve and the foreign central bank enter into a binding agreement for a second transaction that obligates the foreign central bank to buy back its currency on a specified future date at the same exchange rate. The second transaction unwinds the first. At the conclusion of the second transaction, the foreign central bank pays interest, at a market-based rate, to the Federal Reserve.

"When the foreign central bank lends the dollars it obtained by drawing on its swap line to institutions in its jurisdiction, the dollars are transferred from the foreign central bank's account at the Federal Reserve to the account of the bank that the borrowing institution uses to clear its dollar transactions. The foreign central bank remains obligated to return the dollars to the Federal Reserve under the terms of the agreement, and the Federal Reserve is not a counterparty to the loan extended by the foreign central bank. The foreign central bank bears the credit risk associated with the loans it makes to institutions in its jurisdiction."<sup>54</sup>

**Treasuries Purchase Program ("TPP") — Total Potential Support: \$300 Billion**

On March 18, 2009, the FOMC announced that "to help improve conditions in private credit markets, the [FOMC] Committee decided to purchase up to \$300 billion of longer-term Treasury Securities over the next six months."<sup>55</sup> The Federal Reserve states that the goal of TPP is "to provide support to mortgage and housing markets and to foster improved conditions in financial markets more generally" by cheapening the yields of the longer-term Government securities which are the benchmarks against which the rates of long-term loans, such as mortgages, are set.<sup>56</sup>

**Credit to American International Group, Inc. — Total Potential Support: \$122.5 Billion**

The Federal Reserve Board's Monetary Report to Congress states that "In early September, the condition of American International Group, Inc. ("AIG"), a large, complex financial institution, deteriorated rapidly. In view of the likely systemic implications and the potential for significant adverse effects on the economy of a disorderly failure of AIG, on September 16, the Federal Reserve Board, with the support of Treasury, authorized the Federal Reserve Bank of New York to lend up to \$85 billion to the firm to assist it in meeting its obligations and to facilitate the orderly sale of some of its businesses. This facility had a 24-month term, with interest accruing on the outstanding balance at a rate of 3-month Libor plus 850 basis points, and was collateralized by all of the assets of AIG and its primary non-regulated subsidiaries. On October 8, the Federal Reserve announced an additional program under which it would lend up to \$37.8 billion to finance investment-grade, fixed-income securities held by AIG. These securities had previously been lent by

AIG's insurance company subsidiaries to third parties.<sup>257</sup> This facility was repaid in full and terminated on December 12, 2008.<sup>258</sup> Subsequently, in November 2008, Treasury, through TARP, purchased \$40 billion of newly issued AIG preferred shares under the Systemically Significant Failing Institutions ("SSFI") program. The \$40 billion took some of the pressure off the first Federal Reserve line of credit, allowing the Federal Reserve to reduce from \$85 billion to \$60 billion the total amount available under the credit facility.<sup>259</sup> In addition to reducing the size of the line of credit, the Federal Reserve reduced the interest rate on the facility and extended the term of the facility from two years to five years.<sup>260</sup> On March 2, 2009, the Federal Reserve announced authorization for new loans of up to an aggregate amount of approximately \$8.5 billion to special purpose vehicles established by domestic life insurance subsidiaries of AIG that would be repaid by the net cash flows from designated blocks of life insurance policies held by the parent insurance companies.<sup>261</sup>

**Maiden Lane LLC (Bear Stearns) — Total Potential Support: \$29.8 Billion**

In mid-March of 2008, Bear Stearns, a major investment bank and primary dealer, was in imminent danger of failure. According to the Federal Reserve Board's February 2009 Monetary Report to Congress, "A bankruptcy filing would have forced the secured creditors and counterparties of Bear Stearns to liquidate underlying collateral, and given the illiquidity of markets, those creditors and counterparties might well have sustained substantial losses. If they had responded to losses or the unexpected illiquidity of their holdings by pulling back from providing secured financing to other firms and by dumping large volumes of illiquid assets on the market, a much broader financial crisis likely would have ensued. Thus, the Federal Reserve judged that a disorderly failure of Bear Stearns would have threatened overall financial stability and would most likely have had significant adverse implications for the U.S. economy."<sup>262</sup> To prevent a complete collapse of Bear Stearns, therefore, the Federal Reserve invoked its emergency authorities under Section 13(3) of the Federal Reserve Act to authorize a loan of \$30 billion, secured by \$30 billion in Bear Stearns' assets, to be used by JPMorgan to purchase Bear Stearns and to assume the company's financial obligations. A limited liability company, Maiden Lane LLC was formed to facilitate these arrangements, particularly to hold and manage certain assets. On June 26, 2008, JPMorgan completed the acquisition. Maiden Lane LLC purchased approximately \$30 billion in Bear Stearns assets on that date with approximately \$29 billion of funding from the Federal Reserve to Maiden Lane LLC and a subordinated loan of approximately \$1 billion from JPMorgan.<sup>263</sup> Today, the Federal Reserve is managing the disposition of Bear Stearns' assets.

**Maiden Lane II LLC and Maiden Lane III LLC (American International Group, Inc.)  
— Total Potential Support: \$22.5 Billion and \$30.0 Billion, Respectively**

The Federal Reserve Board's April 2009 Monetary Report to Congress states that "In November 2008, the Federal Reserve also announced plans to restructure its lending related to AIG by extending credit to two newly formed limited liability companies. The first, Maiden Lane II LLC, received a \$22.5 billion loan from the Federal Reserve and a \$1 billion subordinated loan from AIG and purchased residential mortgage-backed securities from AIG. As a result of these actions, the securities lending facility established on October 8 was subsequently repaid and terminated. The second new company, Maiden Lane III LLC, received a \$30 billion loan from the Federal Reserve and a \$5 billion subordinated loan from AIG and purchased multi-sector collateralized debt obligations on which AIG ha[d] written credit default swap contracts."<sup>64</sup> The Federal Reserve's first quarterly report on its credit and liquidity programs shows a decline in fair value on the assets held in the AIG-related Maiden Lane facilities — a decline in fair value of \$2.5 billion and \$6.4 billion, respectively, for Maiden Lanes II and III.<sup>65</sup>

**Bridge Loan to JPMorgan Chase & Bear Stearns — Total Potential Support:  
\$12.9 Billion**

According to the Federal Reserve, on March 14, 2008, FRB NY made an overnight discount window loan of \$12.9 billion to JPMorgan to facilitate its purchase of Bear Stearns; this was done simultaneously, in a back-to-back transaction, to provide secured financing to Bear Stearns.<sup>66</sup> The loan was repaid in full the following Monday, March 17, 2008, "with interest of nearly \$4 million." The Federal Reserve Board describes this decision to extend credit as "designed to provide funding to Bear Stearns to meet its immediate liquidity needs for that day and to give the company and policymakers additional time to develop a more permanent solution to the company's severe liquidity pressures that threatened to cause its sudden default and bankruptcy."<sup>67</sup>

**Federal Deposit Insurance Corporation**

FDIC supports banks by insuring depositors against loss. Once depositors need not worry about the financial health of any particular bank, the entire banking system can avoid the destabilizing and dangerous potential for "runs on the bank" or other precipitous withdrawals of funds. Historically a standby guarantor of deposits, the current banking crisis has drawn FDIC into the business of direct guarantees of debt instruments, investment funds, and asset values — businesses increasingly

distant from its core. Table 3.6 provides a summary of the key FDIC initiatives related to the financial crisis. As with the Federal Reserve, any of FDIC's TARP-related programs such as its involvement in PPIP and the Asset Guarantee Program ("AGP"), are omitted from this discussion because they are already mentioned in Section 2: "TARP Overview" of this report.

#### Enhanced FDIC Deposit Insurance — Total Potential Support: \$700 Billion

Since the 1980s, FDIC has insured deposits up to a maximum of \$100,000 per depositor. In late 2008, in response to the liquidity crisis and uncertain solvency in the banking industry, FDIC received statutory authority to increase its coverage to \$250,000 for individual accounts.<sup>368</sup> FDIC states, "If a depositor's accounts at one FDIC-insured bank or savings association total \$250,000 or less, the deposits are fully insured. A depositor can have more than \$250,000 at one insured bank or savings association and still be fully insured provided the accounts meet certain requirements."<sup>369</sup> According to FDIC, "the standard insurance amount of \$250,000 per depositor is in effect through December 31, 2013. On January 1, 2014, the standard insurance amount will return to \$100,000 per depositor for all account

TABLE 3.6

| NON-TARP GOVERNMENT SUPPORT OF THE FINANCIAL SECTOR<br>FEDERAL DEPOSIT INSURANCE CORPORATION (\$ BILLIONS) |            |                 |                           |   |
|--|------------|-----------------|---------------------------|---|
| Program  | Coverage   | Current Balance | Maximum Balance 6/30/2009 | Total Potential Support Related to Crisis * |
| Enhanced Deposit Insurance (to \$250K/account) <sup>†</sup>  | Depositors | \$—             | \$—                       | \$700.0 <sup>‡</sup>                        |
| Temporary Liquidity Guarantee Program - Debt Guarantees ("TLGP - DGP")                                     | Banks      | 345.8           | 345.8 <sup>‡</sup>        | 940.0 <sup>§</sup>                          |
| Temporary Liquidity Guarantee Program - Transaction Account Guarantee Program ("TLGP - TAG")               | Depositors | 0.4             | 0.4 <sup>¶</sup>          | 684.0 <sup>  </sup>                         |
| <b>Total</b>   |            | <b>\$346.2</b>  | <b>\$346.2</b>            | <b>\$2,324.0</b>                            |

Notes: Numbers affected by rounding.

\* Total Potential Support does not account for any collateral pledged.

<sup>†</sup> As of 3/31/2009, the Deposit Insurance Fund (DIF) remained solvent and FDIC had yet to draw on any of the additional borrowing authority granted by Congress. FDIC, Chief Financial Officer's Report to the Board, First Quarter 2009, [www.fdic.gov/about/strategic/corporate/cfo\\_report\\_1stqr\\_09/ows\\_summary.html](http://www.fdic.gov/about/strategic/corporate/cfo_report_1stqr_09/ows_summary.html), accessed 7/13/2009.

<sup>‡</sup> Estimate as of 12/31/2008, Congressional Budget Office, "The Budget and Economic Outlook: Fiscal Years 2009-2019," p. 41.

<sup>§</sup> Federal Deposit Insurance Corporation, Monthly Reports on Debt Insurance Under the Temporary Liquidity Guarantee Program, 6/31/2009, [www.fdic.gov/regulations/responses/tdgp/reports.html](http://www.fdic.gov/regulations/responses/tdgp/reports.html), accessed 6/23/2009.

<sup>¶</sup> FDIC, Chief Financial Officer's Report to the Board, Q4 2008, [www.fdic.gov/about/strategic/corporate/cfo\\_report\\_4qtr\\_08/sum\\_trends\\_results.html](http://www.fdic.gov/about/strategic/corporate/cfo_report_4qtr_08/sum_trends_results.html), accessed 6/20/2009.

<sup>||</sup> As of 3/31/2009, during 2008 FDIC paid out \$70 million in guaranteed claims of depositors. FDIC, Chief Financial Officer's Report to the Board, Q4 2008, [www.fdic.gov/about/strategic/corporate/cfo\\_report\\_4qtr\\_08/sum\\_trends\\_results.html](http://www.fdic.gov/about/strategic/corporate/cfo_report_4qtr_08/sum_trends_results.html), accessed 6/20/2009. During Q1 2009, FDIC paid out \$523 million, [www.fdic.gov/about/strategic/corporate/cfo\\_report\\_1stqr\\_09/corp\\_fund\\_fm\\_statement.html](http://www.fdic.gov/about/strategic/corporate/cfo_report_1stqr_09/corp_fund_fm_statement.html), accessed 6/30/2009.

<sup>|||</sup> FDIC, Supervisory Insights, Summer 2009, p. 4, FDIC, Supervisory Insights, Summer 2009, p. 4, [www.fdic.gov/regulations/examinations/supervisory/insights/summ09/iss\\_sum09.pdf](http://www.fdic.gov/regulations/examinations/supervisory/insights/summ09/iss_sum09.pdf), accessed 7/9/2009.

categories except IRAs and other certain retirement accounts, which will remain at \$250,000 per depositor.<sup>770</sup>

The Congressional Budget Office ("CBO"), in its "Budget and Economic Outlook: Fiscal Years 2009 to 2019," estimates that the temporary increase in the limit of deposit insurance will "increase the amount of insured deposits by about \$700 billion, or 15 percent."<sup>771</sup> Claims on deposit insurance are paid by the Deposit Insurance Fund ("DIF"), which is financed by fees levied on insured banks. In the event that the funds available in the DIF should be insufficient to cover claims, FDIC can borrow from Treasury (historically up to \$30 billion, but recently increased to \$100 billion with a temporary authority up to \$500 billion).<sup>772</sup> As of the end of March, 2009, FDIC had not borrowed from Treasury to cover any losses to DIF.<sup>773</sup>

**Temporary Liquidity Guarantee Program (Debt Guarantee Program) — Total Potential Support: \$940 Billion**

The Temporary Liquidity Guarantee Program ("TLGP") was established in October 2008 to address "disruptions in the credit market, particularly the interbank lending market, which reduced banks' liquidity and impaired their ability to lend. The goal of the TLGP is to decrease the cost of bank funding so that bank lending to consumers and businesses will normalize."<sup>774</sup> The program "does not rely on the taxpayer or the deposit insurance fund to achieve its goals;"<sup>775</sup> rather, it is "entirely funded by industry fees."<sup>776</sup> TLGP has two components, the debt guarantee program ("DGP") discussed in this paragraph and the Transaction Account Guarantee ("TAG") program described in the following paragraph. DGP provides an FDIC guarantee of newly issued senior unsecured debt of depository institutions. The goal of the DGP is to "create significant investor demand, and dramatically reduce funding costs for eligible banks and bank holding companies."<sup>777</sup> FDIC-insured institutions were automatically included in the program, but given the option not to participate. Participating institutions may issue debt under the DGP until October 31, 2009, with the debt being guaranteed until "the earliest of the opt-out date, the maturity of the debt, the mandatory conversion date for mandatory convertible debt, or December 31, 2012."<sup>778</sup>

**Temporary Liquidity Guarantee Program (Transaction Account Guarantee Program) — Total Potential Support: \$684 Billion**

On October 14, 2008, FDIC announced the temporary Transaction Account Guarantee ("TAG") program, which is the second component of the TLGP. It provides depositors with "unlimited coverage for non-interest-bearing transaction accounts if their bank is a participant in FDIC's TLGP. Non-interest-bearing checking accounts include Demand Deposit Accounts ("DDAs") and any transaction account that has unlimited withdrawals and that cannot earn interest. Also

included are low-interest NOW ["Negotiable Order of Withdrawal"] accounts that cannot earn more than 0.5% interest.<sup>779</sup> The program is scheduled to end on December 31, 2009. On June 23, 2009, FDIC voted to seek comment on whether to extend the TAG until June 30, 2010.<sup>780</sup> As with the debt guarantee component, FDIC-insured institutions were given the option not to participate in the TAG program.

#### U.S. Department of the Treasury

Outside of TARP, Treasury is using its non-EESA resources and authorities to support a number of other programs for the benefit of the financial industry. EESA, the legislation that created TARP, was not the first financial rescue act of Congress in 2008. Prior to EESA, Congress passed the Housing and Economic Recovery Act of 2008 ("HERA") in July 2008. As such, many of Treasury's earlier efforts at restoring stability to the financial sector arose out of provisions in this law. Table 3.7 provides a summary of the key Treasury initiatives related to the financial crisis.

TABLE 3.7

| NON-TARP GOVERNMENT SUPPORT OF THE FINANCIAL SECTOR                             |                                 | U.S. TREASURY (\$ BILLIONS) |                                 |  |
|---|---------------------------------|-----------------------------|---------------------------------|--|
| Program   | Coverage                        | Current Balance             | Maximum Balance as of 6/30/2009 | Total Potential Support Related to Crisis* |
| Money Market Mutual Fund ("MMMF") Program                                       | Money Market Mutual Funds       | \$—                         | \$—                             | \$3,355.3 <sup>a</sup>                     |
| GSE Preferred Stock Purchase Agreements ("PSPA")                                | Fannie/Freddie; Housing Markets | 59.8                        | 59.8 <sup>b</sup>               | 400.0 <sup>c</sup>                         |
| GSE MBS Purchase Program  | Fannie/Freddie; Housing Markets | 145.7                       | 145.7 <sup>d</sup>              | 314.0 <sup>e</sup>                         |
| GSE Credit Facility Program   | Fannie/Freddie; Housing Markets | —                           | —                               | 25.0 <sup>f</sup>                          |
| Other HERA/Treasury (Tax Benefits and CDBG)                                     | Homeowners, Communities         | 19.0                        | 19.0                            | 19.0 <sup>g</sup>                          |
| Student Loan Purchases, and Asset-Backed Commercial Paper Conduits <sup>h</sup> | Higher Education                | 32.6                        | 32.6 <sup>b</sup>               | 195.0 <sup>i</sup>                         |
| Potential International Fund Liabilities  | International Agencies          | —                           | —                               | 100.0 <sup>j</sup>                         |
| <b>Total</b>  |                                 | <b>\$257.1</b>              | <b>\$257.1</b>                  | <b>\$4,408.3</b>                           |

Notes: Numbers affected by rounding.

\*Total potential support does not account for any collateral pledged.

<sup>a</sup>Per Treasury, the MMFF provided coverage to all participating money market mutual funds as of 9/19/2008. Treasury Press Release, "Treasury Announces Extension of Temporary Guarantee Program for Money Market Funds," 9/19/2008, [www.ostreas.gov/news/releases/tg79.htm](http://www.ostreas.gov/news/releases/tg79.htm), accessed 6/25/2009. The amount, \$3,355 billion, represents the total money market mutual funds outstanding at the end of Q3, 2008. Federal Reserve Board Statistical Release Z.1, Flow of Funds Accounts of the United States, 6/11/2009, Table L.206.

<sup>b</sup>Data as of 4/15/2009. White House, FY 2010 Budget, [www.whitehouse.gov/omb/budget/fy2010/assets/gov.pdf](http://www.whitehouse.gov/omb/budget/fy2010/assets/gov.pdf), accessed 6/25/2009.

<sup>c</sup>Data as of 4/16/2009. White House, FY 2010 Budget, [www.whitehouse.gov/omb/budget/fy2010/assets/gov.pdf](http://www.whitehouse.gov/omb/budget/fy2010/assets/gov.pdf), accessed 6/25/2009.

<sup>d</sup>Treasury, Monthly Treasury Statement, May 2009, [www.fms.treas.gov/mst/mst0509.pdf](http://www.fms.treas.gov/mst/mst0509.pdf), accessed 6/25/2009.

<sup>e</sup>Treasury, "Budget in Brief FY 2010," [www.ostreas.gov/offices/management/budget/budgetbrief/fy2010/08HousingGSE.pdf](http://www.ostreas.gov/offices/management/budget/budgetbrief/fy2010/08HousingGSE.pdf), accessed 6/25/2009; represents the sum of Treasury's estimates for FY 2008, FY 2009, and FY 2010.

<sup>f</sup>House Financial Services Committee, Summary of Key Provisions in HR 3221, Housing and Economic Recovery Act of 2008, [www.financialservices.house.gov/FHA.html](http://www.financialservices.house.gov/FHA.html), accessed 6/25/2009.

<sup>g</sup>House Financial Services Committee, Summary of Key Provisions in HR 3221, Housing and Economic Recovery Act of 2008, [www.financialservices.house.gov/FHA.html](http://www.financialservices.house.gov/FHA.html), accessed 6/25/2009.

<sup>h</sup>As of May 31, 2009. Treasury, Monthly Treasury Statement, May 2009, [www.fms.treas.gov/mst/mst0509.pdf](http://www.fms.treas.gov/mst/mst0509.pdf), accessed 7/2/2009.

<sup>i</sup>Federal Register, "Vol. 34, No. 10, 1/15/2009, Notices: Department of Education Federal Family Education Loan Program," <http://federalstudentaid.ed.gov/Help/library/EA43FedReg.pdf>, accessed 6/28/2009.

<sup>j</sup>Treasury, "Fact Sheet: IMF Reform and New Arrangements to Borrow," 5/18/2008, [www.treas.gov/press/releases/tg136.htm](http://www.treas.gov/press/releases/tg136.htm), accessed 6/25/2009.

**Money Market Mutual Fund ("MMMF") Program — Total Potential Support:  
\$3.4 Trillion**

Treasury initiated the temporary Money Market Mutual Fund ("MMMF") guarantee program on September 29, 2008. The stated intent was to address temporary dislocations in credit markets by guaranteeing "the share price of any publicly offered eligible money market mutual fund — both retail and institutional — that applies for and pays a fee to participate in the program."<sup>383</sup> According to Treasury, the program provided "coverage to shareholders for amounts that they held in participating money market funds as of the close of business on September 19, 2008. The guarantee will be triggered if a participating fund's net asset value falls below \$0.995, commonly referred to as breaking the buck."<sup>382</sup>

Originally designed to last for three months, the program has been renewed and extended by the Treasury Secretary to run until the close of business on September 18, 2009.<sup>383</sup> Funding for the program was drawn not from TARP funds, but from the Exchange Stabilization Fund, which was established by the Gold Reserve Act of 1934.<sup>384</sup> The Exchange Stabilization Fund has assets of approximately \$50 billion, and the total exposure of the MMMF program is theoretically approximately \$3.4 trillion — the total amount of money market mutual funds outstanding as of the third quarter of 2008, when the program was created.<sup>385</sup>

**GSE Preferred Stock Purchase Agreements ("PSPA") — Total Potential Support:  
\$400 Billion**

HERA provided temporary authority for Treasury to purchase obligations of the housing GSEs. In September 2008 FHEA, established under HERA to oversee the housing GSEs, put Fannie Mae under Federal conservatorship, and Treasury entered into a Preferred Stock Purchase Agreement ("PSPA") with Fannie Mae to make investments of up to \$100 billion in senior preferred stock as required to maintain positive equity.<sup>386</sup> According to the White House's FY 2010 budget document, "On February 18, 2009, Treasury announced that the funding commitments for the PSPA would be increased to \$200 billion. As of April 16, 2009, Fannie Mae has received \$15.2 billion under the PSPA."<sup>387</sup> Similarly, in September 2008, FHEA put Freddie Mac under Federal conservatorship and Treasury entered into a PSPA with Freddie Mac to make investments of up to \$100 billion in senior preferred stock as required to maintain positive equity. On February 18, 2009, Treasury announced that the funding commitments for the Freddie Mac PSPA would be increased to \$200 billion, the same as Fannie Mae's commitment. As of April 16, 2009, Freddie Mac has received \$44.6 billion under the PSPA.<sup>388</sup> According to Treasury's FY 2010 budget, "the function of the PSPAs is to instill confidence in investors that Fannie Mae and Freddie Mac will remain viable entities critical to the functioning of the housing and mortgage markets."<sup>389</sup>

**GSE MBS Purchase Program — Total Potential Support: \$314 Billion**

HERA also gave Treasury the authority to purchase GSE MBS in the open market, and Treasury announced the program on September 7, 2008.<sup>290</sup> According to Treasury's FY 2010 budget, "The function of the GSE MBS Purchase Program is to help improve the availability of mortgage credit to American homebuyers and mitigate pressures on mortgage rates. To promote the stability of the mortgage market, Treasury has purchased GSE MBS in the secondary market. By purchasing these guaranteed securities, Treasury sought to broaden access to mortgage funding for current and prospective homeowners as well as to promote market stability."<sup>291</sup>

**GSE Credit Facility Program — Total Potential Support: \$25 Billion**

The third Treasury program conducted under HERA relating to the GSEs is a program designed to "ensure credit availability to the housing GSEs by providing secured funding on an as-needed basis."<sup>292</sup> All of the GSEs (Fannie Mae, Freddie Mac, and the FHLBs) would be able to borrow under the program if needed until December 31, 2009. Treasury's FY 2010 budget describes the program as one of short-term loans — less than one month but greater than one week — collateralized by MBS issued by Fannie Mae and Freddie Mac and advances made by the FHLBs; no loan can have a maturity date later than December 31, 2009.<sup>293</sup>

**Other HERA 2008 Programs — Total Potential Support: \$19 Billion**

HERA focused on the early centers of the financial crisis — the home mortgage markets and the housing-related GSEs. Beyond the GSE programs, the other components pertaining to Treasury include measures to support home prices in general, and to support families and communities harmed by the mortgage market problems. Specifically, the act introduced \$15 billion in homebuyer tax credits, extension of the property tax deduction to non-itemizing filers, as well as \$4 billion in emergency assistance for neighborhood real estate market stabilization.<sup>294</sup>

**Joint Treasury/Department of Education Student Loan Programs — Total Potential Support: \$195 Billion**

Treasury and the Department of Education have jointly announced four programs to support the student loan markets, which have been affected by the credit crisis. The authority for these new programs is addressed in the Ensuring Continued Access to Student Loans Act of 2008. The first of these programs is the Participation Program, under which the Government will buy participations in pools of student loans. The second is the Purchase Program, through which the Government will purchase individual loans from lenders so that the lender's balance sheets can be freed up to make new student loans. The third is the Short Term Purchase Program ("STPP"), which is a time extension of the Purchase Program. The fourth new program is the Asset-Backed Conduit Program ("ABCP").

under which the Government will issue forward commitments to purchase Federal Family Educational Loan Program ("FFELP") loans from qualified ABS issuers.<sup>385</sup>

**Commitments to International Fund — Total Potential Support: \$100 Billion**

On April 2, 2009, President Obama secured an agreement to increase the International Monetary Fund ("IMF") New Arrangements to Borrow ("NAB") by up to \$500 billion, of which the United States committed up to \$100 billion. According to Treasury, "expanding the NAB will ensure the IMF has adequate resources to play its central role in resolving and preventing the spread of international economic and financial crises. Large and urgent financing needs projected for emerging markets and developing countries cannot be met from pre-crisis IMF lending resources."<sup>386</sup>

**Other Federal Agencies Supporting Financial Markets**

In addition to the Federal Reserve, Treasury, and FDIC, the Federal Government operates a number of financial agencies, many of which are running their own financial rescue programs as outlined in Table 3.8.

**Federal Home Finance Agency ("FHFA") — Fannie Mae and Freddie Mac — Total Potential Support: \$5.5 Trillion**

FHFA was created on July 30, 2008, as part of HERA. The agency is an independent regulator of certain housing-related GSEs.<sup>387</sup> These institutions are Fannie Mae, Freddie Mac, and the FHLBs. The financial markets have historically viewed the GSEs as quasi-governmental, and awarded them high ratings and low borrowing costs in the anticipation that the U.S. Government would bail them out if they were ever in trouble.

In August and September of 2008, Fannie and Freddie lost market confidence as their losses grew and their financial situations became uncertain, and both had difficulty raising funds. Instead of shutting down the companies, FHFA brought them into Federal conservatorship and worked with Treasury and the Federal Reserve to institute the various purchase and credit programs mentioned above. By bailing out Fannie Mae and Freddie Mac, FHFA has reinforced the market's assumptions that the obligations of the GSEs are implied liabilities of the U.S. Government.<sup>388</sup> Outstanding debt obligations and MBS guarantees of those two firms alone exceed \$5.5 trillion.<sup>389</sup>

**FHFA — Federal Home Loan Banks ("FHLBs") — Total Potential Support: \$1.3 Trillion**

The Federal Home Loan Banks ("FHLBs") are a system of 12 regional banks from which local lending institutions borrow funds to finance housing and other lending. The FHLBs are organized as member-owned cooperatives, focused on providing

TABLE 3.8

| NON-TARP GOVERNMENT SUPPORT OF THE FINANCIAL SECTOR<br>OTHER FEDERAL HOUSING AND FINANCIAL SYSTEM SUPPORT (\$ BILLIONS) |                            |                 |                                 |  |
|---|----------------------------|-----------------|---------------------------------|--|
| Agency / Program  | Coverage                   | Current Balance | Maximum Balance as of 6/30/2009 | Total Potential Support Related to Crisis* |
| FHFA — Fannie Mae / Freddie Mac Conservatorship <sup>a</sup>  | Fannie Mae and Freddie Mac | \$—             | \$—                             | \$5,500.0 <sup>b</sup>                     |
| FHFA — Implied Guarantee of FHLB liabilities <sup>a</sup>   | Federal Home Loan Banks    | —               | —                               | 1,300.0 <sup>b</sup>                       |
| National Credit Union Administration ("NCUA")   |                            |                 |                                 |  |
| Temporary Corporate Credit Union Liquidity Guarantee Program ("TCCULGP")  | Credit Unions              | 15.2            | 15.2 <sup>c</sup>               | 15.2                                       |
| NCUA Homeowners Affordability Relief Program ("HARP") and Credit Union System Investment Program ("CU SIP")             | Credit Unions              | 8.4             | 8.4 <sup>c</sup>                | 41.0 <sup>d</sup>                          |
| Increase in Guarantees by Government National Mortgage Assoc. ("GNMA") <sup>e</sup>                                     | Mortgage Lenders           | 149.2           | 149.2                           | 149.2 <sup>f</sup>                         |
| Increase in Guarantees by Federal Housing Authority ("FHA") <sup>g</sup>  | Mortgage Lenders           | 134.5           | 134.5                           | 134.5 <sup>f</sup>                         |
| Increase in Guarantees by Dept. of Veterans Affairs ("VA") <sup>h</sup>   | Mortgage Lenders           | 10.6            | 10.6                            | 10.6 <sup>f</sup>                          |
| <b>Total</b>  |                            | <b>\$317.9</b>  | <b>\$317.9</b>                  | <b>\$7,150.5</b>                           |

Notes: Numbers affected by rounding.

\* Total potential support does not account for any collateral pledged.

<sup>a</sup> These obligations have been viewed as implying an "implied" guarantee because of historical U.S. Government involvement and support. In 2001, the CBO stated: "CBO attributes the greater liquidity of GSE securities over those of other financial firms to the implicit guarantee, much as the Government guarantee of Treasury securities is often cited as the reason for their liquidity." Congressional Budget Office, "Federal Subsidies and the Housing GSEs," Appendix A: Responses to Analyses of the Congressional Budget Office's 1996 Subsidy Estimates," 5/2001, www.cbo.gov/doc.cfm?index=2841&type=0&sequence=7, accessed 7/1/2009.

<sup>b</sup> Federal Housing Finance Agency (FHFA), "The Housing GSE's," Presentation by James Lockhart, Executive Director, 12/10/2008, www.fhfa.gov/web/Exec/216/WFE1108WebVersion.pdf, accessed 6/28/2009.

<sup>c</sup> Does not include impact of deposit insurance increase to \$250,000.

<sup>d</sup> NCUA, Preliminary NCUA Financial Highlights, 3/31/2009, www.ncua.gov/Resources/Reports/annual/2009/Mar09PRELIMFINREPT.pdf, accessed 6/28/2009.

<sup>e</sup> NCUA, "Statement of Michael E. Fryzel, Chairman, National Credit Union Administration, on HR 2351, The Credit Union Share Insurance Stabilization Act," 3/20/2009, www.house.gov/oversight/hearing/financialservices\_deny/fryzel\_testimony.pdf, accessed 7/14/2009.

<sup>f</sup> Congressional Budget Office, "The Budget and Economic Outlook – Fiscal Years 2009 and 2010," January 2009.

<sup>g</sup> Revisions finalized in 2008 over 2007.

<sup>h</sup> GNMA, Report to Congress, Fiscal Year 2008, 11/7/2008, www.ginnie.gov/reporttocongress/, accessed 6/28/2009.

<sup>i</sup> Federal Housing Administration, "Message from the Chief Financial Officer," p. 323, 11/17/2008, www.secure.gov/offices/cfo/reports/actions2.pdf, accessed 6/28/2009.

<sup>j</sup> White House, Budget FY 2009 – Department of Veterans Affairs, www.whitehouse.gov/omb/budget/fy2009/veterans.html, accessed 6/28/2009.

low-cost funding for their members. According to the Council of Federal Home Loan Banks, the FHLBs provide financing to approximately 80% of U.S. lending institutions.<sup>400</sup>

It is true that FHFA, and by extension Treasury, do not have full legal liability for all of Fannie Mae's and Freddie Mac's losses, but it has created a very strong implied guarantee by taking responsibility for the entities and increasing their participation in the financial markets, instead of closing them. By bailing out Fannie Mae and Freddie Mac, the FHFA creates an assumption in the market that it would do the same for the FHLBs. The FHLBs have total liabilities of approximately \$1.3 trillion.<sup>401</sup>

**NCUA — Temporary Corporate Credit Union Liquidity Guarantee Program ("TCCULGP") — Total Potential Support: \$15.2 Billion**

The National Credit Union Administration ("NCUA") essentially acts as the FDIC of the nation's credit unions. The independent agency charters and supervises credit unions, as well as insures their depositors (technically, "shareholders") against loss through the National Credit Union Share Insurance Fund ("NCUSIF").<sup>402</sup> As of March 31, 2009, NCUA insured approximately \$612 billion of deposits.<sup>403</sup>

NCUA has initiated several programs to address financial system difficulties, in addition to its normal deposit insurance programs. The first is the Temporary Corporate Credit Union Liquidity Guarantee Program ("TCCULGP"), under which NCUA insures the senior unsecured debt of member institutions experiencing temporary liquidity difficulties.<sup>404</sup> On May 21, 2009, the TCCULGP was extended to June 30, 2010, for new issuances, with the debt being guaranteed until June 30, 2017. Further, the guaranteed debt limit was revised to "the greater of: 1) 100% of maximum unsecured debt obligations outstanding from September 30, 2007, to September 30, 2008, limited to no more than \$10 billion, 2) amount approved by the Office of Corporate Credit Unions not to exceed the greater of \$100 million or 5% of liabilities and shares."<sup>405</sup> As of April 21, 2009, there were 23 corporate credit unions participating in the program.<sup>406</sup>

**NCUA Homeowners Affordability Relief Program ("HARP") and Credit Union System Investment Program ("CU SIP") — Total Potential Support: \$41 Billion**

The other major financial rescue programs initiated by NCUA were the Homeowners Affordability Relief Program ("HARP")<sup>407</sup> and the Credit Union System Investment Program ("CU SIP").<sup>408</sup> These programs intend to help members avoid delinquency and default (HARP) and increase the liquidity in the credit union system (CU SIP).

**Government National Mortgage Association ("GNMA") — Total Potential Support: \$149.2 Billion**

GNMA guarantees investors the timely payment of principal and interest on MBS backed by Federally insured or guaranteed loans, thus helping to provide liquidity to the housing markets. The largest housing agency that supplies mortgages to GNMA-backed MBS is the Federal Housing Administration ("FHA"). Other Federal mortgage programs participating in GNMA's programs include those of the Veteran's Administration.<sup>402</sup> The guarantees are thus redundant, in the sense that another Federal program is already insuring much of the principal amount, but the ultimate potential losses to the Federal Government depend on the particulars of the individual losses. Outstanding single-family guarantees in September 2008 were \$537.3 billion, and outstanding multi-family guarantees were \$39.4 billion. Collectively, those amounts were up \$149.2 billion in 2008 as the private financial sector lost its ability to absorb them.<sup>410</sup>

**Federal Housing Administration ("FHA") — Total Potential Support: \$134.5 Billion**

FHA provides home mortgage insurance to lenders; if the borrower should fail to make payments and goes into foreclosure, FHA will insure the lender against most of its losses. FHA is the oldest of the Federal housing agencies. In 2008, it had outstanding liabilities of more than \$576.4 billion in single-family and multi-family mortgage programs, an increase of \$134.5 billion from the previous year.<sup>411</sup>

**Department of Veterans Affairs ("VA") Home Loan Guarantee Program —****Total Potential Support: \$10.6 Billion**

The Department of Veterans Affairs ("VA") runs a mortgage guarantee program similar to FHAs, but limited to veterans of the U.S. military. VA's programs provide 100% financing (that is, there is no down payment required).<sup>412</sup> There were estimated to be nearly \$35 billion in VA loans outstanding in 2008, an increase of nearly \$11 billion (44%) over the previous year.<sup>413</sup>

SECTION 4

TARP OPERATIONS AND  
ADMINISTRATION



Under the Emergency Economic Stabilization Act of 2008 ("EESA"), Congress authorized the Treasury Secretary to take such actions as necessary to build the operational and administrative infrastructure to support the Troubled Asset Relief Program ("TARP") activities. EESA authorized the establishment of an Office of Financial Stability ("OFS") within the U.S. Department of the Treasury ("Treasury") to be responsible for the administration of TARP.<sup>414</sup> Treasury has the authority to establish program vehicles, issue regulations, directly hire or appoint employees, enter into contracts, and designate financial institutions as financial agents of the Federal Government.<sup>415</sup> In addition to using permanent and interim staff, OFS relies on contractors and financial agents in legal, investment consulting, accounting, and other key service areas.<sup>416</sup>

### TARP ADMINISTRATIVE AND PROGRAM EXPENDITURES

Treasury stated that it had incurred \$27.5 million in TARP-related administrative expenditures through June 30, 2009.<sup>417</sup> Table 4.1 summarizes these expenditures, as well as additional obligations through June 30, 2009. The majority of these costs are allocated to Personnel Services and Non-Personnel Other Services.

TABLE 4.1

| TARP ADMINISTRATIVE EXPENDITURES AND OBLIGATIONS (\$ MILLIONS) |   |  |
|--|---|--|
| Budget Object Class Title                                      | Obligations for Period Ending 6/30/2009 | Expenditures for Period Ending 6/30/2009 |
| <b>Personnel Services</b>                                      |   |  |
| Personnel Compensation & Services                              | \$7,897,655                             | \$7,186,531                              |
| <b>Total Personnel Services</b>                                | <b>\$7,897,655</b>                      | <b>\$7,186,531</b>                       |
| <b>Non-Personnel Services</b>                                  |   |  |
| Travel & Transportation of Persons                             | \$107,630                               | \$75,975                                 |
| Transportation of Things                                       | 24,105                                  | 105                                      |
| Rents, Communications, Utilities & Misc. Charges               | 80,659                                  | 30,435                                   |
| Printing & Reproduction  | 395                                     | 395                                      |
| Other Services   | 54,516,949                              | 19,953,191                               |
| Supplies & Materials   | 81,783                                  | 81,783                                   |
| Equipment  | 222,966                                 | 217,857                                  |
| Land & Structures  | —                                       | —  |
| <b>Total Non-Personnel Services</b>                            | <b>\$55,034,487</b>                     | <b>\$20,359,741</b>                      |
| <b>Grand Total</b>   | <b>\$62,932,142</b>                     | <b>\$27,546,272</b>                      |

Note: Numbers affected by rounding.

Source: Treasury, response to SIGTARP data call, 7/8/2009.

Additionally, Treasury has released details of programmatic expenditures. These expenditures include costs to hire financial agents and legal firms associated with TARP operations. Treasury shows the allocation of these programmatic costs at \$64 million as of June 30, 2009.<sup>418</sup>

TARP operations are projected to cost approximately \$175 million for fiscal year 2009.<sup>419</sup> These costs are not reflected in determining any gains or losses on the TARP-related transactions and are not included in the \$699 billion limit on asset purchases. Therefore, these expenditures will add to the Federal budget deficit regardless of whether the TARP transactions result in a gain or a loss for the Government.<sup>420</sup>

## CURRENT CONTRACTORS AND FINANCIAL AGENTS

As of June 30, 2009, Treasury had retained 45 outside contractors, including 4 asset managers, to provide a range of services to assist in administering TARP. As permitted in EESA, Treasury has used streamlined solicitation procedures and has structured several agreements and contracts to allow for flexibility in obtaining the required services expeditiously. Table 4.2 lists outside vendors as of June 30, 2009.<sup>421</sup>

As required by EESA, SIGTARP must report the biographical information for each person or entity hired to manage the troubled assets associated with TARP.<sup>422</sup> Since the publication of SIGTARP's April Quarterly Report, there have been four important staff- or contractor- related developments at OFS:

- confirmation of a new Assistant Secretary of the Treasury for Financial Stability
- appointment of a Special Master for TARP Executive Compensation
- creation of a Treasury position for restructuring/exit strategy
- appointment of three asset managers

### Assistant Secretary

On June 19, 2009, Herbert Allison was confirmed by the U.S. Senate to be the Assistant Secretary of the Treasury for Financial Stability, replacing Neel Kashkari, who served on an interim basis.<sup>423</sup> In this role, Mr. Allison is responsible for "developing and coordinating Treasury's policies on legislative and regulatory issues affecting financial stability, including overseeing the Troubled Asset Relief Program (TARP)."<sup>424</sup> He will also have the title of Counselor to the Secretary.

### Special Master for TARP Executive Compensation

On June 10, 2009, the President announced plans to appoint Kenneth Feinberg as the Special Master for TARP Executive Compensation, to "ensure compensation

TABLE 4.2

| OUTSIDE VENDORS |   |                                  |                      |
|-----------------|---|----------------------------------|----------------------|
| Date            | Vendor                                      | Purpose                          | Type of Transaction* |
| 10/10/2008      | Simpson, Thacher & Bartlett                 | Legal Services                   | BPA                  |
| 10/11/2008      | ErnstKnupp                                  | Investment and Advisory Services | BPA                  |
| 10/14/2008      | Bank of New York Mellon                     | Custodian and Cash Management    | Financial Agent      |
| 10/16/2008      | PricewaterhouseCoopers                      | Internal Control Services        | BPA                  |
| 10/18/2008      | Ernst & Young                               | Accounting Services              | BPA                  |
| 10/23/2008      | GSA – Turner Consulting**                   | Archiving Services               | IAA                  |
| 10/29/2008      | Hughes Hubbard & Reed                       | Legal Services                   | BPA                  |
| 10/29/2008      | Squire Sanders & Dempsey                    | Legal Services                   | BPA                  |
| 10/31/2008      | Lindholm & Associates**                     | Human Resources Services         | Contract             |
| 11/7/2008       | Thacher Proffitt & Wood***                  | Legal Services                   | BPA                  |
| 11/14/2008      | Securities and Exchange Commission          | Detailees                        | IAA                  |
| 11/14/2008      | CSC Systems and Solutions                   | IT Services                      | Procurement          |
| 12/3/2008       | Trade and Tax Bureau – Treasury             | IT Services                      | IAA                  |
| 12/5/2008       | Department of Housing and Urban Development | Detailees                        | IAA                  |
| 12/5/2008       | Washington Post                             | Vacancy Announcement             | Procurement          |
| 12/10/2008      | Thacher Proffitt & Wood***                  | Legal Services                   | BPA                  |
| 12/12/2008      | Pension Benefit Guaranty Corporation        | Legal Services                   | IAA                  |
| 12/15/2008      | Office of Thrift Supervision                | Detailees                        | IAA                  |
| 12/24/2008      | Cushman and Wakefield of VA, Inc.           | Painting                         | Procurement          |
| 1/6/2009        | Office of the Comptroller of the Currency   | Detailees                        | IAA                  |
| 1/7/2009        | Colonial Parking                            | Parking                          | Procurement          |
| 1/9/2009        | Internal Revenue Service                    | Detailees                        | IAA                  |
| 1/27/2009       | Cadwalader Wickersham & Taft, LLP           | Legal Services                   | BPA                  |
| 1/27/2009       | Whitaker Brothers Bus. Machines             | Office Machines                  | Procurement          |
| 2/2/2009        | Government Accountability Office            | Oversight                        | IAA                  |
| 2/9/2009        | Pat Taylor and Associates, Inc.**           | Temporary Employee Services      | Contract             |
| 2/12/2009       | Locke Lord Bissell & Lidell LLP             | Legal Services                   | Contract             |
| 2/18/2009       | Freddie Mac                                 | Homeownership Program            | Financial Agent      |
| 2/18/2009       | Fannie Mae                                  | Homeownership Program            | Financial Agent      |
| 2/20/2009       | Congressional Oversight Panel               | Oversight                        | IAA                  |
| 2/20/2009       | Simpson, Thacher & Bartlett                 | Legal Services                   | Contract             |
| 2/22/2009       | Venable LLP                                 | Legal Services                   | Contract             |
| 3/6/2009        | Boston Consulting Group                     | Management Consulting Support    | Contract             |
| 3/16/2009       | EARNEST Partners                            | Asset Management Services        | Financial Agent      |
| 3/23/2009       | Heery International Inc.                    | Architects                       | Procurement          |
| 3/30/2009       | McKee Nelson, LLP                           | Legal Services                   | Contract             |
| 3/30/2009       | Sonnenschein Nath & Rosenthal               | Legal Services                   | Contract             |
| 3/30/2009       | Cadwalader Wickersham & Taft, LLP           | Legal Services                   | Contract             |
| 3/30/2009       | Haynes and Boone LLP                        | Legal Services                   | Contract             |
| 3/31/2009       | FI Consulting**                             | Modeling and Analysis            | BPA                  |

Continued on next page.

| OUTSIDE VENDORS (CONTINUED) |                                  |                           |                       |
|-----------------------------|----------------------------------|---------------------------|-----------------------|
| Date                        | Vendor                           | Purpose                   | Type of Transaction * |
| 4/3/2009                    | American Furniture Rentals **    | Office Furniture          | Procurement           |
| 4/17/2009                   | Herrman Miller                   | Office Furniture          | Procurement           |
| 4/17/2009                   | Bureau of Printing and Engraving | Detailee                  | IAA                   |
| 4/21/2009                   | AllianceBernstein                | Asset Management Services | Financial Agent       |
| 4/21/2009                   | FSI Group                        | Asset Management Services | Financial Agent       |
| 4/21/2009                   | Piedmont Investment Advisors     | Asset Management Services | Financial Agent       |
| 5/14/2009                   | Phacil Inc. **                   | FOIA Services             | Contract              |
| 5/26/2009                   | Anderson, McCoy & Orla, LLP**    | Legal Services            | Contract              |
| 5/26/2009                   | Simpson, Thacher & Bartlett      | Legal Services            | Contract              |
| 6/8/2009                    | Department of Interior           | IT Services               | IAA                   |
| 6/29/2009                   | Department of Interior           | Website Testing           | IAA                   |

## Notes:

\*IAA = Inter-Agency Agreement; BPA = Blanket Purchase Agreement.

\*\* Small or Women/Minority-Owned Small Business.

\*\*\* Contract responsibilities assumed by Sorenstein Nath &amp; Rosenthal via novation.

Source: Treasury, response to SIGTARP data call, 7/8/2009.

plans are consistent with the public interest.<sup>325</sup> As mentioned previously in the "Executive Compensation" discussion in Section 2: "TARP Overview," Mr. Feinberg, whose mediation experience includes acting as the Special Master of the September 11th Victim Compensation Fund, "will review payments and compensation plans for the executives and the 100 most highly compensated employees of TARP recipients that have received exceptional assistance to ensure that compensation is structured in a way that gives those employees incentives to maximize long-term shareholder value and protect taxpayer interests."<sup>326</sup> Companies receiving exceptional financial assistance include those receiving assistance under the Systemically Significant Filing Institutions ("SSFI"), the Targeted Investment Program ("TIP"), and the Automotive Industry Financing Program ("AIFP"), and currently include the American International Group ("AIG"), Citigroup, Bank of America, Chrysler, General Motors ("GM"), GMAC and Chrysler Financial.

#### Restructuring/Exit Strategy

On May 18, 2009, Treasury announced the hiring of Jim Millstein as its Chief Restructuring Officer, within OFS. Mr. Millstein, whose restructuring experience included 28 years of advisory work as a lawyer and as an investment banker, has taken the lead in managing Treasury's investment in AIG and other significant investments and in developing exit strategies for Treasury from these investments over time.

#### Asset Managers

On April 22, 2009, Treasury announced the selection of three firms to manage its portfolio of assets issued by banks and other institutions participating in the Capital Purchase Program ("CPP") and other TARP programs. The assets to be managed include senior preferred shares, senior debt, equity warrants, and other equity and

debt obligations. Following a review of more than 200 submissions from interested firms, Treasury selected AllianceBernstein L.P., FSI Group, LLC, and Piedmont Investment Advisors, LLC for agreements valid until April 20, 2014.<sup>427</sup> According to OFS, AllianceBernstein is a leading global investment management firm that offers "high-quality research and diversified investment services to institutional clients, individuals and private clients in major markets around the world."<sup>428</sup> The firm is headquartered in New York City and employs more than 500 investment professionals with expertise in growth equities, value equities, fixed-income securities, blend strategies and alternative investments.<sup>429</sup>

According to OFS, FSI Group operates a "multi-strategy investment platform focused on opportunities in the financial services sector."<sup>430</sup> The firm is based in Cincinnati and specializes in financing and investing in banks, thrifts, insurance companies, Real Estate Investment Trusts ("REITs"), real estate operating companies and other financial services firms.

According to OFS, Piedmont Investment Advisors, LLC is a money management firm specializing in "core equity and fixed-income management."<sup>431</sup> The firm was founded in August 2000 and is based in Durham, North Carolina.

#### Responsibilities

The three asset management firms have each been assigned a representative cross-section of Treasury holdings, weighted towards the specialty of each firm. AllianceBernstein has been allocated assets relating to 390 of the 644 financial institutions in OFS's portfolio, a broad mix of holdings diversified along institutional size and geographic lines.<sup>432</sup> FSI Group was allocated 184 institutions, weighted towards small, publicly held, local institutions.<sup>433</sup> Piedmont was allocated 70 institutions, weighted towards the larger institutions, given their specialty in macro-level analysis.<sup>434</sup>

The firms will all employ a "buy-and-hold" management approach, focusing on the policy goal of market stability over the typical asset manager goals of diversification and return on investment.<sup>435</sup> The asset managers will conduct analysis and ongoing valuation of the Treasury holdings in their portfolios on behalf of Treasury and the taxpayers, and advise Treasury on management of the accounts and "strategy and optimal timing to execute warrants or monetize preferred shares and other equity securities or debt obligations, consistent with both the duty to the taxpayer and the goal of market stability," as well as strategies relating to corporate actions (i.e., proxies, disclosures, mergers/acquisitions, de-listings, etc.).<sup>436</sup> However, the managers will not execute any transactions unless specifically instructed by OFS.<sup>437</sup> Should OFS request a trade or transaction, the asset managers will advise Treasury on its disposition strategy and negotiate with broker/dealers to achieve

**Index Fund:** Portfolio that tracks an established index, and thus requires minimal research on the part of the asset manager — typically providing a lower management fee structure.

results "consistent with best execution at the most favorable prices reasonably obtainable."<sup>438</sup>

Given their buy-and-hold strategy, OFS intends to compensate the asset managers with fees consistent with an index fund manager. OFS will pay a fee of approximately 3 basis points (0.03%) of the asset manager's portfolio per quarter.<sup>439</sup>

#### Key Deliverables and Compliance Roles

Each of the asset managers will provide several deliverables as well as regular compliance information to OFS, including:<sup>440</sup>

- monthly valuations of preferred shares and warrants for the financial institutions assigned to the asset manager
- detailed cash flow projections for each security held
- monthly yield and maturity probability matrices
- IT security report
- annual certification
- annual SAS 70
- quarterly disclosure on organizational conflicts of interest
- quarterly disclosure on personal conflicts of interest
- certification of communications with Treasury employees
- quarterly confidentiality certification
- quarterly compliance reports
- quarterly disclosure of revenue-sharing agreements

#### Conflict Mitigation

Treasury has identified several potential conflicts of interest on the part of the asset managers, ranging from the potential of TARP institutions being clients of the asset manager to the individual fund managers potentially owning shares of stock in institutions that have received TARP funds, among others, and has adopted mitigation plans that address these conflicts. Treasury recognizes that its decisions to sell off portions of its portfolio represent material non-public information that cannot be shared by the particular individuals working on the Treasury portfolios with other members of the asset management firm. To address these concerns, Treasury has required each asset manager to "wall off" or segregate the employees who receive this information.<sup>441</sup> These ethical walls are intended to keep Treasury's sell or warrant execution decisions confidential so that other parts of the firm are not made aware of, and therefore cannot profit from, this potentially market-moving information. To further segregate the TARP-related information, OFS has required an IT barrier that will prevent this confidential information from being electronically accessed by others in the firm.<sup>442</sup>

### Valuation Methodology

The asset managers will provide monthly valuation reports to OFS regarding their view of the fair market value of the assets in their respective portfolios. OFS will also prepare audited annual financial statements that will use a net present value ("NPV") valuation of the assets, as is required for annual statements for Government agencies under the Federal Credit Reform Act of 1990.<sup>443</sup> The asset managers are working with Treasury and each other to develop a uniform template in order for the valuations provided by each asset manager to be consistent and to minimize any difference in approaches among the firms.<sup>444</sup>

### CONFLICTS OF INTEREST

Within the framework of TARP procurement and contracting, actual or potential conflicts of interest ("COIs") can exist at the organizational level or pertain to an individual employee. EESA provides the Treasury Secretary the authority to issue regulations or guidelines necessary to address and manage, or to prohibit, COI that can arise in connection with the administration and execution of TARP.<sup>445</sup>

TARP-related COI may occur due to a variety of situations, such as when retained entities perform similar work for Treasury and other clients. In these situations, contracted entities may find that their duty to certain clients may impair their objectivity when advising Treasury or may affect their judgment about the proper use of nonpublic information. Conflicts may also arise from the personal interests of individuals employed by retained entities. Accordingly, Treasury has issued interim guidelines to address potential COI.<sup>446</sup>

These interim COI rules require interested contractors to provide sufficient information to evaluate the potential for organizational COI and plans to mitigate them.<sup>447</sup> The mitigation plan then becomes a binding term of the contract arrangement. On potential personal COI, the provisions require that managers and employees of a hired entity disclose any financial holdings or personal and familial relationships that could impair their objectivity.<sup>448</sup>

Financial agents and contractors have identified potential COI, and these parties have proposed solutions to mitigate the identified conflicts. In response to recommendations made to Treasury by the Comptroller General,<sup>449</sup> Treasury has taken steps to formalize its oversight and monitoring of potential COI.<sup>450</sup>

**Fair Market Value:** The price that a knowledgeable buyer and a knowledgeable seller would be able to agree upon in the open market, provided that both have access to sufficient information.

**Net Present Value ("NPV"):** The present value of the estimated future cash inflows minus the present value of the cash outflows.



SECTION 5 SIGTARP RECOMMENDATIONS



One of the responsibilities of the Office of the Special Inspector General for the Troubled Asset Relief Program ("SIGTARP") is to provide recommendations to the U.S. Department of the Treasury ("Treasury") so that Troubled Asset Relief Program ("TARP") initiatives can be designed or modified to facilitate transparency and effective oversight and prevent fraud, waste, and abuse. SIGTARP has made such recommendations in both its Initial Report to Congress, dated February 6, 2009 (the "Initial Report"), and its April Quarterly Report to Congress, dated April 21, 2009 (the "April Quarterly Report"). This section sets forth SIGTARP's new or ongoing recommendations and summarizes Treasury's responses to prior recommendations. Appendix G sets forth Treasury's written responses to prior SIGTARP recommendations.

## RECOMMENDATIONS RELATING TO THE PUBLIC-PRIVATE INVESTMENT PROGRAM

The Public-Private Investment Program ("PPIP") is a program in which Government funds will be invested side-by-side with private investor equity to purchase legacy assets, including the "toxic" assets widely believed to be one of the root causes of the current financial crisis. The aspect of PPIP that has proceeded the furthest toward implementation thus far is the Treasury-led Legacy Securities Program. As discussed more fully in Section 2 of this report, under the Legacy Securities Program, Treasury, through an application process, has pre-qualified fund managers to manage Public-Private Investment Funds ("PPIFs"). The fund managers will raise private capital for equity participation in the PPIF that will be matched, dollar-for-dollar, with TARP funds. The PPIF will then be able either to obtain non-recourse financing in TARP funds of up to 100% of the amount of total equity or access even greater non-recourse financing from the Federal Reserve through the Term Asset-Backed Securities Loan Facility ("TALF") for purchase of TALF-eligible assets. The fund manager, who earns a fee both from Treasury and from the private investors, will then use the money to purchase and manage legacy mortgage-backed securities ("MBS").

### April Quarterly Report Recommendations

In the April Quarterly Report, SIGTARP observed that many aspects of PPIP could make it inherently vulnerable to fraud, waste, and abuse, identifying four areas of particular vulnerability:

- **Conflicts of Interest:** PPIF managers might have a powerful incentive to make investment decisions that benefit themselves at the expense of the taxpayer. By their nature and design, including the availability of significant leverage, the PPIF transactions in these frozen markets will have a significant impact on how

any particular asset is priced in the market. As a result, the increase in the price of such an asset will greatly benefit anyone who already owns or manages the same asset, potentially including the PPIF manager who is making the investment decisions.

- **Collusion:** A closely related vulnerability is that PPIF managers might be persuaded, through kickbacks, *quid pro quo* transactions, or other collusive arrangements, to manage the PPIFs not for the benefit of the PPIF (and taxpayers), but rather for the benefit of themselves and their collusive partners. The significant non-recourse, Government-financed leverage presents a great incentive for collusion between the buyer and seller of the asset, or the buyer and other buyers, whereby the taxpayer may be exposed to a significant loss while others profit.
- **Money Laundering:** Because of the significant leverage available and the inherent imprimatur of legitimacy associated with PPIP and TALE, these programs present an ideal opportunity to money-laundering organizations, which are continually looking for opportunities to make their illicit proceeds appear to be legitimate, thereby “laundering” those proceeds.
- **Interaction with TALE:** In announcing the details of PPIP, Treasury has indicated that PPIFs under the Legacy Securities Program could, in turn, use the leveraged PPIF funds to purchase legacy MBS through TALE, thereby greatly increasing Government exposure to losses with no corresponding increase of potential profits. This leverage upon leverage would magnify the incentives for conflicts of interest and collusion and could severely undermine the validity of the methodology that the Federal Reserve has used to build the haircut percentages in TALE.

To address these vulnerabilities, SIGTARP made a series of recommendations in the April Quarterly Report. In summary form, SIGTARP recommended the following:

- Treasury should impose strict conflicts-of-interest rules upon PPIF managers that specifically address whether and to what extent the managers can (i) invest PPIF funds in legacy assets that they hold or manage on behalf of themselves or their clients or (ii) conduct PPIF transactions with entities in which they have invested on behalf of themselves or others.
- Treasury should mandate transparency with respect to the participation and management of PPIFs, including disclosure to Treasury of the beneficial owners of all of the private equity stakes in the PPIFs, public disclosure of all transactions undertaken in them, and reporting to Treasury on any and all holdings and transactions in the same types of legacy assets on their own behalf or on behalf of their clients.

- Treasury should require PPIF managers to provide PPIF equity stakeholders (including TARP) "most-favored-nations clauses," requiring that the fund managers treat the PPIFs on at least as favorable terms as given to all other parties with whom they deal and acknowledge that they owe the PPIF investors — both the private investors and TARP — a fiduciary duty with respect to the management of the PPIFs.
- Treasury should require that all PPIF managers have stringent investor-screening procedures, including comprehensive "Know Your Customer" requirements at least as rigorous as that of a commercial bank or retail brokerage operation, and require that the identities of all of the beneficial owners of the private interests in the fund be disclosed to Treasury so that Treasury can do appropriate diligence to ensure that investors in the funds are legitimate.
- Treasury should not allow Legacy Securities PPIFs to invest in TALE unless significant mitigating measures are included to address the increased dangers presented by the interaction, such as prohibiting TARP lending if the PPIF invests through TALE or proportionately increasing haircuts for PPIFs that do so.

#### Developments in the Design of the Legacy Securities Program

Since the April Quarterly Report, Treasury has consulted with SIGTARP, consistent with Treasury's obligations under Section 402 of the Helping Families Save Their Homes Act of 2009 (the "Ensign-Boxer Amendment"), as it developed the details of the Legacy Securities Program. Among other things, Treasury conducted these activities:

- met with SIGTARP representatives to discuss the design of the Legacy Securities Program on several occasions
- invited SIGTARP to observe its interviews with potential PPIF manager applicants
- at SIGTARP's suggestion, met and had multiple conversations with staff at the Federal Reserve Board (the "Federal Reserve") and the Federal Reserve Bank of New York ("FRBNY") who manage Federal Reserve programs involving asset managers in similar contexts
- provided SIGTARP with drafts of the PPIF term sheets and ethical standards and conflicts-of-interest rules

As a result of these consultations, SIGTARP provided Treasury with both oral feedback and written recommendations, suggestions, and comments, as reflected in two letters dated June 10, 2009, and June 19, 2009 (collectively, the "SIGTARP Letters").

In the SIGTARP Letters, which are included in Appendix G, SIGTARP made dozens of comments, ranging from recommendations concerning issues

**"Most-Favored-Nations Clause":** A clause in an agreement granting to one entity the same terms as are then or may thereafter be granted to any other entity.

**"Know Your Customer" Requirements:** A money-laundering and terrorist-financing prevention measure requiring institutions to obtain customer information beyond basic identification information.

Section 402 of Helping Families Save Their Homes Act of 2009 ("Ensign-Boxer Amendment"): **Amendment to Helping Families Save Their Homes Act of 2009 that calls for increased PPIF oversight and allocates an additional \$15 million to SIGTARP with the direction that these funds be prioritized for performance audits and investigations of recipients of non-recourse loans under any EESA-funded program. See Section 1 of this report for a detailed description of the amendment.**

**Fiduciary Duty:** A duty obligating a fiduciary (an individual or business in a position of authority who acts on behalf of another individual — an agent or trustee) to act with loyalty and honesty and in a manner consistent with the best interests of the other individual.

**Leverage on Leverage:** Refers to the original design of PPIP in which a private investor could borrow Government debt through PPIP and then leverage its equity and the Government debt with more Government debt through TALF.

**Skin in the Game:** Equity stake in an investment; down payment; the maximum amount an investor can lose.

fundamental to the design of PPIP to potential contract terms and other drafting comments. As reflected in Treasury's response to SIGTARP's PPIP recommendations, also included in Appendix G, Treasury has incorporated many of the recommendations into the design of PPIP, and, as a result, the program has a significantly improved compliance and fraud-prevention regime than that initially proposed. The following are some of SIGTARP's recommendations implemented by Treasury:

- All of the PPIF managers will be required to be registered Investment Advisors with the Securities and Exchange Commission ("SEC") pursuant to the Investment Advisors Act of 1940. The fund managers therefore are subject to provisions relating to fiduciary duty; certain antifraud protections; rules relating to record keeping, advertising, custody of client funds and assets; and disclosure.
- Treasury is requiring PPIF managers to have and implement a range of policies and procedures on ethics and conflicts of interest, including policies relating to valuation, trading allocation, arm's-length transactions, and personal trading.
- Treasury is requiring the PPIF managers to report to Treasury a list of all eligible assets held or under consideration for purchase by a manager in both PPIF and non-PPIF funds, including positions and valuations in all eligible assets across the manager firm. Treasury will thus be able to analyze and compare holdings, transactions, and valuations not only across all of the PPIFs but also across all of the non-PPIF funds managed by PPIF firms. If implemented well, this information could be a powerful tool to detect instances of conflicts of interest, collusion, and improper asset valuation across the Legacy Securities Program.
- As recommended in the April Quarterly Report, Treasury has taken into account the leverage-on-leverage issues implicated by allowing PPIFs to access TALF lending. Although Treasury and the Federal Reserve are permitting PPIFs to access TALF, the haircuts for TALF will be proportionally increased so that the combination of Treasury- and TALF-supplied debt will not exceed the total amount of TALF debt that would be available to leverage the PPIP equity alone. This significant concession by Treasury adopts SIGTARP's recommendation and effectively ameliorates the leverage-on-leverage and "skin-in-the-game" issues that were raised in the April Quarterly Report.

Although Treasury has implemented most of SIGTARP's suggestions, SIGTARP believes that there remain some significant areas in which Treasury's plan for PPIP falls short. As discussed below, SIGTARP has ongoing recommendations about PPIP, including areas that could threaten the credibility of the program. To sum up the substantial back-and-forth between Treasury and SIGTARP concerning the design of the PPIP compliance and anti-fraud regime since the April Quarterly

Report, the following can be stated:

1. Treasury has fulfilled its statutory obligation to consult with SIGTARP with respect to the design of the PPIP Legacy Securities Program and has engaged repeatedly with SIGTARP (and the Federal Reserve and FRBNY, for that matter) on the design of the compliance and anti-fraud provisions of PPIP.
2. Treasury has adopted a majority of SIGTARP's recommendations, and the design of the PPIP Legacy Securities Program has been vastly improved from a compliance and anti-fraud perspective as compared to when the program was initially described to SIGTARP.
3. However, disagreements remain, and SIGTARP believes that there remain several fundamental vulnerabilities in the program on issues relating to conflicts of interest and collusion, transparency, performance measures, and anti-money laundering.

#### Ongoing Recommendations

Although Treasury has already identified the nine PPIF managers and released term sheets detailing the basic framework of the PPIFs, final agreements have yet to be drafted, and Treasury still has the opportunity to improve the program before it is finally implemented. To that end, SIGTARP makes the following ongoing and as yet unadopted recommendations regarding the design of the PPIP Legacy Securities Program.

- **PPIP Recommendation #1 — Strict Walls:** SIGTARP continues to recommend that Treasury require the imposition of strict information barriers or “walls” between the PPIF managers making investment decisions on behalf of the PPIF and those employees of the fund management company who manage non-PPIF funds. Treasury's failure to do so thus far constitutes a material deficiency in the program.

Treasury's stated goal for PPIP is to “restart” the substantially frozen legacy securities markets. By its design, PPIP will provide the PPIF managers significant power to set prices for the legacy securities that they purchase in what Treasury has described as an illiquid market. Under these circumstances, the trading decisions of PPIF managers — using investment vehicles that are 75% funded by taxpayer money — constitute valuable, proprietary, market-moving information. This price-setting power and access to information that is unavailable to other participants in the market (i.e., knowing what the PPIF will buy and at what price) could create opportunities for several kinds of abuses by PPIF managers, including the incentive to overpay for securities already held in the manager's non-PPIF funds or to use information about upcoming trading in PPIP to benefit its non-PPIF funds to the

detriment of the PPIF or to those participants in the market that were not selected by Treasury to manage PPIF funds.

A common method of dealing with this situation in which proprietary information in one part of a business could lead to improper advantages in another part of the business is the imposition of strict information barriers or walls wherein the market-moving information is insulated, or walled off, from the rest of the firm through separation of employees, facilities, or technology and/or policies and procedures limiting dissemination of the information. Here, SIGTARP believes that the best practice would be to impose a wall similar to those imposed by FRBNY in several of its financial crisis-related programs that would separate those individuals making investment decisions for the PPIF from pertinent information concerning non-PPIF funds, and vice-versa, but allowing fund managers to access the more general expertise of the firm, such as market research. Such a wall should also include information technology barriers, strict policies forbidding the dissemination of PPIF information within the firm, and a rigorous compliance regime to ensure enforcement of those policies. Thus, it would prohibit individuals making investment decisions for the PPIF from managing other funds involving eligible assets.

Treasury has refused to require walls in PPIP despite the fact that such walls have been imposed upon asset managers in similar contexts in other Government bailout-related programs, including by Treasury itself in other TARP-related activities. For example, walls between the asset managers working for the Government and the rest of their firms are required in at least the following programs:

- FRBNY's Agency MBS Purchase Program (involving Goldman Sachs, PIMCO, BlackRock, Wellington)
- FRBNY's Commercial Paper Funding Facility (PIMCO)
- FRBNY's management of the Maiden Lane I, II, and III portfolios (BlackRock)
- In TALE, ethical walls are required for the collateral monitor that is tasked with providing advice to FRBNY on MBS valuations, and primary dealers have submitted conflict remediation plans that confirm that they have imposed walls isolating their business units that interact with TALE
- Treasury's management of assets obtained in TARP generally through financial agents (AllianceBernstein, FSI, Piedmont)
- TARP's Unlocking Credit for Small Businesses Program ("UCSB") (Earnest Partners)

Indeed, of the nine asset managers selected by Treasury to manage PPIFs, one-third of them (BlackRock, Wellington, and AllianceBernstein) are already required to operate walls in connection with other Government programs.

Notwithstanding the fact that walls are common when a firm has access to information that it could use to the unfair advantage of others (i) in the industry

generally, (ii) in other Government bailout program contexts, (iii) in other TARP-related programs, and (iv) with respect to at least some of the very firms that were selected as PPIF managers. Treasury has “concluded that such an arrangement is simply not practical in the context of PPIP.” In supporting this statement, Treasury has explained its positions, which SIGTARP summarizes below:

1. Treasury first suggests that “[r]equiring a segregated investment team would be likely to reduce investment performance of the PPIF,” arguing in particular that a segregation would preclude the PPIF from gaining the expertise of a manager’s “A Team” (the most experienced and talented managers at a company) and would hinder “team-oriented” investment processes.

In this argument, Treasury seems to be suggesting that it can obtain either talented managers or managers without inherent conflicts, but not both. Although SIGTARP noted in the April Quarterly Report that there may be difficulty selecting an experienced manager that is also non-conflicted, SIGTARP believes that such a dichotomy offers a false choice. In light of the amount of taxpayer money being invested in the PPIFs, Treasury should have the negotiating power to obtain competent and unconflicted management for the PPIFs. If a particular fund management company cannot accommodate that basic requirement, then Treasury should reject that company and retain one that can. Moreover, even if the dichotomy were as Treasury describes, in light of the substantial risks that a non-segregated manager presents to the taxpayer, to the PPIF private equity investors, and to the market as a whole, SIGTARP submits that the program may very well be better served by competent, non-conflicted personnel even if they do not fit into Treasury’s definition of what would constitute an “A Team.”

2. Treasury next suggests that requiring segregated investment teams would actually *increase* risk “by limiting fund manager participation in the PPIP,” arguing in particular that: many fund managers have indicated that they would withdraw if required to use a segregated investment team and thus Treasury would have to concentrate its investments in the hands of a few fund managers; requiring segregation would “undermine protections against fund manager misconduct,” because the team approach provides “checks and balances within the organization;” and implementing a wall would be time consuming, costly, and not feasible for many firms.

To the extent that Treasury suggests that segregation would decrease participation and thus lead to increased reliance on a few managers, it is not convincing that Treasury cannot find sufficient numbers of non-conflicted management companies to do the job. Again, Treasury, which has the power to adjust its eligibility

requirements for fund managers, should have sufficient bargaining power to mandate appropriate segregation in a sufficient number of firms (more than one hundred companies initially applied), particularly in light of the fact that three of its nine PPIF managers already abide by such walls in connection with other Government programs. In any event, even if segregation would lead to using fewer or different kinds of firms, in light of the seriousness of the risks associated with non-segregation of managers, it may well be that the program would be better served by a substantially different mix of non-conflicted firms rather than the current group of firms that are apparently unwilling to mitigate fully their conflicts.

To the extent that this argument suggests that a wall would somehow increase the risk of misconduct by limiting detection opportunities among the "team," SIGTARP believes that such argument is without merit. Walls limit information flow between investment decision makers on one side of the wall and investment decision makers on the other; nothing about the institution of a wall minimizes compliance scrutiny or general supervision. To accept Treasury's argument might suggest that Treasury and FRBNY are increasing the risk of misconduct in a whole series of Government programs in which they require walls, including TARP-related programs, a contention that SIGTARP squarely rejects. At their core, walls or information barriers are designed to prevent an unfair benefit to the firm as a whole; it is simply not persuasive to argue that wider dissemination of such confidential, market-moving information would somehow reduce, rather than increase, that risk.

3. Treasury suggests that requiring segregated investment teams is not necessary, arguing in particular that (i) the PPIF managers "will not have material non-public information from Treasury," that Treasury is nothing but a passive investor that will not be sharing its market views, and that the most analogous FRBNY program is TALF, which does not involve similar segregation for TALF borrowers; (ii) that the other mitigation procedures are sufficient; and (iii) that a wall will not completely eliminate the risks of misconduct.

The first part of this argument does not address the core risks associated with the market power being conveyed upon the individual fund managers. Although there may be differences between the mechanics of some of the Government programs in which walls are required, they are distinctions without a difference. PPIF is structured in such a way that its managers have the ability — through massive amounts of taxpayer funds — to move, indeed, to set, prices in illiquid markets, an ability they would not have absent the Government funds with which they are being entrusted. That, in turn, makes information about PPIF transactions (what securities will be bought, and for how much) extremely valuable, irrespective of whether the decisions are being made by the PPIF manager or by Treasury, and

irrespective of whether the investment decision is based on the fund manager's analysis, proprietary Treasury information, or for that matter, by random chance. Recently, a Treasury official, in explaining Treasury's decision to require a wall for those asset managers working for Treasury in connection with the CPPF program, stated that walls are commonly used when a party has access to "market-moving," proprietary information, such as Treasury's decision to sell certain assets. In PPIF, there can be no reasonable dispute that a PPIF manager's decision to buy a particular MBS at a particular price with hundreds of millions of dollars of taxpayer funds is market-moving, proprietary information. Moreover, Treasury's argument that the walls in other Government programs are designed to prevent the sharing of the Government's market views fails to address the strict walls that are required by FRBNY for BlackRock in the Maiden Lane portfolios in which BlackRock has discretion over the trading activities, much like the PPIF managers. Indeed, it is worth noting that Treasury's PPIF ethical standards recognize the value of this information by imposing a rule that individual PPIF managers may not share their purchase decisions with investors or other fund managers (even though the PPIF managers themselves are permitted to manage other funds while having access to this same information). The most straightforward and comprehensive protection against the improper use of market-moving information is an effective wall.

Treasury's citation to the fact that TALF borrowers need not establish walls is also not persuasive. Individual TALF borrowers do not have the price-setting power that PPIF managers will have, and TALF, unlike PPIF, was not designed so that any single market participant would have the ability to set prices in an illiquid market. A better comparison within TALF is the relationship with the new collateral monitor (which provides certain valuation services to FRBNY), which is required to maintain appropriate walls.

SIGTARP believes that Treasury's next point — that the alternative mitigation provisions in the program are sufficient — both underestimates the efficacy of walls and overestimates the ability to predict the ways that a fund manager can devise to take advantage of proprietary information. As noted above, Treasury is imposing some significant provisions to mitigate the absence of a wall: the allocation policy, for example, if properly implemented, should diminish the risk of "front running," i.e., using the PPIF trading information to buy securities at a relatively cheap price before the PPIF purchases move the market in those securities. Similarly, requiring the fund manager to have its own "skin in the game" will also help align its interests with the taxpayers' to a certain degree. These alone, however, are not sufficient. Imagine a PPIF manager who is deciding which of 10 similar residential mortgage-backed securities ("RMBS") the PPIF will purchase. The fund manager knows that the PPIF purchase will significantly increase the market price of whichever security is selected. With a wall in place, the manager should have every incentive to purchase the best securities at the lowest prices. Without a wall, the manager

Front Running: Entering into a trade while taking advantage of advance knowledge of pending orders from other investors.

may already be managing a fund with a substantial position in one of those 10 RMBS, and thus the manager would have every incentive to buy only that security, irrespective of quality, and at a price as high as possible in order to drive up the non-PPIF fund performance and thus the manager's own personal compensation. There are currently no mitigation procedures to address this issue, and indeed, there is nothing in place that would prevent a pre-approved manager from using the time period between his selection and the launch of the program from building a position in a security in non-PPIF funds with the intent of later using taxpayer funds to drive up the price of the security (and therefore his personal compensation). Only by imposing a wall, and fully aligning the manager's compensation with the PPIF's performance, can this danger be averted.

Even more fundamentally, a wall may provide some protection against the myriad other ways in which information on one side of the wall or the other could be used to generate illicit gains in non-PPIF funds. Can a creative manager make a profit by trading in the equity of an institution from which a PPIF is purchasing MBS? If a manager knows that the PPIF will be investing heavily in a particular MBS, can that manager participate in a derivative transaction involving that same security and thereby reap profits? Is there a member of the firm on the non-PPIF side of the wall who is willing to sell proprietary PPIF trading information to another firm? No one can answer these questions definitively, but one thing is certain: a wall will likely decrease the risks of these and similar unpredictable bad scenarios.

If nothing else, the reputational risk that Treasury and the program face if a PPIF manager generates massive profits in its non-PPIF funds as a result of an unfair informational advantage justifies the imposition of a wall. If this occurs, failure to impose a wall, on the other hand, will leave Treasury vulnerable to an accusation that has already been leveled against it by members of Congress and the media — that Treasury is using TARP to pick winners and losers and that, by granting certain firms the PPIF manager status, Treasury is benefiting a chosen few at the expense of the dozens of firms that were rejected, the market as a whole, and the American taxpayer. This reputational risk is not one that can be readily measured in dollars and cents, but is a risk that could jeopardize what is left of the fragile trust the American people have in TARP and, by extension, their Government. As FRBNY has learned through developing its own programs, imposition of a wall is a small price to pay to guard against such risk.

- **PPIF Recommendation #2 — Disclosure of Trading Activities in the PPIFs:** SIGTARP recommends that Treasury periodically disclose PPIF trading activity and require PPIF managers to disclose to SIGTARP within seven days of the close of the quarter, all trading activity, holdings, and valuations so that SIGTARP may disclose such information, subject to reasonable protections, in its quarterly reports.

As a matter of basic transparency, in light of the billions of dollars of taxpayer equity and loans that provide the majority of funding for the PPIFs, the public should be permitted to know, to the greatest extent possible, the activity and holdings in the PPIFs. Such transparency not only dissuades misconduct and promotes sound management, but also promotes a better public understanding of PPIP and thus enhances the credibility of PPIP and TARP more broadly. Even more importantly, the most significant investors in each PPIF, the American taxpayers, have a right to know the status of their investments. The lack of transparency as to what use TARP funds were put by recipients in other TARP programs, in SIGTARP's view, has damaged the credibility of TARP and therefore may have threatened its viability; Treasury should not repeat that apparent error with PPIP. Moreover, disclosure of the PPIF transactions, and in particular the price at which such transactions occur, would appear to be required to bring about the "price discovery" that Treasury has claimed as one of the core purposes of PPIP. Failure to provide transparency on trading prices and valuations creates a "tree falling in the woods problem:" without such transparency, the market (other than the PPIF managers themselves) is far less likely to "discover" market prices in a way that will facilitate re-starting trading outside of Government-supported efforts.

Unfortunately, Treasury has stated that it will not require such disclosure "as this would [do] harm to the fund's operation by revealing competitive and proprietary information regarding the fund's investment positions and strategy." Instead, Treasury intends to disclose no more than the bare minimum required by statute — disclosure of only the 10 largest positions held in each PPIF. SIGTARP is cognizant of the fact that certain trading information may have, for a time, significant proprietary value and is not advocating unreasonably premature disclosure. However, Treasury's default position should be in favor of disclosure in a manner designed to promote price discovery in the legacy securities markets and to promote transparency. SIGTARP has expressed its willingness to work with Treasury to find the right balance among the proprietary interests of the PPIF managers, the public's interests in transparency, and the broader market's interests in price discovery.

In light of Treasury's refusal to publish this information, to meet a basic level of transparency, and to meet SIGTARP's statutory obligation to report to Congress for the preceding quarter "all purchases" of troubled assets, "[a] list of the troubled assets purchased," and "the profit or loss incurred on each sale" of such assets, SIGTARP intends to include in its quarterly report the identity of the securities purchased, the purchase price, the amounts held, the sale prices, and the value of the taxpayer's positions, redacted as appropriate to avoid the dissemination of any confidential information that could harm the PPIF investment.<sup>45</sup> Although Treasury has designed PPIP so that the troubled assets are technically its interests

in the PPIFs, and not the actual toxic assets they purchase, SIGTARP does not believe that this absolves it from complying with the spirit, if not the letter, of its EESA requirements. These categories of information are no different than that typically disclosed on a periodic basis by mutual funds, for example, in SEC Forms N-Q and N-CSR. To fulfill this role, and in order to keep constant SIGTARP's Quarterly Report production schedule of providing transparency with the shortest delay possible, SIGTARP would need such data, along with any claims of confidentiality, within seven days of the end of a quarter; Treasury has indicated that delivery within 15 days would be "reasonable and consistent with industry practice." Such a 15-day delivery would force SIGTARP to alter its scheduled issuance of Quarterly Reports by more than a week. Unless delivery within seven days proves impossible, "industry practice" should not interfere with timely transparency.

- PIIP Recommendation #3 — Performance Metrics and Removal of the Manager:** SIGTARP recommends that appropriate metrics be defined and an evaluation system be put in place to monitor the effectiveness of the PPIF managers, both to ensure that they are fulfilling the terms of their agreements and to measure their performance. The conditions that would give Treasury "cause" to remove a manager should be expanded to include a manager's performance below a certain standard benchmark, or if Treasury concludes that the manager has materially violated compliance or ethical rules.

Treasury has indicated that it is in the process of developing appropriate measurement metrics, and SIGTARP will monitor the progress on this issue. As drafted, however, the provision in the term sheet relating to the removal of the PPIF manager may significantly limit Treasury's ability to remove a manager for poor performance or even for other significant malfeasance. As drafted, for example, Treasury may, in essence, only remove a manager with the consent of a majority of the private equity interests or for "cause." Cause includes a breach of the capital contribution requirement or a formal (*i.e.*, judicial) finding of fraud, gross negligence, bad faith or willful misconduct, securities law violation, or a conviction or guilty plea of a felony.<sup>452</sup> To use an extreme example, if a fund manager is arrested for stealing from Treasury's equity portion of the PPIF for the benefit of its private investors, Treasury could not remove that manager until the manager was convicted (which could take years) unless a majority of the private equity investors (who, in this example, are the beneficiaries of the crime) consent. In light of the very significant role of TARP funds in the PPIFs, Treasury should obtain the ability to remove managers unilaterally under appropriate circumstances.

- PIIP Recommendation #4 — Disclosure of Holdings and Transactions in Related Assets:** SIGTARP recommends that Treasury require fund managers to

disclose to Treasury, as part of the Watch List process outlined in the PPIF term sheet, not only information about holdings in eligible assets but also holdings in related assets or exposures to related liabilities.

As discussed previously in this section, at SIGTARP's suggestion, Treasury is requiring PPIF managers to disclose to Treasury information about holdings in eligible assets not only in the PPIF but also in the managers' non-PPIF funds. This is a very substantial step in the right direction and will be, if implemented properly, a powerful tool to detect issues arising from conflicts of interest, collusion, and improper valuation. Treasury, however, has so far refused to require reporting beyond eligible assets, and SIGTARP views this as a significant limitation. There are many asset types or liability exposures that could be held in a manager's non-PPIF fund whose value is predictably tied to eligible assets and thus should be disclosed. For example, credit default swaps or other derivative products could change in value based upon a manager's PPIF investment decisions. Treasury should require disclosure about any such assets or potential liabilities.

- **PPIF Recommendation #5 — Beneficial Ownership Issues:** Treasury should require PPIF managers to obtain and maintain information about the beneficial ownership of all of the private equity interests, and Treasury should have the unilateral ability to prohibit participation of private equity investors.

To its credit, Treasury has adopted many of the anti-money laundering and "Know Your Customer" suggestions made by SIGTARP. However, two significant issues remain. First, although PPIF managers must provide Treasury with all information in their possession with respect to beneficial ownership of the private equity interests, those rights are meaningless unless managers are required to obtain and maintain such information in the first instance. Treasury should make that obligation explicit. Moreover, Treasury should insist upon the unilateral right to prohibit participation of certain private investors. The resources to screen investors that are available to the managers simply do not match the resources of Treasury. If the Government finds that a potential investor is the subject of a criminal investigation, for example, that fact might not be discoverable by the manager or discloseable by Treasury. The terrible toll on the program resulting from participation by organized crime, terrorists, or fraudsters mandates that Treasury have unilateral authority to prohibit participation without explanation.

## CONTINUED USE OF RATINGS AGENCIES IN TALF

SIGTARP made a series of recommendations to Treasury with respect to its participation in the implementation of TALF in both its Initial Report and its April Quarterly Report. Because the recommendations impact the Federal Reserve and FRBNY as the primary implementers of TALF, since January, SIGTARP has been in regular contact with the Federal Reserve and FRBNY to discuss those recommendations and the TALF compliance and anti-fraud regime more generally. The Federal Reserve and FRBNY have engaged constructively in those discussions, have adopted many of the recommendations, and have independently developed additional protections. As a result, TALF's design is far better, from a compliance and anti-fraud perspective, than it was when the program was first announced. The status of the implementation of SIGTARP's recommendations is set forth in Table 5.1 later in this section, and two letters from the Federal Reserve to the Special Inspector General describing plans for bolstering the protections in connection with the expansion of TALF to commercial mortgage-backed securities ("CMBS"), dated May 5, 2009, and May 22, 2009, are included in Appendix G: "Correspondance Regarding SIGTARP Recommendations."

In the April Quarterly Report, one of SIGTARP's recommendations was that, with respect to the potential expansion of TALF to legacy RMBS, rating agency determinations should be dispensed with and a security-by-security screening for each legacy RMBS be implemented instead. Although the decision of whether RMBS will be permitted to be used as collateral in TALF is still under consideration, the Federal Reserve and FRBNY have informed SIGTARP that, in designing the TALF provisions relating to CMBS, they have taken several steps to reduce the importance of ratings from the credit rating agencies in determining the eligibility of CMBS. For example, FRBNY has engaged a collateral monitor that will assist it in excluding high-risk CMBS regardless of its rating. Although these measures represent a significant improvement of TALF, ratings from credit rating agencies remain an important, although not exclusive, asset-eligibility prerequisite in TALF: newly issued ABS must receive a AAA rating from two of three credit rating agencies (Standard & Poor's, Moody's Investors Service, and Fitch Ratings) and not have a rating of less than AAA from the third agency. For newly issued CMBS, a AAA rating is required from two of five eligible agencies (adding DBRS Inc. and Realpoint LLC) and, again, no lower rating from the other three can exist.

Since SIGTARP's April Quarterly Report, there have been several developments that raise additional concerns about TALF's use of ratings agencies. Most ratings agencies, by the nature of their business model, have inherent conflicts of interest — they are paid by the issuers of the very securities that they are rating. As a result, the agency has an incentive to issue a high rating to attract future business from that issuer. As one commentator recently characterized the conflict, it would be as

if Hollywood studios paid movie critics to review their films, any individual critic would have a strong incentive to give a particular film a good review, even if it was terrible, out of fear that the studio would not give the critic future business. This inherent conflict played out with disastrous consequences in the recent credit crisis in which AAA ratings for many MBS, in particular certain classes of RMBS, had little or no relation to the creditworthiness of the securities.

Over the last quarter, there has been reporting that these conflicts may be impacting TALF. For example, Moody's Investors Services ("Moody's"), one of the major agencies that has been qualified to rate all TALF securities, has complained of a "race to the bottom," in which issuers are selecting other agencies to rate TALF securities because they are employing lower standards and therefore are more likely to give a potential TALF security the necessary AAA rating. Although SIGTARP has not yet undertaken any independent review of Moody's claims, its complaints further highlight the dangers of relying on these inherently conflicted institutions. The expansion from three to five of the number of rating agencies from which the issuer may obtain ratings with respect to newly issued CMBS (albeit with one, Realpoint, that does not receive payment from issuers), without an increase in the number of AAA ratings required, has the potential of giving issuers more incentives and opportunities to take advantage of the conflicts inherent in the ratings process.

**Recommendation**

- SIGTARP recommends that Treasury and FRBNY examine Moody's assertions and develop mechanisms to ensure that acceptance of collateral in TALF is not unduly influenced by the improper incentives to overrate that exist among the rating agencies. This may include further limiting the importance of credit ratings in TALF eligibility decisions, continuing to develop alternative methods of evaluating the creditworthiness of TALF collateral, and/or proportionally increasing the number of required AAA ratings from credit agencies whenever there is an increase in the number of eligible agencies.

In response to this recommendation, the Federal Reserve has indicated that it has discussed these concerns with the rating agencies and will continue to develop and enhance its risk management tools and processes as it refines the design of the expanded TALF.

## REQUIRING RECIPIENTS TO ACCOUNT FOR USE OF TARP FUNDS

From its inception, SIGTARP has advocated that, as a matter of fundamental transparency, Treasury should require TARP recipients to disclose what they have been able to do with TARP funds, and SIGTARP has made formal recommendations along these lines in both its Initial Report and its April Quarterly Report. With the exception of mandating such reporting in a few of the extraordinary assistance agreements — most notably the Citigroup and Bank of America Targeted Investment Program (“TIP”) agreements and Treasury’s recent agreement with American International Group, Inc. (“AIG”) — Treasury has refused to adopt this recommendation, arguing that the fungible nature of money would make such reports not “meaningful.” Treasury instead decided to track the effects of the TARP funds by measuring institutions’ lending over time.

As a result of Treasury’s refusal to require reporting more broadly on actual TARP fund use, SIGTARP decided to undertake the task itself by conducting a survey of more than 360 institutions that had received TARP funds through the end of January 2009. The results of the survey demonstrate that, despite the inherent fungibility of money, financial institutions are capable of providing at least basic narrative descriptions of how they used TARP funds. Although most banks reported that they did not segregate or track TARP fund usage on a dollar-for-dollar basis, they were able to provide insights into their actual or planned use of TARP funds; indeed, more than 98% of survey recipients reported their actual uses of TARP funds. Moreover, the results show that institutions commonly have used TARP funds in ways that will not immediately or directly register on a bank’s lending report. In addition to activities that would directly lead to lending, for example, banks reported that TARP funds have been used in these ways:

- to increase capital cushions to absorb unexpected losses
- to purchase mortgage-backed securities, thus not resulting in lending by the bank itself, but supporting lending by other institutions in the MBS pipeline
- to pay down debt, thus de-leveraging the bank’s balance sheet and improving its ability to withstand further economic downturn
- to acquire other banks

All of these activities could be, depending on the circumstances, considered commercially reasonable, yet would not necessarily be captured by Treasury’s lending surveys.

Treasury’s reasons for refusing to adopt this recommendation have been

squarely refuted by SIGTARP's audit results and are belied by Treasury's own inclusion of use of funds provisions in its agreements with AIG, Bank of America, and Citigroup. Further, the claim that the information provided by banks would be "unreliable" is contradicted both by the threat of criminal penalty should a bank be untruthful to Treasury, and Treasury's reliance on self-reporting throughout its compliance regime. Imposition of a condition designed to foster basic transparency should not be used as a punitive measure required of only those institutions that are compelled to seek extraordinary assistance, but rather should be an integral feature of TARP as a whole.

**Ongoing Recommendation**

- To improve transparency over the use of funds, SIGTARP continues to recommend that the Treasury Secretary require TARP recipients to submit periodic reports to Treasury on their use of funds, including what they were able to do with their TARP funds, such as lending, investments, acquisitions, and other activities that they could not have conducted without TARP funding. SIGTARP also recommends that the Treasury Secretary require TARP recipients to retain all supporting documentation in conjunction with any reporting requirement that Treasury may impose.

**TRACKING THE IMPLEMENTATION OF RECOMMENDATIONS IN PREVIOUS REPORTS**

SIGTARP has now made dozens of individual recommendations, and updating compliance of each one in narrative form is quickly becoming impractical. The following table, Table 5.1, summarizes SIGTARP's prior recommendations, gives an indication of SIGTARP's view of the level of implementation to date, and provides a brief explanation for that view where necessary. For more details on the recommendations, readers are directed to the Initial Report and April Quarterly Report. Treasury's views on the level of implementation of the recommendations are set forth in a letter to the Special Inspector General dated July 2, 2009, which is included in Appendix G: "Correspondence Regarding SIGTARP Recommendations."

TABLE 5.1  
SIGTARP RECOMMENDATIONS TABLE

| Recommendation  | Implemented | Partially Implemented | In Process | Not Implemented | TBD | Comments  |
|---|-------------|-----------------------|------------|-----------------|-----|---|
| 1 Treasury should include language in the automobile industry transition term sheet regarding SIGTARP's oversight related expressly giving SIGTARP access to relevant documents and personnel.  | X           |                       |            |                 |     |   |
| 2 Treasury should include language in new TARP agreements to facilitate compliance and oversight. Specifically, SIGTARP recommends that each program participant should (1) acknowledge explicitly the jurisdiction and authority of SIGTARP and other oversight bodies, as relevant, to oversee compliance of the conditions contained in the agreement in question; (2) establish internal controls with respect to that condition; (3) report periodically to the Compliance department of the Office of Financial Stability ("OFS-Compliance") regarding the implementation of those controls and its compliance with the condition; and (4) provide a signed certification from an appropriate senior official to OFS-Compliance that such report is accurate. |             | X                     |            |                 |     | Although Treasury has made substantial efforts to comply with this recommendation in many of its agreements, there are exceptions, including in its agreements with servicers in MHA.   |
| 3 All existing TARP agreements, as well as those governing new transactions, should be posted on the Treasury website as soon as possible.  |             |                       |            |                 |     | Treasury agreed to do so in late January, but as of the drafting of this report, it has still not posted 220 Cpp agreements, as well as contracts with Bank of America (BP) and TALF on its website listing of contracts. Treasury has stated that it will have all agreements on its website by August 15, 2009. |
| 4 Treasury requires all TARP recipients to report on the actual use of TARP funds.  |             | X                     |            |                 |     | See discussion in this section.   |
| 5 Treasury quickly determines its going-forward valuation methodology.  |             |                       | X          |                 |     |   |
| 6 Treasury begins to develop an overall investment strategy to address its portfolio of stocks and decide whether it intends to exercise warrants of common stock.  |             |                       | X          |                 |     |   |
| 7 In formulating the structure of TALF, Treasury should consider requiring, before committing TARP funds to the program, that certain minimum underwriting standards and/or other fraud prevention mechanisms be put in place with respect to the ABS and/or the assets underlying the ABS used for collateral.   |             | X                     |            |                 |     | Although Treasury and the Federal Reserve have not adopted minimum underwriting standards in TALF, they have adopted other significant fraud prevention and credit protection measures. SIGTARP will continue to monitor the effectiveness of these measures.   |
| 8 Agreements with TALF participants should include an acknowledgment that (1) they are subject to the oversight of OFS-Compliance and SIGTARP; (2) with respect to any condition imposed as part of TALF, that the party on which the condition is imposed is required to establish internal controls with respect to each condition, report periodically on such compliance, and provide a certification with respect to such compliance.  |             |                       |            | X               |     |   |

Continued on next page.

**SIGTARP RECOMMENDATIONS TABLE (CONTINUED)**

| Recommendation  | Partially Implemented |            |     | Not Implemented |     | Comments  |
|---|-----------------------|------------|-----|-----------------|-----|---|
|   | Implemented           | In Process | TBD | Implemented     | TBD |   |
| 9 Treasury should give careful consideration before agreeing to the expansion of TALF to include MBS without a full review of the program's impact on the market and without considering certain important fraud prevention measures.   |                       |            | X   |                 |     | Implementation is in process with respect to MBS, as discussed earlier in this section, but remains to be determined with regard to RMBS.   |
| 10 Treasury should express any expansion of TALF to legacy MBS without significant modifications to the program to ensure a full assessment of risks associated with such an expansion.   |                       |            |     |                 | X   | Although expansion of TALF to legacy MBS is in process, no decision has been made with respect to including legacy RMBS.  |
| 11 Treasury should formalize its valuation strategy and begin providing values of the TARP investments to the public.   |                       |            |     |                 | X   | Although Treasury is in the process of developing a valuation strategy, it has not committed to making its estimate of the value of its investments public on more than the minimum required by statute — annually — even though it is receiving monthly valuation summaries from its asset managers. |
| 12 Treasury and the Federal Reserve should provide to SIGTARP, for public disclosure, the identity of the borrowers who surrender collateral in TALF.   |                       |            |     | X               |     | The Federal Reserve and Treasury continue to work on this issue. SIGTARP intends to revisit this issue with the Federal Reserve once a collateral surrender takes place.  |
| 13 In TALF, Treasury should dispense with rating agency delimitations and require a security-by-security screening for each legacy RMBS. Treasury should refuse to participate if the program is not designed so that RMBS, whether new or legacy, are subject to the same screening process. Treasury should also require that the loans underlying the RMBS are not in certain categories or are in categories that have been proven to be riddled with fraud, including certain undocumented subprime residential mortgages. |                       |            |     |                 |     | No decision has yet been made with respect to expanding TALF to include RMBS.   |
| 14 In TALF, Treasury should require significantly higher haircuts for all MBS, with particularly high haircuts for legacy RMBS, or other equally effective mitigation efforts.  |                       |            |     |                 | X   | Implementation is in process with respect to MBS, as discussed earlier in this section, but remains to be determined with regard to RMBS.   |
| 15 Treasury should require additional anti-fraud and credit protection provisions, specific to all MBS, before participating in an expansion of the program, including underwriting standards and other fraud prevention measures.  |                       |            |     |                 | X   | Implementation is in process with respect to MBS, as discussed earlier in this section, but remains to be determined with regard to RMBS.   |
| 16 Treasury should design a robust compliance protocol with complete access rights to all TALF transaction participants for itself, SIGTARP, and other relevant oversight bodies.   |                       |            |     | X               |     | Term sheets indicate that Treasury will adopt this recommendation through mitigating measures that address the concerns raised by the recommendation.   |
| 17 Treasury should not allow Legacy Securities PFPS to invest in TALF unless significant mitigating measures are included to address these dangers.   | X                     |            |     |                 |     |   |
| 18 All TALF modeling and decisions, whether on haircuts or any other credit or fraud loss mechanisms, should account for potential losses to Government interests broadly, including TARP funds, and not just potential losses to the Federal Reserve.  | X                     |            |     |                 |     |   |

Continued on next page.

**SIGTARP RECOMMENDATIONS TABLE (CONTINUED)**

| Recommendation   | Partially Implemented |            |                 | Not Implemented |   | Comments   |
|--|-----------------------|------------|-----------------|-----------------|---|--|
|  | Implemented           | In Process | Not Implemented | TBD             |   |  |
| 19 Treasury should address the confusion and uncertainty on executive compensation by immediately issuing the required regulations.  | X                     |            |                 |                 |   | Although not immediate or final, Treasury did issue regulations on June 15, 2009.  |
| 20 Treasury should significantly increase the staffing levels of OFS-Compliance and ensure the timely development and implementation of an integrated risk management and compliance program.  |                       | X          |                 |                 |   |  |
| 21 Treasury should require CFP participants to (1) establish an internal control to monitor their actual use of TARP funds, (2) provide periodic reporting on their actual use of TARP funds, (3) certify to OFS-Compliance, under the penalty of criminal sanction, that the report is accurate, that the same criteria of internal controls and regular certified reports should be applied to all conditions imposed on CFP participants (i.e. unknown-ownership, etc.), and (4) require CFP participants to sign a written other oversight bodies, as appropriate, to oversee conditions contained in the agreement. |                       |            |                 |                 | X | Treasury has reported that in its draft documents, it is including "most of the suggestions of SIGTARP," but is refusing to adopt a use of funds reporting requirement.  |
| 22 Treasury should impose strict conflicts-of-interest rules upon PPF managers across all programs that specifically address whether and to what extent the managers can (i) invest PPF funds in legacy assets that they hold or manage on behalf of themselves or their clients or (ii) conduct PPF transactions with entities in which they have invested on behalf of their selves or others.   |                       |            |                 |                 | X | See discussion in this section.  |
| 23 Treasury should require that all PPF fund managers: (1) have stringent investor screening procedures, including comprehensive "Know Your Customer" requirements at least as rigorous as that of a commercial bank or retail brokerage operation to prevent money laundering and the participation of actors prone to abusing the system, and (2) be required to provide Treasury with the identities of all CFP beneficial owners of the private funds in which they have invested, and that Treasury take appropriate steps to ensure that investors in the funds are legitimate.                                    |                       |            |                 |                 | X | See discussion in this section.  |
| 24 Treasury should require non-favored-issuer classes: PPF managers to acknowledge that they owe Treasury a fiduciary duty, and that each manager adopt a robust ethics policy and compliance apparatus.   | X                     |            |                 |                 |   | Term sheets indicate that Treasury will adopt this recommendation.   |
| 25 Treasury should require servicers in MHA to submit third party verified evidence that the applicant is residing in the subject property before funding a mortgage modification.   |                       |            |                 |                 |   | Treasury is requiring servicers to obtain and retain such information, which is a significant improvement, but is not requiring submission of such evidence prior to authorizing funding of such loans. Treasury is also requiring servicers to obtain third party verification of residence during the loan review process. |

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**SIGTARP RECOMMENDATIONS TABLE (CONTINUED)**

| Recommendation | Implemented   | Partially Implemented | In Process | Not Implemented | TBD | Comments   |
|----------------|---|-----------------------|------------|-----------------|-----|--|
| 26             | In MHA, Treasury should require a closing-like procedure be conducted that would include: (1) a closing warning sheet that would warn the applicant of the consequences of fraud; (2) the inclusion of signatures and thumbprint of each participant; (3) the inclusion of identification documents of all participants in the transaction; (4) verbal and written warnings regarding hidden fees and payments so that applicants are made fully aware of them; (5) the benefits to which they are entitled under the program (to prevent a corrupt servicer from collecting payments from the homeowner); and (6) the fact that no fee should be charged for the modification. | X                     |            |                 |     | Treasury is not addressing a closing-like procedure in this recommendation. It is, however, requiring certain written requirements: (1) a fraud warning sheet to each applicant, (2) warnings about fees, (3) requiring servicers to maintain records of payment allocation.                           |
| 27             | Additional anti-fraud protections should be adopted in MHA to verify the identity of the participants in the transaction and to address the potential for servicers to steal from individuals receiving Government subsidies without applying them for the benefit of the homeowner.  |                       |            |                 | X   | Treasury has stated that it will take steps to address this recommendation.  |
| 28             | In MHA, Treasury should require the servicer to compare the income reported on a mortgage modification application with the income reported on the original loan application.   |                       |            | X               |     | After refusing to adopt this recommendation, Treasury has adopted an alternative method of income verification at SIGTARP's recommendation.  |
| 29             | In MHA, Treasury should require that verifiable, third-party information be used to verify the applicant's income before any modification payments are made.  | X                     |            |                 |     | Treasury has not addressed the deficiency identified in SIGTARP's April Quarterly Report. It continues to rely on servicer representations that the homeowner has made three full payments before entering the program, but does not require any minimum payments after a mortgage enters the program. |
| 30             | In MHA, Treasury should defer payment of the \$1,000 incentive to the servicer until after the homeowner has verifiably made a minimum number of payments under the mortgage modification program.  |                       |            | X               |     | Treasury has refused to adopt this significant anti-fraud measure designed to detect predators who are committing large-scale fraud. This represents a material deficiency in the MHA anti-fraud regime.   |
| 31             | In MHA, Treasury should proactively educate homeowners about the nature of the program, warn them about modification fees for late payments, and require that no fee is necessary to participate in the program.  | X                     |            |                 |     |  |
| 32             | In MHA, Treasury should require its agents to keep track of the names and identifying information for each participant in each mortgage modification transaction and to maintain a database of such information.  |                       |            |                 | X   |  |



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428. Treasury Press Release, 4/22/2009, [www.finnancialstability.gov/inf/210/WMF121008webhome.pdf](http://www.finnancialstability.gov/inf/210/WMF121008webhome.pdf), accessed 6/24/2009.

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451. CBO "08-141," Troubled Asset Relief Program: Additional Issues Need to Better Ensure Integrity, Accountability and Transparency," 1/22/2008.

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APPENDICES

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\*Visit [www.sigtarp.gov](http://www.sigtarp.gov) to view Appendix A: Glossary; Appendix B: Acronyms and Abbreviations; Appendix E: Public Announcement of Audits; Appendix F: Key Oversight Reports and Testimonies, and for further reference material.

## CROSS-REFERENCE TO REPORTING REQUIREMENTS

This appendix provides Treasury's responses to data call questions regarding the reporting requirements of the Special Inspector General for the Troubled Asset Relief Program outlined in EESA Section 121, as well as a cross-reference to related data presented in this report. Italics style indicates relevant narrative taken verbatim from source documents.

| # | EESA Section      | EESA Reporting Requirement   | Treasury Response to SIGTARP Data Call  | SIGTARP Report Section  |
|---|-------------------|--|---|---|
| 1 | Section 121(c)(A) | A description of the categories of troubled assets purchased or otherwise procured by the Secretary. | <p>Treasury posts several documents on its public website that are responsive to this question, available at <a href="http://www.financialstability.gov/latest/reportsanddocs.html">http://www.financialstability.gov/latest/reportsanddocs.html</a>. Specifically, tranche reports and reports required under section 105(a) of the Emergency Economic Stabilization Act of 2008 (EESA) describe, at a high level, Treasury's programs and troubled asset purchases. The transaction reports describe these purchases in detail, including the type of asset purchased, the identity of the institution selling the asset, and the price Treasury paid for the asset. Other sources for this information are the determinations signed by the Secretary of the Treasury, designating certain financial instruments as "troubled assets" under section 3(9)(B) of EESA. Troubled asset determinations signed by the Treasury Secretary since March 30, 2009 are provided in response to [#3].</p> <p>Below are program descriptions from Treasury's FinancialStability.gov website, as of 6/30/2009:</p> <p>CPP: Treasury created the Capital Purchase Program (CPP) in October 2008 to stabilize the financial system by providing capital to viable financial institutions of all sizes throughout the nation. With a strengthened capital base, financial institutions have an increased capacity to lend to U.S. businesses and consumers and to support the U.S. economy.</p> <p>CAP: The purpose of the CAP is to restore confidence throughout the financial system that the nation's largest banking institutions have a sufficient capital cushion against larger than expected future losses, should they occur due to a more severe economic environment, and to support lending to creditworthy borrowers.</p> <p>SSF: Systemically Significant Failing Institution Program (SSF) was established to provide stability and prevent disruptions to financial markets from the failure of institutions that are critical to the functioning of the nation's financial system.</p> <p>AGP: The Asset Guarantee Program (AGP) provides government assurances for assets held by financial institutions that are critical to the functioning of the nation's financial system, which face a risk of losing the critical confidence that is needed for them to continue to lend to other banks.</p> <p>TIP: Treasury created the Targeted Investment Program (TIP) to stabilize the financial system by making investments in institutions that are critical to the functioning of the financial system. This program focuses on the complex relationships and reliance of institutions within the financial system. Investments made through the TIP seek to avoid significant market disruptions resulting from the deterioration of one financial institution that can threaten other financial institutions and impair broader financial markets and pose a threat to the overall economy.</p> <p>TALF: The TALF is designed to increase credit availability and support economic activity by facilitating renewed issuance of consumer and small business ABS at more normal interest rate spreads... Under the TALF, the Federal Reserve Bank of New York (FRBNY) will provide non-recourse funding to any eligible borrower owning eligible collateral... The U.S. Treasury's Troubled Assets Relief Program (TARF) will purchase \$20 billion of subordinated debt in an SPV created by the FRBNY. The SPV will purchase and manage any assets received by the FRBNY in connection with any TALF loans. Residual returns from the SPV will be shared between the FRBNY and the U.S. Treasury.</p> | <p>Section 2: "TARP Overview"</p> <p>Appendix D: "Transaction Detail"</p> |

| EESA # | EESA Reporting Requirement  | Treasury Response to SIGTARP Data Call   | SIGTARP Report Section           |
|--------|---|--|----------------------------------|
|        |   | <p>FFIP: To address the challenge of legacy assets, Treasury – in conjunction with the Federal Deposit Insurance Corporation and the Federal Reserve – has announced the Public-Private Investment Program as part of its efforts to repair balance sheets throughout our financial system and ensure that credit is available to the households and businesses, large and small, that will help drive us toward recovery... Using \$75 to \$100 billion in TARP capital and capital from private investors, the Public-Private Investment Program will generate \$500 billion in purchasing power to buy legacy assets – with the potential to expand to \$1 trillion over time.</p> <p>UCSR: The Treasury Department will begin making direct purchases of securities backed by SBA loans to get the credit market moving again, and it will stand ready to purchase new securities to ensure that community banks and credit unions feel confident in extending new loans to local businesses.</p> <p>AIFP: The objective of the Automotive Industry Financing Program (AIFP) is to prevent a significant disruption of the American automotive industry, which would pose a systemic risk to financial market stability and have a negative effect on the economy of the United States... Treasury has issued loans to the automobile industry and received warrants, which are a form of equity in a company, in return. Treasury's loans to the automobile industry are working to stabilize the financial system by addressing these companies' short term needs, while providing them enough time to craft restructuring plans that will help them achieve viability.</p> <p>ASSP: (ASSP) will provide up to \$5 billion in financing, giving suppliers the confidence they need to continue shipping parts, pay their employees and continue their operations.</p> <p>AWCP: The Treasury Department announced an innovative new program to give consumers who are considering new car purchases the confidence that even in this difficult economic period, their warranties will be honored. This program is part of the Administration's broader program to stabilize the auto industry and stand behind a restructuring effort that will result in stronger, more competitive and viable American car companies.</p> <p>HAMP (a program under MHA): The Home Affordable Modification program has a simple goal: reduce the amount homeowners owe per month to sustainable levels to stabilize communities. This program will bring together lenders, investors, servicers, borrowers, and the government, so that all stakeholders share in the cost of ensuring that responsible homeowners can afford their monthly mortgage payments – helping to reach up to 3 to 4 million at-risk borrowers in all segments of the mortgage market, reducing foreclosures, and helping to avoid further downward pressures on overall home prices.</p> |                                  |
| 2      | Section 121(c)(B) A listing of the troubled assets purchased in each such category described under [Section 121(c)(A)]. | Treasury posts transaction reports for all the troubled asset purchases on its public website within two business days after each transaction. Information on all transactions is available at <a href="http://www.financialstability.gov/impact/transactions.htm">http://www.financialstability.gov/impact/transactions.htm</a> . Since the publication of the SIGTARP Report in April, Treasury has continued to invest funds in financial institutions across the United States through the Capital Purchase Program (CPP), and as of May 31, 2009 more than \$15 billion has been allocated towards the Making Home Affordable Program. Guidelines for all TARP programs, which explain each program's scope and purpose are also posted on Treasury's website at <a href="http://www.financialstability.gov/readtostability/programs.htm">http://www.financialstability.gov/readtostability/programs.htm</a> . Additional information about these programs and related purchases is available in tranche reports and Section 105(a) reports, which are posted on Treasury's website. Information is also available in the troubled asset determinations attached as part of the response to [#3].   | Appendix D: "Transaction Detail" |
| 3      | Section 121(c)(C) An explanation of the reasons the Secretary deemed it necessary to purchase each such troubled asset. | Pursuant to Section 3(i)(9)(B) of EESA, the Secretary of the Treasury periodically designates financial instruments as "troubled assets" and submits written determinations to appropriate committees of Congress. Attached below are all troubled asset determinations signed by the Secretary of the Treasury since Treasury responded to SIGTARP's previous data call on April 8, 2009. [Treasury provided determinations for HAMP, AIFP, and SSF (AIG)]. Additional information on the TARP programs associated with these "troubled assets", including each program's scope and purpose, can be found online at <a href="http://www.financialstability.gov/readtostability/programs.htm">http://www.financialstability.gov/readtostability/programs.htm</a> .   | Section 2: "TARP Overview"       |
| 4      | Section 121(c)(D) A listing of each financial institution that such troubled assets were purchased from.                | See #2 above   | See #2                           |

## APPENDIX C | CROSS-REFERENCE TO REPORTING REQUIREMENTS | JULY 21, 2009

| EESA Section #         | EESA Reporting Requirement   | Treasury Response to SIGTARP Data Call  | SIGTARP Report Section  |
|------------------------|--|---|---|
| 5<br>Section 121(c)(E) | A listing of and detailed biographical information on each person or entity hired to manage such troubled assets.  | <p>As of June 30, 2009, four financial institutions have been selected as financial agents to provide asset management services to the Treasury. EARNEST Partners was engaged on March 16, 2009 to provide asset management services for the Small Business Administration (SBA) related loans and securities. Detailed biographical information on EARNEST Partners was provided to SIGTARP for incorporation in its July 2009 Quarterly Report. As of June 30, 2009, the Treasury and EARNEST Partners had not acquired any assets under the Small Business Support Program. Therefore, there are no assets assigned to the asset manager.</p> <p>On April 21, 2009, the Treasury selected AllianceBernstein L.P., FSI Group, LLC, and Piedmont Investment Advisors, LLC as financial agents to provide asset management services for the portfolio of equity securities, warrants and senior subordinated securities issued to the Treasury by financial institutions.</p> <p>AllianceBernstein is a leading global investment management firm that offers high-quality research and diversified investment services to institutional clients, individuals and private clients in major markets around the world. The firm, headquartered in New York City, employs more than 500 investment professionals with expertise in growth equities, value equities, fixed income securities, blend strategies and alternative investments.</p> <p>FSI Group LLC operates a multi-strategy investment platform focused on opportunities in the financial services sector. The firm, based in Cincinnati, specializes in financing and investing in banks, thrifts, insurance companies, REITs, real estate operating companies and other financial services firms.</p> <p>Piedmont Investment Advisors is a professional money management firm specializing in core equity and fixed-income management. The firm was founded in August 2000 and is based in Durham, North Carolina.</p> <p>The three asset management firms discussed above are collectively assigned to manage the assets issued to the Treasury under the CIP, with participating financial institution assigned a single lead asset manager that is the Treasury's primary representative with that institution.</p> | <p>Section 4: "TARP Operations and Administration"</p> <p>Appendix C: "Reporting Requirements" of SIGTARP's April 21, 2009 Quarterly Report to Congress</p> |
| 6<br>Section 121(c)(F) | A current estimate of the total amount of troubled assets purchased pursuant to any program established under section 101, the amount of troubled assets on the books of the Treasury, the amount of troubled assets sold, and the profit and loss incurred on each sale or disposition of each such troubled asset. | This information is contained in our transactions reports, which are posted on Treasury's website at <a href="http://www.financialstability.gov/latest/reportsanddocs.html">http://www.financialstability.gov/latest/reportsanddocs.html</a> . The most recent TARP transactions report (as of June 30, 2009) [was provided to SIGTARP]. The transactions report captures the total obligation under each TARP program.   | <p>Obligations by Program provided in Table C.1 below</p> <p>Section 2: "TARP Overview"</p> <p>Appendix D: "Transaction Detail"</p>                         |
| 7<br>Section 121(c)(G) | A listing of the insurance contracts issued under section 102.   | On January 16, 2009, TARP closed on the guarantee transaction with Citigroup, as announced in a joint statement by the Treasury, Federal Reserve and FDIC on November 23, 2008. No other insurance contracts have been issued as of June 30, 2009.  | Section 2: "TARP Overview"  |

| # | EESA Section   | EESA Reporting Requirement  | Treasury Response to SIGTARP Data Call   | SIGTARP Report Section  |
|---|----------------|---|--|---|
| 8 | Section 121(f) | A detailed statement of all purchases, obligations, expenditures, and revenues associated with any program established by the Secretary of the Treasury under sections 101 and 102. | The extent of Treasury's appropriation for TARP is described in section 118 of EESA. Treasury's authority to purchase troubled assets is described in section 115 of EESA. The amount of troubled assets purchased, by institution and in the aggregate, is listed on Treasury's transaction reports, which are published on Treasury's website. Treasury also reports the appropriated amount of TARP funds by program category in the FSP Budget report provided (to SIGTARP). | Obligations by Program provided in Table C.1 below<br><br>Section 2: "TARP Overview"<br><br>Section 4: "TARP Operations and Administration"<br><br>Appendix D: "Transaction Detail" |

Note: TARP participation in TALF has increased to \$80 billion according to Treasury Office of Financial Stability, Chief of Compliance and CFO, SIGTARP interview, 3/30/2009.

Sources: Program descriptions: Treasury, "Programs" webpage, 5/7/2009 ("Updated" date), <http://www.financialstability.gov/sof/robustability/programs.htm>, accessed 6/30/2009; ASSP: "Treasury Announces Auto Suppliers Support Program," 3/19/2009, [http://www.financialstability.gov/last/autos\\_L8.html](http://www.financialstability.gov/last/autos_L8.html), accessed 6/30/2009; AWCIP: "Obama Administration's New Warrantee Commitment Program," no date, <http://www.financialstability.gov/obcs/WarranteeCommitmentProgram.pdf>, accessed 6/30/2009; TALF: Federal Reserve, "Term Asset-Backed Securities Loan Facility (TALF) Frequently Asked Questions," no date, <http://www.federalreserve.gov/newsevents/press/monetary/monetary20090303a.pdf>, accessed 6/30/2009; Treasury, responses to SIGTARP data call, 6/30/2009 and 7/8/2009.

TABLE C.1

| TOTAL AMOUNT OF TROUBLED ASSETS PURCHASED AND HELD ON TREASURY'S BOOKS, AS OF 6/30/2009 (S BILLIONS) |                          |                       |                                  |
|--|--------------------------|-----------------------|----------------------------------|
|  | Obligations <sup>a</sup> | Expended <sup>b</sup> | On Treasury's Books <sup>c</sup> |
| Capital Purchase Program ("CPP")   | \$203.2                  | \$203.2               | \$203.2                          |
| Systemically Significant Failing Institutions ("SSFI")   | 69.8                     | 41.2                  | 41.2                             |
| Targeted Investment Program ("TIP")  | 40.0                     | 40.0                  | 40.0                             |
| Automotive Industry Financing Program ("AIFP") <sup>d</sup>  | 85.0                     | 54.3                  | 54.3                             |
| Asset Guarantee Program ("AGP") <sup>e</sup>   | 5.0                      | —                     | —                                |
| Term Asset-Backed Securities Loan Facility ("TALF") <sup>f</sup>                                     | 20.0                     | 0.1                   | 0.1                              |
| Making Homes Affordable (MHA)  | 18.0                     | —                     | —                                |
| <b>Total</b>   | <b>\$441.0</b>           | <b>\$338.7</b>        | <b>\$338.7</b>                   |

## Notes:

Numbers affected by rounding.

<sup>a</sup> According to Treasury, "From a budgetary perspective, what Treasury has committed to spend (e.g., signed agreements with TARP recipients)." Based on "Face Value Obligations" from Treasury source document (TARP/Financial Stability Plan Tracking Report).

<sup>b</sup> According to Treasury, "Represents TARP cash that has left the Treasury." Based on "Face Value Disbursed/Outlays" from Treasury source document (TARP/Financial Stability Plan Tracking Report).

<sup>c</sup> According to Treasury, "All assets are currently carried at par value."

<sup>d</sup> According to Treasury, "The face value obligations exceed the expected program usage amount for the AIFP because the final amount expected to be spent out of the Chrysler DIP and Ext financing is expected to be lower than originally obligated."

<sup>e</sup> According to Treasury, "Reflects negative subsidy of \$750 million off of the total \$201 billion Citigroup guarantee, not just the \$9 billion portion guaranteed by Treasury via the TARP (breakdown of \$301B: \$58 from the USF, \$40B from Cit, \$38 from the FDIC, and \$251B from the Federal Reserve)."

<sup>f</sup> According to Treasury, "Term Asset-Backed Securities Loan Facility (TALF-I): Up to \$20B may be disbursed as credit protection for the \$200B Federal Reserve Loan Facility. TARP is temporarily carrying this at a 100 percent subsidy. Initial funding of \$100M on 3/25/09."

Source: Treasury, response to SIGTARP data call, 7/8/2009.









































## CORRESPONDENCE REGARDING SIGTARP RECOMMENDATIONS

This appendix provides copies of the following correspondence:

| CORRESPONDENCE |                 |          |   |
|----------------|-----------------|----------|---|
| Date           | From            | To       | Regarding   |
| 5/5/2009       | Federal Reserve | SIGTARP  | TALF Fraud Mitigation Factors   |
| 5/22/2009      | Federal Reserve | SIGTARP  | TALF Fraud Mitigation Factors   |
| 6/10/2009      | SIGTARP         | Treasury | PIP Recommendations   |
| 6/19/2009      | SIGTARP         | Treasury | PIP Recommendations   |
| 7/2/2009       | Treasury        | SIGTARP  | Response to SIGTARP's 6/10/2009 and 6/19/2009 PIP Recommendations         |
| 7/2/2009       | Treasury        | SIGTARP  | Response to recommendations contained in SIGTARP's April Quarterly Report |
| 7/15/2009      | Treasury        | SIGTARP  | Additional response to SIGTARP recommendations                            |

2

If you have questions about any aspect of the TALF program, please do not hesitate to contact me. We would also be happy to meet with you again to provide you with an update on the program.

Sincerely,

William R. Nelson  
Associate Director



BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON, DC 20540

May 5, 2009

Mr. Neil M. Barofsky, Special Inspector General  
Office of the Special Inspector General for the Troubled Asset Relief Program  
1000 Pennsylvania Avenue, N.W., Suite 1044  
Washington, DC 20520

Dear Mr. Barofsky,

On May 4, 2009 the Federal Reserve and the Department of the Treasury announced an expansion of TALF to fund newly issued commercial mortgage-backed securities (CMBS) and insurance premium finance asset-backed securities (AFBS). The facility will also offer loans with five-year maturities. To mitigate the risk to the U.S. taxpayer, as in existing TALF programs, the Federal Reserve will lend only against AAA-rated tranches of new securitizations and only to borrowers with a strong financial position. The program also includes additional measures to protect an economic stake in the transaction. The program also includes additional measures to protect against fraud and other risks. In particular:

- Haircuts for TALF loans collateralized by CMBS are 15 percent or greater, substantially more than those for the most tranches currently accepted in TALF.
- The underlying loans backing the CMBS are required to be first liens with documented rent paid on current leases, a requirement that should mitigate the potential for fraudulent claims about the income-producing potential of a given property.
- Some of the interest on collateral financed with a five-year loan will be diverted toward accelerated repayment of the loan, with significantly greater amounts diverted in the fourth and fifth years, effectively increasing the haircut over time and ensuring that investors have an economic interest in the repayment of the principal on the TALF loan.
- The program will fund only CMBS tranches that are not subordinated to any other claims on the pool.
- CMBS pledged to the facility will be reviewed by a collateral gatekeeper before it is accepted.

2

- The Federal Reserve Bank of New York (FRBNY) will engage a **collateral monitor** to assess the eligibility of collateral. The Federal Reserve will provide the collateral monitor with a set of rules to screen the collateral for eligibility prior to the provision of TALF financing. Those rules will exclude any CMBS with underlying loans that are not performing satisfactorily or that otherwise poses unacceptable risk. In addition, the collateral monitor will estimate the value of collateral under adverse economic conditions, and the FRBNY will not make a loan that exceeds the stressed valuation.
  - As with previous asset classes, **conservative haircuts** have been set to address the risk that the collateral will decline in value and ensure that investors have an equity stake in the transaction. Further, the haircuts are based on a percentage of par, but applied on a dollar basis to market prices. This results in larger haircuts as a *percentage of purchase price* for assets that are bought at steeper discounts relative to par, tending to increase the Federal Reserve's protection for what may be riskier collateral.
  - Some of the interest on collateral items specified limits will be diverted toward **interest and repayments** of the loan. The Federal Reserve will also require the borrower to have a strong incentive for accurate diligence, and reduce the likelihood that the borrower will elect not to repay the loan.
  - Investors will be required to provide **arms length transaction** certifications in association with any legacy CMBS purchase financed by TALF credit. Such certifications will prohibit transactions with affiliates, enhance price discovery, and reduce the likelihood of collusive behavior. The custodian and the collateral monitor will check the reasonableness of the transaction price.
  - As with other eligible asset classes, **due diligence and the determination of borrower eligibility** will continue to be performed by the primary dealers in their role as TALF agents.
- In addition to these CMBS-specific measures, the Federal Reserve continues to strengthen its risk management of the TALF and to making a significant investment in measures to protect the program from fraud.
- The FRBNY has engaged a nationally recognized law firm to conduct a **comprehensive assessment of fraud risk** for the TALF program. This assessment will include a review of fraud cases and investigations, consultations with a wide range of relevant law enforcement, government agencies, academics, law firms and public and private investors, and recommendations regarding additional measures, strategies, or controls to reduce the potential fraud risk associated with the program.



BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON, D.C. 20540

May 22, 2009

Mr. Neil M. Barofsky, Special Inspector General  
Office of the Special Inspector General for the  
Troubled Asset Relief Program  
1301 Pennsylvania Avenue, NW, Suite 1064  
Washington, DC 20220

Dear Mr. Barofsky:

As you know, on Tuesday, May 19, the Board of Governors approved the expansion of the Term Asset-Backed Securities Loan Facility (TALF) to include AAA-rated legacy commercial mortgage-backed securities (CMBS). Inclusion of this asset class is intended to promote the program's overall goal to increase credit availability and support economic activity, in part by facilitating renewed liquidity and issuance of consumer and business asset-backed securities and CDOs. Approximately 20 percent of outstanding commercial mortgages are financed through CMBS.

Only fixed-rate CMBS paying both principal and interest that is senior to all other tranches in a given pool will be accepted. This includes AAA CMBS issued prior to 2005 and senior AAA CMBS issued in or after 2006 when the market practice of sub-tranching AAA CMBS into multiple classes is discontinued. Moreover, the program will include measures to protect against losses. In addition to the existing TALF risk management and compliance measures, the Federal Reserve has included and continues to develop a number of provisions for the legacy CMBS program that will help protect the government against loss or fraud:

- Eligible CMBS must have a current rating in the **highest long-term investment grade** rating category from at least two rating agencies that are eligible to rate TALF CMBS and must be in the highest long-term investment grade rating from any TALF CMBS-eligible rating agency.



**OFFICE OF THE SPECIAL INSPECTOR GENERAL  
FOR THE TROUBLED ASSET RELIEF PROGRAM**

180 L Street, NW, 8<sup>th</sup> Floor  
Washington, D.C. 20520

June 10, 2009

Diane Morse  
Chief Risk and Compliance Officer  
Office of Financial Stability  
United States Department of the Treasury  
180 L Street, NW  
Washington, D.C. 20220

Herbert Allison  
Deputy Secretary  
United States Department of the Treasury  
Main Treasury Building  
1500 Pennsylvania Avenue, NW  
Washington, D.C. 20220

Re: Additional SIGTARP PPIP Recommendations

Dear Messrs. Allison and Morse:

As you know, the Office of the Special Inspector General for the Troubled Asset Relief Program ("SIGTARP") made a number of recommendations regarding the Public-Private Investment Program ("PPIP") in our Quarterly Report dated April 21, 2009 (the "Report"). Over recent weeks, we have appreciated the opportunity to meet with you and other officials from the Office of Financial Stability ("OFS") to discuss the evolution of the program, and in this letter we memorialize and describe in greater detail several of the recommendations that we have made over the course of these meetings. These recommendations, of course, are not intended to replace those found in the Report; rather, they are refinements or additional considerations that should be taken into account as the fund managers are selected and final terms are developed.

**Registration of Fund Managers**

As an initial matter, prior to being accepted as fund managers for a Public-Private Investment Fund ("PPIF"), each manager should be required to become (if they are not already) registered Investment Advisors with the Securities and Exchange Commission and thus subject to the Investment Advisors Act of 1940 (the "Advisors Act"). The Advisors Act identifies Investment Advisors as fiduciaries and subjects them to certain antifraud provisions as well as rules regarding record keeping, contracts, advertising, custody of client funds and assets, disclosure, and transparency, among others. These minimum protections are set forth in an ongoing series of regulatory frameworks already applicable to fund managers in many contexts; the Advisors Act merely consolidates these rules and provides for the uniformity of the advice of which must be registered.

- The FRBNY is establishing an **inspection program** in order to ensure that the primary dealers are faithfully carrying out their responsibilities under TALF.

We remain committed to a strong program of risk management and compliance for the TALF that helps protect the Federal Reserve and the U.S. taxpayer. We look forward to discussing these efforts with you.

Sincerely,

William R. Nelson  
Associate Director

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be himself is managing other funds so that the management firm could buy the same or related securities before the run up of the price that will result from the existing PPIF purchases. Similarly, such information could be used to unload securities in other parts of the firm in advance of sales within the PPIF of a given security. Of course, the value of this information, if truly available, would not necessarily be limited to transactions made by the PPIF Firm, but could be shared with other firms or PPIFs on a *quid pro quo* basis.

Simply put, absent a wall, it is likely that advance information about buy and sell decisions could readily be used for the benefit of the other funds managed by the PPIF manager at the expense of the general market and, eventually, of the PPIF itself. While a wall, standing alone, will not necessarily put a halt to such behavior, based on our own analysis, our consultations with others (including the FRBNY), and as was made apparent by the comments of FRBNY at the June 3, 2009, meeting, we believe that such a wall is essential to protect against these and the other dangers identified in our Report. The mechanisms and details of the wall, including mandatory cooling off periods and periodic review by Treasury, should be at least as stringent as those provisions imposed by FRBNY.

One of the arguments repeatedly advanced by Treasury in opposition to a wall is that the firms would not risk harming their client investors or their reputations by making decisions contrary to the interests of the PPIF. Unfortunately, we believe these observations do not reflect the realities of the marketplace. As we have noted in our meetings, similar comments were made regarding such formerly highly regarded firms as Citicorp, WorldCom, and Relco, to name a few. Further, such comments do not reflect that an investor's satisfaction with a firm is not limited to its performance in one particular fund: even if a PPIF is not profitable, an investor would likely be satisfied if the manager of that fund makes a significant profit (such as in circumstances where other funds that the manager manages are profitable) or if the manager is able to successfully hedge against the problems in the PPIF across all of their investments with that manager.

While we understand that the imposition of a strict wall may result in increased expenses and fees, may dissuade some of the more than 100 fund manager applicants from participating in the PPIF program, and may also result in making some personnel at the firms not available to the program, we believe that, in light of the announced structure of the program, those risks and expenses would be worth it to protect the interests of both the taxpayer and the market generally.

#### Other Conflict Rules

In any event, Treasury should also require certain conflict mitigation policies and procedures. For example, Treasury should require each PPIF manager to disclose to the investors of the PPIF, including a detailed listing of all the ways in which its financial interest and those of its clients, are likely to be affected by the PPIF, (b) present a policy acceptable to Treasury with respect to

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#### Conflicts of Interest – Implementation of a “Wall”

When we made our initial recommendations, we had assumed that Treasury would follow, at a minimum, the conflict of interest provisions instituted by the Federal Reserve Bank of New York (“FRBNY”) with respect to asset managers it retained in several of its programs, including its Agency Mortgage-Backed Security Purchase Program. Its management of the assets required or managed as part of the bailout purchases of American International Group and Bear Stearns as its Commercial Paper Funding Facility. As you know, these programs involve many of the same risks and conflicts of interest that we have identified. FRBNY has instituted an aggressive, albeit not perfect, conflict plan that includes the following: (1) managers who work on FRBNY projects from the rest of their firms; (2) FRBNY has, in the context of programs that are, in our view, not as inherently fraught with conflicts issues, that requiring a strict wall is possible. Comparing the conflicts regime implemented by FRBNY to that being contemplated by Treasury for use with PPIF fund managers seems particularly apt in light of the fact that there appears to be some commonality between the FRBNY vendors and the fund managers under consideration for the PPIF program.

In our discussions with OIG, however, it has become apparent that Treasury’s inclination is not to require such a wall between those managing the PPIF and the rest of their firms. Because we felt that requiring such a wall was the only measure that could adequately address the innumerable conflicts and disillusion dangers inherent in the design of the PPIF program, we encouraged OIG to meet with FRBNY officials to discuss the mechanics and economic feasibility of mandating such a wall. On June 3, 2009, such a meeting occurred and was attended by representatives of OIG, SIGTARP and FRBNY. We believe that this meeting only further demonstrated the vital importance of requiring such a wall in the PPIF program.

In our view, the need for a wall in the PPIF program is made necessary by, among other things, the very design and purpose of the program, which gives the fund manager an unprecedented ability to set prices for illiquid mortgage-backed securities (“MBS”). As has been noted repeatedly, one of the purposes of the PPIF program is to increase the prices in the “frozen” MBS markets by bringing additional liquidity to those markets. In light of the anticipated size of the PPIFs, the dollar-for-dollar equity matching, and the leverage on top of the equity, a PPIF manager’s buy and sell decisions will likely have a dramatic impact on the market price of the securities involved. As we detailed in our Report, this creates an incentive for a PPIF manager to overpay for a given security in order to otherwise benefit his company by raising the price of any such security or related securities already in that firm’s portfolio. A wall would not only mitigate that danger (because the fund manager would be walled off from knowing the trading activity or holdings elsewhere in the firm), but would also limit the dangers of “front-running” or insider trading. This danger, initially raised by SIGTARP and then independently raised by FRBNY in the June 3, 2009, meeting, would result from the fund manager sharing its buy decision with other fund managers (or even without the need to share if

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any findings on the part of PPF managers to satisfy their contractual terms or with managers who are performing poorly.

**PPP and TALE**

Finally, while we appreciate the briefing that OES provided regarding Treasury's initial thoughts regarding the interaction between PPP and TALE, until the above issues concerning the PPP are resolved, it is difficult for us to evaluate the other factors outlined in our meeting. It is hard to say that the increased leverage provided by the TALE will only increase the already significant power of the PPF manager to set prices. We cannot duly assess the vulnerabilities of the investment portfolio without first knowing whether the PPF manager will be walled off from the rest of the firm's business.

Very truly yours,  
  
NEIL M. BAROFSKY  
Special Inspector General

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conflicts of interest that includes rules on who within the firm shall have access to PPF information, including any and all assets in the same or similar assets with the allocated among the PPF and the other funds under the same management. Once the policies have been implemented and controls are in place to ensure their compliance, the program begins. Treasury should establish a compliance protocol within OES to police these conflicts mitigation issues.

Additionally, Treasury should collect information, not for public disclosure, from every PPF manager on holdings, valuation and transactions in the same or similar assets in their other funds and retain a third-party to review that data to screen for conflicts and collusive conduct. By compiling all activity in the PPPs with all of the various managers' activity in the same or similar assets, Treasury can identify and detect the effects of problematic conditions and/or collusive behavior. Treasury should also require that Treasury, SIGTARP and other pertinent oversight bodies have access to all of the fund manager's books, records and relevant personnel. The agreements should also require that such reports from the fund managers be certified by a senior executive and provide for strict penalty provisions should the fund manager violate the conflict of interest provisions.

**Disclosure**

As previously stated, it is SIGTARP's recommendation that, subject to reasonable protections of a manager's strategy (such as a reasonable delay in reporting if necessary), all transactions in the PPF itself should be disclosed to SIGTARP for inclusion in our quarterly reports. Such reporting should be certified and provided to SIGTARP within seven calendar days of the end of the Quarter.

**Other Provisions**

SIGTARP also reiterates its recommendations that Treasury: 1) prohibit the fund manager from engaging in marketing related to Treasury's relationship to the manager (other than with respect to marketing the PPF itself, which should also be carefully limited); 2) require so-called "key man" provisions mandating that the PPF obtain the services of the personnel who were present during the application process; 3) institute a comprehensive ban on all insider access to PPF information with provisions that are as strict as those established by the FDNY in its programs; and 4) require the recording of all telephone calls of the PPF fund manager and employees.

We also think it essential that appropriate metrics be defined and an evaluation system be in place to monitor the effectiveness of the PPF managers, both to ensure that they are fulfilling the terms of their agreements and to measure their performance against pre-established benchmarks that are fair and reasonable. To that end, there must be mechanisms in place to deal with

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7. or accepting commitments in any vehicle dealing in any Eligible Assets without USI's written consent. Further, as currently written, the exception permitting actions that require USI's written consent to make investments to maintain diversification in non PPPF fund could swallow the rule.
  8. Restrictions on Hedging, Proxies, Resolutions, or Certain Transactions and Restrictions on Affiliates. You should consider prohibiting all of these.
  9. Allocation of Business Time. Consistent with the comments above, those making investment decisions for the PPPF should be exclusive to the PPPF.
  10. Removal of the General Partner. Treasury should have greater removal rights. Standardized language for both for cause and without cause terminations should be used. For cause should be at the initial stages of adverse proceedings (such as bankruptcy proceedings) and without cause should be at the time a manager or a key person. It should be in USI's discretion at that point to terminate.
  11. Reports and Financial Information. Monthly reports should be delivered within 7 business days of the end of the month. Quarterly reports should be delivered within 7 SIGTARP's quarterly report. As we have explained, it will be responsible for us to meet our reporting obligations under the current proposed schedule. As noted above, items on Eligible Assets should include Date, CUSIP, positions, size, pricing, and other information. The information should be provided to USI in a format that Treasury so that it can be analyzed. The document retention policy should be "acceptable" to Treasury.
  12. Notice. Although this is not a section, standard notice provisions should apply. At a minimum, Treasury should receive notice of the commencement of any action (regulatory, criminal, civil or otherwise), and any material event of default occurring against the manager.
- As to the PPPF Ethical Standards and Conflict of Interest Rules we have the following observations:
1. Please include SIGTARP anywhere that USI has a disclosure or review right. For example, while SIGTARP has access to the fund's books and records, under the document, only USI has access to key persons and other personnel.
  2. Standards and Penalties. Treasury should have the ability to change behavior and alter unwritten action. There should be strict penalty provisions, including termination, for violations of the terms and conditions, beyond merely requiring the fund to undo the bad act.
  3. Proprietary Interest and Interests for Other Clients. All interest in any vehicle should be disclosed as to all changes in those interests. USI and SIGTARP should have access to all information for all managers about assets in funds.

OFFICE OF THE SPECIAL INSPECTOR GENERAL  
FOR THE SECURITIES AND EXCHANGE PROGRAM  
1801 L STREET, NW, 8TH FLOOR  
WASHINGTON, D.C. 20520

June 19, 2009

Herbert Allison  
Counselor to the Secretary  
United States Department of the Treasury  
1500 Pennsylvania Avenue, NW  
Washington, D.C. 20229

Duane Morse  
Chief Risk and Compliance Officer  
Office of Financial Stability  
1801 L Street, NW  
Washington, D.C. 20229

Re: Additional SIGTARP PPPF Recommendations

Dear Messrs. Allison and Morse:

As requested, I have included below some of the suggestions and recommendations that my office has provided Treasury with regard to the Legacy Securities Public Private Investment Program ("PPP"). As with our June 10, 2009, letter to you, the comments herein are intended to supplement, and not replace, our earlier recommendations.

As to the proposed Equity Term Sheet, we appreciate that you have accepted our previous recommendations that all Managers will be required to register with the SEC as investment advisers and that the fund will be required to register with the SEC as an investment adviser. We also appreciate that you have agreed to limit the fund's investment rights as written, consistent with the kind distribution pro rate and requiring an annual budget for Partnership. However, we have the remaining suggestions:

1. Consistent with the USI has consent rights, the standard for vehicles being consent should be "for any reason or no reason" or "in the sole and absolute discretion" instead of the lower standard of "reasonable."
2. Conversely, all fees and distributions should be, at a minimum, "reasonable."
3. Participation in the Ethical Activities. This section should delete the following language, "but would adversely affect USI, the Partnership or the Partnership's ability to carry out its business," through the end of that sentence, "which notice will be accompanied..." through the end of that sentence.
4. Distribution. In the "Proxies" paragraph, if any payments are made to the fund for the 12 months ending 12/31/08, it should be pro rata to annual tax payments made since USI is a non-taxed entity.
5. Penalties and Standards. There should be explicit and reasonable. The reasonableness standard should be determined by the proposed annual budget.
6. Exclusivity. As drafted, there is little exclusivity. Without a work, written consent from the fund, the fund should be prohibited from making investments in other funds managed, and there should be a blanket prohibition against forming, advising on



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4. **Allocation & Valuation/Driving Policy:** All Qualified Fund Managers ("QFM") should submit an allocation and pricing policy for approval. All vehicles should be reported immediately to UST and SIGTARP.
5. **Collateralizing:** Complete prohibition of firm management or staff investing personally in the PPF in any way.
6. **Record Access:** We repeat the overarching need that anytime UST receives access, so should SIGTARP.
7. **Reviews:** This section should include UST and SIGTARP's ability to perform unannounced inspections and reviews of the PPF and have access to all information across all positions of the QFM regardless of vehicle.
8. **Eligible Asset Watch List:** This section should require that UST receive a monthly consolidated report from each of the QFMs across all funds for all eligible and like assets that includes: position, size, pricing, corp. relevant dates, and all other relevant information. This report will provide a consolidated view of all positions across all funds within the QFM's portfolio. As noted earlier, as part of Treasury's compliance, such data should be analyzed by Treasury or a third party.
9. **Disclosure of Conflicts:** In addition to providing quarterly compliance certification to UST, QFM's should provide immediate notification of non-compliance to UST and SIGTARP.
10. **Disclosure of Beneficial Ownership:** UST and SIGTARP need a complete "look through" to the beneficial owners. The PPF Fund Managers should disclose to UST all KYC/beneficial ownership information for every investor. Further, UST should have the ability to conduct due diligence on investors for any or no reason. These same requirements apply to the Investor Diligence section.
11. **Conflicts with Damaged Affiliates:** Should apply to all legal affiliates. UST should review all transactions between the PPF and affiliates. UST should have the ability to receive information from the buyer and seller of each security (which is required by the Federal Reserve in the TALF program). Non-compliant transactions identified and all information should be forwarded immediately to UST and SIGTARP.
12. **Conflicts with Phlegmat Agents and BD Relationships:** Non-compliant transactions should be identified and reported immediately to UST and SIGTARP. Fund Managers need to initiate best efforts remedial action and report steps taken to correct issue.
13. **Asset Custody, Flipping and Round-tripping:** Again, QFM's should submit policies and procedures to UST and UST should approve. Also, again, quarterly reporting and immediate notification and reporting to UST and SIGTARP of non-compliance should be required.

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14. **Use of Fund Manager Incentive/Retained Programs:** UST should have a unilateral right to reject.
  15. All QFM's should be required to refer immediately any instance or suspected instance of fraud, waste or abuse to SIGTARP, and to inform their employees of this requirement and provide them with SIGTARP's hotline information.
- Due to our limited amount of time to review each of the documents, and that we have not yet received amended versions of Schedule A's, we expect to have additional comments going forward.

To reiterate with respect to the broader issues, we continue to believe that the failure to demand that the PPF managers be subject to a strict ethical wall represents a material deficiency in the PPF program. This deficiency leaves the program materially vulnerable not only to the risk of fraud, waste or abuse, but also to the risk of reputational damage. The program, as currently structured, also creates an enormous reputational risk to Treasury and the TALF program. In its current format, the selected asset managers could profit, in their non-PPF funds, by the decisions that they make in the PPF program. This could result in the perception that the program is already built to fail. This could result in the perception that the program has been rigged to fail, leaving the program subject to criticism that it permits a few selected funds to profit unfairly at the expense of the PPF and the rest of the market. In particular, in light of the negative publicity surrounding them, the reputational damage of announcing that these very same corporations will be managing Government funds in the PPF Program, with significantly less stringent conflict of interest restrictions than those implemented by the Federal Reserve, could be significant. We believe that the program as currently structured could exist in a state of constant jeopardy, and that the program as currently structured could exist in a state of jeopardy that could be imposed that would address our concerns about a wall, the proposals that you have shared with us appear insufficient.

Similarly, we do not believe that proposed standards for the interaction between the PPF and TALF programs adequately address our previously expressed concerns regarding dilution of the "but for" and "skin in the game." We also continue to be concerned that the dangers presented by the failure to implement an ethical wall will only be exacerbated by increasing the PPF leverage through the TALF program.

With these warnings and recommendations in mind, we have and will continue to provide you with our thought regarding the various terms and conditions that you have shared with us. We believe that the program as currently structured could exist in a state of jeopardy that could be imposed that would address our concerns about a wall to the program.

Finally, as we noted, it is absolutely essential that Treasury establish a rigorous compliance regime to oversee the PPF Fund Managers. This program should include, among other things, specific terms and conditions that will enable those monitoring by dedicated Treasury staff to identify non-compliance, and to take appropriate remedial actions. We believe that the program as currently structured could exist in a state of jeopardy that could be imposed that would address our concerns about a wall, and remedies as necessary, including for poor or non-compliant performance.



DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

July 2, 2009

Nail M. Benofky  
Special Inspector General for the Troubled Asset Relief Program ("SIGTARP")  
1801 L Street, NW, 6<sup>th</sup> Floor  
Washington, DC 20220

Re: June 10, 2009 letter regarding Additional SIGTARP PPP Recommendations ("June 10 Letter"), and June 19, 2009 letter regarding Additional SIGTARP PPP Recommendations ("June 19 Letter").

Dear Mr. Benofky,

The U.S. Department of the Treasury ("Treasury" or "UST") welcomes the recommendations made by the Special Inspector General for the Troubled Asset Relief Program ("SIGTARP") made in the June 10 Letter and the June 19 Letter. Treasury's ability to achieve the objectives of the Legacy Securities Public Private Investment Program ("PPP") is enhanced by the role of the Special Inspector General for the Troubled Asset Relief Program ("SIGTARP") and has benefited from your involvement in the development of the PPP. The June 10 Letter and the June 19 Letter contain many good ideas and suggestions, and we have considered them carefully.

This letter addresses the recommendations set forth in your June 10 Letter and June 19 Letter. We first explain the process we followed in designing the PPP. We then respond to each of your recommendations and set forth Treasury's views on those recommendations. In most cases, Treasury agrees with the suggestions made. We have explained how Treasury has addressed the issues raised in the recommendations and discussed, where applicable, additional actions we are taking to address the issues. In some cases, Treasury believes that the specific recommendation would not help carry out Treasury's objectives under the Emergency Economic Stabilization Act of 2008 ("EESA"). Treasury outlines the reasons for not adopting certain of the recommendations in whole or in part and, in certain cases, the alternate ways available to address the underlying concern raised by the SIGTARP and the measures we are taking to address the concern. Treasury also discusses certain standards and Conflicts of Interest Rules Recommendations (the "Rules") with the Rules for U.S. Equity and Debt Investments in the S-PPP, all of which are referenced in this letter.

**How Treasury Developed Conflicts of Interest Rules for S-PPP**

Treasury's conflict of interest Rules are the product of a rigorous and thorough development process that included extensive interaction with the SIGTARP staff, as well as with prospective PPP fund managers and the compliance professionals at the Federal Reserve Bank of New York (FRBNY).

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As always, we are available to meet with you to discuss these issues more fully if that would be helpful to you.

Very truly yours,

Nail M. Benofky  
Special Inspector General

meeting was attended by QFS compliance and risk personnel along with the Acting Chief Investment Officer of QFS. A representative from the SIGTARP also attended these meetings.

- Treasury took into consideration information obtained from all of these discussions in developing the Rules. Throughout this process, Treasury communicated closely with the SIGTARP. Drafts of the terms sheets and Rules were shared and discussed with SIGTARP, and Treasury benefited from SIGTARP's involvement and suggestions.

This process resulted in the development of conflicts standards and procedures that we believe will ensure that the PPP can attract private capital and investment expertise to markets that have been substantially frozen for many months and protect taxpayers' interests and investments. Treasury discussed below. Treasury also received and incorporated comments and suggestions made by the SIGTARP. When we have declined to follow a recommendation, we have done so because we concluded, after full consideration and extensive discussions with your team and FRBNY staff, that it was incompatible with the goals of the S-PPP and would not help carry out Treasury's statutory duties under the PESA. Our reasons for these decisions are explained fully below.

#### Responses to Recommendations in the June 10 Letter

##### 1. Registration of Fund Managers, Conflicts of Interest – Implementation of a "Wall", Other Conflict Rules

Treasury agrees with SIGTARP on the importance of strict conflict of interest rules and protections in the PPP and has worked closely with the SIGTARP on the development of these rules from the outset of the process. Treasury's goal was to ensure that the Rules are on the one hand, as strict as possible to protect the public interest, and on the other hand, as flexible as possible to allow for a range of circumstances. Treasury's conflict of interest rules and ethical guidelines are the product of a rigorous and thorough development process that included extensive interaction with the SIGTARP staff, as well as with prospective PPP fund managers and the compliance professionals at the FRBNY.

This process resulted in the development of conflicts standards and procedures that we believe will ensure that the PPP can attract private capital and investment expertise to markets that have been substantially frozen for many months and protect taxpayers' interests at the same time. We also believe these standards and procedures incorporate all of the SIGTARP's suggestions. All of the standards and procedures incorporated in these standards and procedures – known as the Rules. These measures include, but are not limited to:

- Adoption of the following policies and associated compliance procedures which must be approved by Treasury and any identified violations reported to Treasury and SIGTARP:
  - Allocation & Valuation/Pricing Policy which must comply with the Investment Advisers Act of 1940, as amended, in all material respects;
  - "Arm's Length" Transaction Policy;

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It may be helpful to summarize the process Treasury followed to investigate and mitigate actual and potential conflicts of interest that could affect a Public-Private Investment Fund ("PPP"). This process was conducted in connection with the evaluation of PPP fund manager applicants. Treasury worked closely with the SIGTARP in this process, which included the following steps:

- Treasury required applicants to identify all conflicts of interest and how they would avoid or mitigate those conflicts in a publicly released application for prospective PPP fund managers;
- Treasury assessed each potential PPP fund manager's response for thoroughness (ensuring deficiencies and identified best practices with respect to governance and conflicts mitigation controls);
- For those applicants selected as finalists, Treasury developed extensive legal and compliance questions and conducted detailed questions regarding governance and conflicts of interest issues, including:
  - Internal audit methodology, accounting policies/procedures and internal controls;
  - Mechanisms in place to identify, track, eliminate, mitigate, and monitor organizational and personal conflicts of interest;
  - Policies and procedures regarding affiliates, "roundtripping," valuation, trade allocations and handling material non-public/sensitive information;
  - Responsibilities, authorities and independence of the Chief Compliance Officer; and
  - Other governance and management policies and procedures.
- Treasury evaluated each finalist's responses for thoroughness, feasibility and completeness and benchmarked these responses across several key compliance and conflicts-related metrics;
- Treasury then compiled subsequent legal, governance and conflicts of interest questions for each finalist, as necessary; and
- Treasury discussed several key questions with finalists during in-person presentations made to Treasury at Treasury's offices. A representative from SIGTARP was invited to attend and observe and was present at most of these meetings.

After completion of the evaluation process, Treasury held numerous discussions focused specifically on conflict of interest issues with representatives from potential PPP fund managers; the SIGTARP team; and FRBNY staff, including FRBNY's Chief Compliance Officer, several compliance and legal advisors, and other senior FRBNY individuals responsible for administering various governance-related portions of FRBNY's regulatory programs. As part of this process,

- Treasury also had a comprehensive, multi-hour, in-person discussion with FRBNY personnel at its New York headquarters to address conflicts and governance issues. The

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With respect to conflicts, with PPP Fund manager affiliates holding or servicing Eligible Assets, Treasury will require PPP Fund managers to:

- Not acquire Eligible Assets from or sell Eligible Assets to (i) its affiliates; (ii) any other PPP managed by a different PPP Fund manager (as defined in the definitive documentation); or (iii) any person that has invested 10% or more of the aggregate private capital raised by the PPF; and
- Ensure all PPP transactions must be at arm's length, commercially reasonable, and on terms no less favorable to the PPF than in transactions with unrelated parties.

With respect to conflicts with PPP Fund manager placement agents and broker-dealer relationships, Treasury will require that:

- A PPP may not execute trades through a broker-dealer affiliated with the PPP Fund manager; and
- PPP Fund managers may not have "pay-to-play" arrangements with placement agents, underwriters, and other service providers in which money or other forms of direct or indirect compensation are exchanged for services for the privilege to engage (i.e. play) in such activities.

With respect to potential conflicts of interest of PPP Fund manager employees, Treasury will require that:

- All PPP Fund manager key individuals must be subject to a Code of Ethics and associated Personal Trading Policy; and
- PPP Fund managers must maintain policies that cover handling of material non-public information, personal trading, outside business affiliations, and giving and accepting gifts and entertainment.

Treasury will also require that PPP Fund managers specify, on a quarterly basis, to Treasury, the names of their employees, and that they negotiate with Treasury in good faith over material proposed changes to their policies. Moreover, PPP Fund managers may be removed for material non-compliance with the Rules.

As noted, Treasury's policies and procedures incorporate (precisely) all of SIGTARP's recommendations. Treasury's Code of Ethics (that Treasury has declined to accept is because it is not sufficiently strict) and its Personal Trading Policy (that Treasury has declined to accept because it is not sufficiently strict) are examples of the policies that Treasury has developed to ensure that the team be walled off from other employees of the fund manager, a procedure that the FRBNY has required in certain of its programs. After careful review of this possibility, and extensive consultations with SIGTARP, the FRBNY and potential PPP Fund managers, as well as review of the use of information barriers or walls generally, Treasury decided not to impose such a requirement.

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- o Prohibition of use of Affiliated Broker-Dealer to execute transactions; and
  - o Code of Ethics and associated Personal Trading Policy.
- Investment of a minimum of \$20 million of the General Partner's own capital in the PPF;
- Establishment of "Watch Lists" and associated compliance procedures;
- Reporting to Treasury of any information in the PPP Fund manager's possession regarding the beneficial owners in equity of a PPP in their capacity as beneficial owners;
- Reporting to Treasury of 10 largest positions of the PPF within 15 days after the end of each calendar quarter (and public disclosure of such positions at such time as Treasury determines that such disclosure will not harm the ongoing operations of the PPF); and
- Retention of an independent annual internal controls and financial audit.

To address the proprietary interests and/or interests potential PPP Fund managers hold for other clients in Eligible Assets, Treasury will require PPP Fund managers to:

- Be SEC-registered as an Investment Adviser (all recommended pre-qualified PPP Fund managers are);
- Have a trade allocation policy approved by Treasury and report all positions in Eligible Assets (PPP, non-PPP funds) to Treasury on an ongoing basis;
- Require each PPP Fund manager to invest a minimum of \$20 million in the PPF; they manage and allow co-investment by PPP Fund manager staff and employees in the PPF they manage to better align incentives;
- Require a PPP Fund manager to demonstrate that its compensation system aligns the economic interests of Key Persons with the interests of investors in the PPF;
- Permit Treasury and SIGTARP to conduct annual and ad hoc audits of compliance with all policies;
- Maintain an independent Compliance Department that keeps an Eligible Assets Watch List that includes information on Eligible Assets held across all PPP Fund manager's funds, in addition to the PPF;
- Disclose to Treasury and SIGTARP actual and potential conflicts of interest; and
- Obtain a Type II SAS 70 report and ensure independent third-party verification of its valuations, returns calculations and internal controls.

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better protection for taxpayers without imposing the risks of requiring a segregated PPIF investment team.

Treasury is in the process of expanding this department in connection with the launch of the PPIF program. Treasury will devote whatever resources are necessary to ensure that the compliance and risk regime it has developed for PPIF is fully implemented. The program will be managed by Treasury employees but Treasury will also hire third party professional advisors, including advisors to monitor trading activity in legacy assets across each fund complex. Treasury staffing levels will be sufficient to oversee the independent compliance function within each PPIF as well as the ongoing independent audit function that is required to be performed on all PPIF fund investments. Treasury will also maintain regular dialogue with each PPIF fund manager's compliance department.

## 2. Public disclosure of all transactions in the PPIF

Treasury agrees with the need for transparency with respect to the management of PPIF's and has worked with the SIGTARP to ensure this. Treasury has sought to develop measures that achieve this goal while still ensuring that the program succeeds in attracting wide participation from private investors. Treasury will not require public disclosure of all transactions in the PPIF or in non-PPIF funds as this would harm to the fund's operations by revealing to competitors proprietary information regarding the fund's investment positions and strategy.

However, as required under Section 402 of the Helping Families Save Their Homes Act of 2009 ("Eniger"), each PPIF fund manager will be required to make a quarterly report to the public. Treasury will require that these reports be publicly disclosed at such time as Treasury determines that such disclosures will not harm the ongoing business operations of the PPIF. Treasury and SIGTARP will be able to review all trades in Eligible Assets by the PPIF and any other fund managed by the PPIF fund manager on a no less frequently than monthly basis and Treasury will ensure that they can provide daily access to this information should Treasury or SIGTARP require it).

## 3. Other Provisions

### A. Treasury should prohibit the fund manager from engaging in marketing related to Treasury's relationship to the manager.

PPIF fund managers will be prohibited from engaging in marketing related to USIT's relationship to the PPIF fund manager other than in respect to appropriate and customary disclosures related to marketing the PPIF itself.

### B. Treasury should require so-called "Key Man" provisions mandating that the manager obtain the services of the personnel who were promised during the application process.

Robust "Key Man" protections are something Treasury intends to require from investment managers. During the ongoing due diligence, USIT has met with the key investment professionals who will be responsible for managing each PPIF. For each

• The Rules require each PPIF fund manager to adopt and follow a fair and equitable trade allocation policy. Treasury will approve that policy and Treasury and the oversight bodies will be able to review compliance with that policy.

• The PPIF team already has Treasury and SIGTARP access to data outside of the books and records of the PPIF. Treasury and SIGTARP will be able to review all trades in Eligible Assets by the PPIF and any other fund managed by the PPIF manager no less frequently than on a monthly basis (although some fund managers may be able to provide more frequent data). Treasury will also monitor and audit Treasury or SIGTARP require it). This allows monitoring and auditing of all funds managed by the PPIF fund manager's firm that trade in Eligible Assets and allows Treasury and SIGTARP to see the flow of Eligible Assets throughout the firm. Treasury will be able to review the data and will be able to determine whether the PPIF fund manager is purposely disavow/ing the PPIF relative to non-PPIF funds.

• The PPIF team already explicitly prohibit a PPIF fund manager from trading with affiliate funds.

• Treasury will have the unilateral right to remove the PPIF fund manager for cause and has certain rights to remove the PPIF fund manager without cause with the consent of 2/3 of the private investors.

• PPIF fund managers have internal/external audit and corporate governance processes. The PPIF fund managers have impressive track records and reputations for high ethical standards and compliance. Each maintains internal and external auditors and corporate governance processes.

o While "walling off" investment professionals could further limit the risk that bad actors could inappropriately influence trading, Treasury will not require that all trading be done by individuals who are not individuals determined to do so. Only through the development of a fair trade allocation policy and robust reporting/monitoring of the PPIF fund manager's compliance regime can we protect the interests of taxpayers. Specifically, Treasury believes the best course of action is to require that PPIF fund managers be required to report and analyze actual trading data on a frequent basis.

In summary, Treasury believes the rules and procedures outlined above constitute a comprehensive and robust regime for managing the PPIF and provide sufficient safeguards to protect the interests of taxpayers. These rules and procedures will further the purposes of the PPIF and provide

different levels of the capital structure, etc.), it is difficult to compare PPIF fund managers' returns directly.

- **Adherence to compliance regime.** Metrics are expected to include timeliness of delivery of reports and compliance with the Rules, etc.

Treasury has the ability to end the investment period after 12 months in its sole discretion, and to the extent a certain PPIF fund manager is underperforming, UST and the private investors will have the ability to replace the General Partner of the PPIF fund. The Rules should be amended to include as Events of Default the following Causes in the Partnership Agreements governing each PPIF:

**Response to June 19 Letter**

**Equity Term Sheet Recommendations**

1. **"Generally, where the UST has consent rights, the standard for withholding consent should be 'for any reason or no reason' or 'in the sole and absolute discretion' instead of the lower standard of 'reasonable'."**

The S-PPIF contemplates a partnership with private investors; PPIFS are not formed or controlled by Treasury. Treasury believes that the consent rights contained in the term sheets strike the appropriate balance between adequately protecting the taxpayers' interests and the private investors' interests. Treasury believes that the consent rights are necessary in only two circumstances in the equity term sheet where Treasury's consent is subjected to a reasonableness standard.

First, Treasury may not unreasonably withhold its consent to the approval of the offering memorandum and the related documents. Treasury will review these materials, but expects that these agreements will not impact Treasury (the terms of Treasury's investment will be separately documented) and taxpayers, and that the ability to reasonably object to them provides sufficient protection.

Second, Treasury may not unreasonably withhold its consent to the approval of additional indebtedness to be incurred by the PPIFs. Treasury believes that its debt term sheet already adequately protects the taxpayers' interest on this point because: (i) any additional indebtedness is subject to an Asset Coverage Test, which ensures that the loans are secured by the PPIF's assets; (ii) the maximum amount of debt is limited to the amount of the debt does not get too large; and (iii) the criteria of Treasury's debt is to protect the "favored nation" status and will be based on the weighted average applicable margin applicable to all third-party debt held by a particular PPIF.

2. **Conversely, all fees and distributions should be, at minimum, "reasonable."**
- Treasury agrees with SIGTARP that PPIF expenses borne by private investors and Treasury should be "reasonable" in nature. The equity term sheet was drafted to reflect this standard:

PPIF. Treasury has included "Key Man" provisions that are designed to protect taxpayers' interests by requiring these critical investment professionals to be involved with the PPIF. These provisions were custom tailored with respect to each PPIF fund manager taking into consideration the specific individuals that UST expects to be involved.

- C. **Treasury should institute a comprehensive ban on all insider, cross, or affiliated transactions with provisions at least as strict as those required by the FRENBY in its programs.**

In the Rules, insider, cross and affiliated transactions are prohibited. Throughout the S-PPIF process, Treasury has engaged numerous stakeholders in determining best practices to employ for the Rules, including FRENBY professionals.

- D. **Treasury should require the recording of all telephone calls of the PPIF fund manager and employees.**

Treasury evaluated this issue carefully and determined that the considerable cost and efforts of requiring all telephone calls of the PPIF fund manager to be recorded is not justified by the minimal benefit that this might garner in discouraging a few potential bad actors from sharing material non-public information. The pervasive use of cell-phones and inability to monitor all activities of bad actors would render this practice ineffective. Treasury believes that the best way to ensure that the information is better mitigated by careful screening of PPIF fund manager employees, applying a personal code of ethics to each PPIF fund manager employee, which Treasury requires in its Rules and applying the Rules, generally to review PPIF and non-PPIF transactions to make sure that the fair trade allocation policy is being followed.

- E. **"It is essential that appropriate metrics be defined and an evaluation system be in place to monitor the effectiveness of the PPIF managers, both to ensure that they are fulfilling the terms of their agreements and to measure their performance against pre-established benchmarks and against each other. To the extent that Treasury has any concerns with the current equity findings on the part of PPIF managers to satisfy their contractual term or with managers who are performing poorly."**

Treasury is in the process of developing appropriate metrics to measure the effectiveness of the PPIF fund managers as well as the S-PPIF in general. Performance metrics will be evaluated across three principal areas:

- **Effectiveness of achieving policy goals for programs for Leverage Assets**— Metrics to measure price discovery and restoring the markets for Eligible Assets are expected to include trading volume, bid-ask spreads and pricing for Eligible Assets.
- **Financial performance of a PPIF**— Metrics are expected to include PPIF returns relative to appropriate benchmarks. Given the heterogeneous pool of pre-qualified PPIF fund managers (e.g. CMBS vs. RMBS, participation in



Treasury does not believe that judicial review of adverse proceedings (such as Indictment) would be a prudent use of Cause. This is severely off-market and would chill fund manager and investor participation. Treasury believes that its existing removal rights adequately protect investors.

**10. Reports and Financial Information:** Monthly reports should be delivered within 7 days of the end of each quarter so information may be included in SIGTARP's quarterly report. As we have explained, it will be impossible for us to meet our reporting obligations under the current proposed schedule. As noted above, information on Eligible Assets should include Date, CUSIP, position, size, pricing, dates and any other relevant valuation information to be included in the quarterly report as well as any other relevant information to be included in the quarterly report, but that information will be analyzed. The document provision policy should be "acceptable" to Treasury.

Treasury believes that delivery of reports within 15 calendar days after the end of each month should not prevent SIGTARP from including the data in its quarterly reports, which are not issued until several weeks after the conclusion of the quarter in any event. Treasury agrees with SIGTARP that the information on Eligible Assets should be delivered in the monthly reports (including CUSIP by the end of the quarter) and that the information on their market value and derived income) and has updated the equity term sheet accordingly.

Pursuant to the Rules, documents will be retained for as long as the PPIF is in existence and three (3) years beyond the termination of the PPIF.

**11. Notice:** Although this is not a section, standard notice provisions should apply. At a minimum, Treasury should receive notice of the commencement of any action (regulatory, criminal, civil or otherwise), and any material event of default occurring against the manager.

This issue is dealt with in the "Notice" section of the equity term sheet and already substantially addresses SIGTARP's concerns. However, in response to SIGTARP's comments, it now reads as follows:

"Notice. The General Partner will provide UST and SIGTARP notice of Events of Default (as defined in the Debt Term Sheet), material litigation, material regulatory investigations and other material events (including defaults or other adverse events in respect of Third Party Debt (as defined in the Debt Term Sheet)).

**Ethical Standards and Conflicts of Interest Rules (the "Rules") Recommendations**

**1. Please include SIGTARP anywhere that UST has a disclosure or review right. For example, while SIGTARP has access to this fund's books and records, under the document, only UST has access to key persons and other personnel.**

Treasury will provide SIGTARP a disclosure or review right in cases where Treasury has a disclosure or review right with respect to Reports and Financial Information.

purchased by the PPIF is consistent with its diversification requirements. Treasury believes that the PPIF should be able to invest in the best investment opportunities, regardless of the size of transactions while remaining diversified and promotes the policy objective of increasing the flow of capital into the market for Eligible Assets. As SIGTARP correctly points out, the PPIF fund managers already have the ability to allocate investment opportunities between the PPIF and other funds investing in Eligible Assets subject to a fair and equitable allocation policy.

**7. Restrictions on Hedging Products, Restrictions on Certain Transactions, and Restrictions on Affiliates:** You should consider prohibiting all of these.

These are all prohibited unless consented to in writing by Treasury. This achieves the same outcome as a straight prohibition.

**8. Allocation of Business Lines:** Consistent with comments above, allow making investment decisions for the PPIF should be exclusive to the PPIF.

As discussed above, Treasury will not implement this recommendation, because it is inconsistent with one of the basic premises of SP-PPIF, to partner with the best and most experienced PPIF fund managers to manage Treasury's investments.

PPIF fund managers have been selected based on the experience of the individuals managing the PPIF as well as the firm resources that are available. Our documents already provide that certain key individuals will focus a significant portion of their business on the PPIF's investments. Treasury will not implement this recommendation because PPIF fund managers are to the team-oriented investment process that is crucial in ensuring that taxpayers are adequately protected. A team approach allows firm employees to leverage the entirety of the firm's experience and resources across all investment areas and provides significant synergy to the investment process. Requiring manager segregation would force PPIF fund managers to focus on their own business, which would reduce the ability of the PPIF fund managers to generate follow-on assignments or additional investments. Faced with that choice, no PPIF fund manager is likely to dedicate its top talent to the PPIF. Thus, requiring a wall could significantly reduce performance and thereby harm taxpayers.

**9. Removal of the General Partner:** Treasury should have greater removal rights. Standardized language for both cause and with cause terminations should be used. For cause should be at the initial stages of adverse proceedings (such as Indictment), keyed to notice of the institution of proceedings against the manager or a key person. It should be in UST's discretion at that point to terminate.

Treasury already has very favorable removal rights relative to those of private investors due to the size of its investment in a PPIF. However, in partnering with fund managers, Treasury needs to ensure that the PPIF fund managers are not able to terminate Treasury's investment in the PPIF fund manager, which is not in Treasury's best interest. Treasury retains the right to dissolve the investment period after one year in its sole discretion, thereby limiting any potential harm that might result from adverse proceedings against the PPIF fund manager.



We appreciate your team's involvement to date in consulting with the Treasury during its design of S-PPFP. As discussed above, we have given serious consideration to all of your recommendations and have adopted most of them. While there are certain points on which we disagree, the program has benefited from your team's involvement. I will be available to meet with you to discuss these comments if you would like.

Very truly yours,



Herbert M. Allison, Jr.  
Assistant Secretary for Financial Stability

certifications from the buyer and seller of each security (which is required by the Federal Reserve in the TALF program). Non-compliant transactions identified and all information should be forwarded immediately to UST and SIGTARP.

While Treasury's conflicts policies must be strict, they must also be tailored to maximize benefit while not posing such onerous restrictions as to prevent Treasury from obtaining S-PPFP certificates concerns about the impact of the program on the market for Eligible Assets. Treasury and SIGTARP will have access to all records pertaining to Eligible Assets transactions. Treasury and SIGTARP will be able to check whether the same CUSIPs initially "traded" between PTFs and affiliates.

Requiring written compliance certifications from the broker/dealer of each security is not a requirement for the program. Treasury securities will be purchased or sold through broker dealers. Furthermore, this requirement is overly onerous and superfluous given that Treasury bars affiliate sales (with some exceptions) and requires all sales to be at arms' length. Treasury and SIGTARP will have access to all records pertaining to Eligible Asset transactions. Treasury and SIGTARP will be able to check whether the same CUSIPs initially "traded" between PTFs and affiliates.

**12. Conflicts with Placement Agents and BD Relationships:** Non-compliant transactions should be identified and reported immediately to UST and SIGTARP. Fund Managers need to initiate best efforts remedial action and report steps taken to correct issue.

Treasury will require the prompt reporting to Treasury and SIGTARP of non-compliant transactions with respect to conflicts with placement agents and broker/dealer relationships.

**13. Asset Crossing, Flipside and Round-tripping:** Again, QFM's should submit policies and procedures to UST and UST should approve. Also, again, quarterly reporting and immediate notification and reporting to UST and SIGTARP of non-compliance should be required.

Treasury will require PTF fund managers to submit policies and procedures to Treasury for approval and will require the prompt reporting to Treasury and SIGTARP of non-compliant transactions with respect to asset crossing, flipping and roundtripping.

**14. Use of Fund Manager in Recovery-Related Programs:** UST should have unilateral right to reject.

Treasury will have the unilateral right to reject a PTF fund manager's participation in Recovery-Related Programs.

**15. All QFM's should be required to refer immediately any instance or suspected instance of fraud, waste or abuse to SIGTARP, and to inform their employees of this requirement and provide them with SIGTARP's hotline information.**

PTF fund managers will be required to promptly refer any instance or suspected instance of fraud, waste or abuse to Treasury and SIGTARP, and to inform their employees of this requirement and provide them with SIGTARP's hotline information.



DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

July 1, 2009

Nell M. Bartelky  
Special Inspector General  
Office of the Special Inspector General for the Troubled Asset Relief Program  
Washington, D.C. 20541  
NY 51664  
Washington, D.C. 20220

Dear Mr. Bartelky:

This letter and its attachments continue the response of the Department of the Treasury to the recommendations contained in the Special Inspector General for the Troubled Asset Relief Program's (SIGTARP) *Quarterly Report to Congress*, dated April 21, 2009.

The attached memorandum, entitled *The U.S. Treasury Department's Summary Response to SIGTARP's February 2009 Quarterly Report*, describes the actions Treasury has taken with respect to those recommendations and the recommendations in the SIGTARP's February 2009 quarterly report. The memorandum updates the information set forth in Appendix J of the April SIGTARP Report. *The U.S. Treasury Department's Summary Response to SIGTARP Recommendations in the February 6, 2009 SIGTARP Report*.

Treasury welcomes these recommendations. They contain many good ideas and suggestions, and we have considered them carefully. As described in the memorandum, we agree with most of them. We have described how our policies and programs address the issues raised and have discussed, where applicable, additional actions we are taking to address the concerns raised. Treasury's statutory duties under EISA. However, in those cases we believe there are alternative ways to address the underlying concerns you have raised and we have explained the measures we are employing to do so.

We appreciate your thoughtful recommendations and look forward to continuing to work with you and your team as we pursue our common goal of carrying out the objectives of EISA, which are to promote financial stability and protect the interests of the taxpayers.

Sincerely,

  
Herbert M. Allison Jr.  
Assistant Secretary  
Office of Financial Stability

Enclosure

The U.S. Department of the Treasury  
Summary Response to SIGTARP Recommendations

July 2, 2009

The Department of the Treasury (Treasury) welcomes the recommendations on the Troubled Asset Relief Program (TARP) contained in the Special Inspector General for the Troubled Asset Relief Program's (SIGTARP) in its April 2009 Quarterly Report to Congress. Treasury's ability to achieve the objectives of the Emergency Economic Stabilization Act of 2008 (EISA) is enhanced by the role of the SIGTARP and its review of TARP programs. We have worked closely with SIGTARP and have benefited from their involvement in the development of TARP programs and their post-implementation review. This report contains many good ideas and suggestions, and we have considered them carefully.

In this report, we have addressed the April 2009 recommendations as well as certain of the recommendations in the February 2009 Initial Report to Congress. We have first repeated each recommendation and then described the actions we are taking to address the concerns raised with the suggestions made. We have explained how Treasury's policies and programs have addressed the issues raised in the recommendation, and discussed, where applicable, additional actions we are taking to insure that particular concerns are addressed. In a few areas, Treasury believes the specific recommendation would not help carry out Treasury's statutory duties under EISA. In those cases, we have explained the alternative ways we are employing to address the concerns raised by the SIGTARP, and we have explained the measures Treasury is following to do so.

SIGTARP Recommendation 1:

Treasury should require all TARP recipients to report on the actual use of TARP funds.

TREASURY RESPONSE

Treasury always seeks to ensure accountability for TARP funds and includes measures in each of its programs to ensure such accountability. Reporting requirements necessarily differ depending on the use of funds or the program at issue. TARP programs can be divided for this purpose into two types: programs that are designed to bolster the capital of an institution and programs designed to provide targeted financing on a case-by-case basis. TARP funds provided by Treasury, were designed to stabilize the financial system by providing capital to viable institutions of all sizes. TARP funds have been used to purchase preferred stock (or other securities) from over 600 financial institutions. The use of the TARP funds is to bolster the capital of the institution, which is a use that is evidenced in the legal documentation for the transaction.

- Capital Assistance Program (CAP):** The CAP is designed to ensure that banks have an adequate capital cushion so that they can withstand larger-than-expected losses and maintain lending to creditworthy borrowers in the event that economic conditions deteriorate. The CAP is a program that provides additional capital to financial institutions. Although Treasury has not yet finalized the definitive documentation for CAP, the CAP guidelines provide that the following types of reporting on lending activities will be required. First, as part of the application process, banks must submit a plan for how they intend to use the capital to preserve liquidity and maintain lending to creditworthy borrowers. Second, Treasury will make these plans public when the bank receives the capital under the CAP. In addition, banks receiving capital will be required to submit to Treasury monthly reports on their lending broken out by category. This report will include a comparison to their original business plan. Third, banks that receive capital will have to submit to Treasury a quarterly report on their lending activities. These reports will be posted on Treasury's *FinancialStability.gov* website so that they can be viewed by the public.
- Capital Purchase Program (CPP):** As noted above, to measure the lending and intermediation activities of the 27 largest banks participating in the CPP, Treasury has created a program that will require these banks to submit to Treasury monthly reports on their lending broken out by category. The Snapshot contains quantitative information on three major categories of lending – consumer, commercial, and other activities – based on banks' internal reporting, as well as commentary to explain changes in lending metrics for each category. In addition, Treasury will require participating banks to submit to Treasury monthly reports on their monthly average outstanding balances of consumer loans, commercial loans, and total loans from all CPP participants.
- Making Home Affordable Program (HAMP):** Consistent with the goal of reducing the size of their estimated eligible HAMP portfolios, Treasury has established a cap (7) represent the maximum amount to be paid for incentive payments to servicers, servicers, and investors for qualifying loan modifications. Caps may be reset at the discretion of Treasury based on loan modification demand, servicer participation, or other qualified circumstances (date of loan portfolio, for instance). For an individual servicer, a cash payment is made to the servicer at the successful conclusion of the trial loan modification period (90-120 days). Payments represent (i) incentive payments to the servicer for completing the modification, (ii) payments to the servicer for the cost of the modification, and (iii) payments to the servicer that would be applied to reduce the principal amount of the residential mortgage loan for the borrower. Servicer and investor payments continue for three and five years, respectively.

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Because of the fungible nature of money, it is not possible to say that funds invested as capital were used for particular purposes. However, Treasury believes that the funds could be used for particular purposes. Treasury would be concerned if the funds were used for purposes that Treasury would not expect. Treasury would be concerned if the funds were used for purposes that Treasury would not expect. Treasury would be concerned if the funds were used for purposes that Treasury would not expect.

Treasury is, however, requiring reporting by CPP participants that is intended to measure the effects of the CPP on lending levels, which we believe is the underlying concern expressed by the GAO. Treasury is also requiring reporting by CPP participants that is intended to measure the effects of the CPP on lending levels, which we believe is the underlying concern expressed by the GAO. Treasury is also requiring reporting by CPP participants that is intended to measure the effects of the CPP on lending levels, which we believe is the underlying concern expressed by the GAO.

Separate from the CPP, Treasury has also created more targeted programs under TARP and the Financial Stability Plan in which funds are used to finance particular purposes. These programs include the National Housing Trust Fund, the National Affordable Housing Program, and the National Infrastructure Bank. Treasury is also requiring reporting by CPP participants that is intended to measure the effects of the CPP on lending levels, which we believe is the underlying concern expressed by the GAO.

The following is a program by program description which explains the reporting requirements that are applicable:

**Automotive Industry Financing Program (AIFP):** Treasury, through the TARP, has established a program to provide financing to the automotive industry. The program includes restrictions on use of funds and reporting requirements. All debt obligations with Chrysler and GM require the borrower to report on the use of proceeds either at the time of a draw or quarterly. For the Chrysler and GM DIP loans, the use of proceeds is dictated by an approved budget. After emerging from bankruptcy, the servicer and other entities involved in the program are required to report on the use of proceeds. The loan agreements will also require the entities to establish internal controls to provide reasonable assurance of compliance with applicable requirements.

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use of the capital. Under the Asset Guarantee Program, Treasury agreed to provide a guarantee with respect to a specified pool of assets. Funds are used for the specific purpose of covering losses with respect to such assets.

- **Term Asset-Backed Securities Loan Facility (TALF):** TALF provides loans to borrowers to purchase certain asset backed securities. The transaction documents provide that the loans can only be used for specific types of asset acquisitions and the funds are only advanced for such use.

**SIGTARP Recommendation 2:**  
*Treasury should formalize its going-forward valuation methodology and begin providing value of the TALF investments to the public.*

**Treasury's Response**

Treasury develops asset valuation methodologies for financial statement and accounting purposes as well as for risk analysis and portfolio management purposes. Treasury has created models consistent with OMB guidelines for credit reform cost estimation to derive and account for the value of the assets in the TARP portfolio. Treasury has engaged Ernst & Young to perform independent verification and validation of the models. In addition, CBO will also review and report on the credit reform models' responsibilities. The values of TARP assets derived by the validated credit reform models will be used to reflect the estimated costs to the government in the year-end financial statements of the Office for Financial Stability (OFS) and the President's annual budget, both of which are publicly available.

In addition to the credit reform asset valuation, Treasury tracks the fair market value of the assets in the TARP portfolio as part of its risk analysis and portfolio management functions. To this end, Treasury is developing internal market-based valuation models. Treasury is also working with the investment industry to develop a common framework for direct investment from financial agents to provide asset management services, including valuation services.

The securities in Treasury's portfolio consist primarily of preferred stock and warrants to purchase common stock. Treasury will continue to estimate and estimate the value of the preferred securities. The two primary assumptions necessary for accurately estimating the value of the preferred securities in such a model are the maturity point (i.e., when a financial institution will choose to redeem the security) and the rate used for discounting the cash flows. The external asset managers analyze each security and provide Treasury with the estimated data to appropriately calibrate their valuation models for preferred securities.

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respectively, if the loan remains current and outstanding. While no payments have been made on the loans, Treasury has not received any reports from the servicer regarding payments made in services, borrowers, and investors relative to the service cap beginning in August. In addition, the HAMP compliance agent will verify that Treasury cash disbursements are applied to investors and borrowers, as appropriate.

- **Public Private Investment Partnership (PPIP):** TARP funds for the Legacy Securities Public Private Investment Program (S-PPIP) will be used to (i) make equity investments in investment funds (PIFs) formed by the fund managers selected by Treasury to participate in S-PPIP and (ii) provide loans to the PIFs. The funds received through the TARP's investment in the PIFs are required to be used to purchase mortgage backed securities issued prior to 2009 that were originally rated AAA or an equivalent rating by two or more nationally recognized statistical rating organizations without ratings enhancement and that are secured directly by the actual mortgage loans, leases, or other assets and not other securities (eligible assets) (or in Treasury's discretion, by other assets that are secured by eligible assets). Treasury will also, in light of the single purpose nature of the PIF, definitive documentation will also contain detailed provisions governing the application of all proceeds received by the funds from such investments in legacy securities. Fund managers will be required to provide monthly and periodic reports and financial information to Treasury so that Treasury can monitor compliance with such provisions.

- **Systemically Significant Failing Institution Program (SFFIP):** This program is for systemically significant institutions that are in danger of failing. Treasury through TARP invested \$40 billion in AIG in November 2008 which was used to pay down the debt of AIG. Treasury is also providing additional funding to AIG through the SFFIP. Treasury committed to provide additional funds under certain circumstances. Because this program provides exceptional assistance to failing institutions, the transaction documents contain more extensive restrictions on the recipient than in the CPP or CAP, including with respect to the use of the funds. Treasury is also working with the investment industry to develop a common framework for direct investment from financial agents to provide asset management. The transaction documents require establishment of internal controls to ensure compliance with the restrictions and certified quarterly reports regarding such compliance and regarding use of the capital.

- **Targeted Investment Program/Asset Guarantees Program:** Treasury invested \$20 billion in each of Citigroup and Bank of America pursuant to the Targeted Investment Program. Because this program provides exceptional assistance to systemically significant institutions, the transaction documents contain more extensive restrictions on the recipient than in CPP or CAP, including with respect to dividends, corporate transactions, and other matters. Treasury is also working with the investment industry to develop a common framework for direct investment from financial agents to provide asset management. The transaction documents require establishment of internal controls to ensure compliance with the restrictions and certified quarterly reports regarding such compliance and regarding

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management so as to preserve the integrity of the portfolio valuation process and certainty for market participants.

Treasury is currently in the process of developing the investment policy and asset management guidelines for financial institutions participating in the CPP program, which will be published in the near future. Treasury is currently in the process of developing an investment policy for the preferred stock investments under CPP that generally is described as a "buy and hold" strategy. Its strategy must also recognize the financial institution's right to redeem Treasury's investment under the ARRA as described above. Portfolio management is intended to be relatively passive, and Treasury will not engage trading, arbitrage, or other strategies that would result in the realization of capital gains, net dividend and interest income from the portfolio resulting in individual financial institution redemptions or until market conditions allow market participants to displace Treasury's investment in a particular financial institution.

Treasury also holds warrants for common stock of CPP recipients. When an institution redeems its preferred stock, it has a contractual right to repurchase the warrants at fair market value. The contractual right provides for an independent valuation process. Treasury has recently published its policy in regard to how it will determine fair market value in connection with such process. It also has set forth that Treasury intends to exercise the warrants in the event of a liquidation of the issuer. Treasury's investment policy can be found at [www.financialstability.gov](http://www.financialstability.gov). Treasury does not, at this time, intend to exercise the warrants except under certain circumstances related to mergers and acquisitions activity, although Treasury would consider exercising the warrants in the future. Treasury will review its policies from time to time to ensure they serve the goals of promoting financial stability and protecting the taxpayer.

**SIGTARP Recommendation 4:**  
*Treasury should develop an overall investment strategy to address the vast portfolio of securities it has received assistance may repay that assistance from any source of funds, and that when such assistance is repaid, the Secretary may liquidate the warrants at market price.*

#### Treasury's Response

Treasury has worked with the Federal Reserve Bank of New York (FRBNY) to implement TALF, which is designed to improve credit conditions for consumer, small business, and middle market loans. Treasury is currently in the process of developing asset-backed securities by investors. TALF is run principally by the FRBNY. Treasury's role is to provide debt to an asset disposition vehicle owned and managed by FRBNY which would use such funds in the event TALF borrowers default on the TALF loan or surrender their asset-backed securities. Treasury is not a party to the contracts with TALF borrowers, primary dealers and originators/sponsors and does not provide funds

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The valuation of the warrants in Treasury's portfolio is directly relevant to the process for repurchasing the warrants. Treasury's investment policy provides that Treasury has the right to repurchase the warrants at fair market value. The contract specifies an independent valuation process for determining fair market value. Treasury has recently published a description of the internal procedures it will follow in valuing warrants for repurchase. Treasury is currently in the process of developing an investment policy for applying a robust valuation methodology developed by Treasury as well as relying on the advice of Treasury's external asset managers. Treasury will also publish valuation information on each warrant that is repurchased.

#### SIGTARP Recommendation 3:

*Treasury should develop an overall investment strategy to address the vast portfolio of securities it has received assistance may repay that assistance from any source of funds, and that when such assistance is repaid, the Secretary may liquidate the warrants at market price.*

#### Treasury's Response

Treasury's investment strategy, and in particular its asset management decisions with respect to the investments it has made, are determined by statutory requirements and the policy goals that have been developed in light of such statutory requirements. Treasury's investment strategy is designed to promote the financial stability of the United States and the financial markets, while at the same time protecting the taxpayer. Treasury is given the authority to manage assets, including the discretion to hold assets to maturity or for resale for and until such time as the Secretary determines that the market is optimal for selling such assets in order to maximize the value for taxpayers. EISA, as amended by the Troubled Asset Relief Act, requires Treasury to liquidate the warrants at market price if the institution that has received assistance may repay that assistance from any source of funds, and that when such assistance is repaid, the Secretary may liquidate the warrants at market price.

In light of these statutory mandates, Treasury's primary portfolio objective is to protect the principal of the portfolio and limit the risk of capital loss to the taxpayer while still insuring that it carries out its responsibility to promote financial stability. This objective is to be insured based on the portfolio as a whole, and not necessarily based on the performance of individual investments. Treasury's investment strategy is designed to promote the financial stability of the United States and the financial markets, while at the same time protecting the taxpayer. Treasury is given the authority to manage assets, including the discretion to hold assets to maturity or for resale for and until such time as the Secretary determines that the market is optimal for selling such assets in order to maximize the value for taxpayers. EISA, as amended by the Troubled Asset Relief Act, requires Treasury to liquidate the warrants at market price if the institution that has received assistance may repay that assistance from any source of funds, and that when such assistance is repaid, the Secretary may liquidate the warrants at market price. An additional objective is to ensure that Treasury's external asset managers provide Treasury with stable, thoughtful, transparent, and impartial asset

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the FRBNY administers TALE. The FRBNY, after conducting extensive research, specifically designed TALE to be a limited recourse lending facility with priority for participants. Treasury agreed with the FRBNY that the identities of the TALE borrowers would not be disclosed to Treasury or the public, because such disclosure is unnecessary given the other controls in place and because such disclosure would have a negative impact on the program. Implementing this recommendation would significantly alter that design.

**SIGTARP Recommendation 6:**  
*Treasury should require compliance protocols with complete asset rights for itself, SIGTARP, and other relevant oversight bodies, to all TALE transaction participants.*

**Treasury's Response**

As noted in this response to recommendation 4, while the TALE program was developed by the FRBNY and Treasury, the FRBNY administers the TALE lending facility and enters into contracts with participants. It therefore has the primary responsibility for ensuring that the program is properly administered. Treasury's role in the TALE is limited as described above. However, Treasury is very concerned with the compliance protocol. The FRBNY provides regular updates to Treasury on the program, and works with Treasury on major design aspects of the compliance program. Treasury has the right to monitor the FRBNY's internal controls and compliance measures for the program. Treasury also has the right to request information from the FRBNY to ensure that the compliance protocol is robust.

**SIGTARP Recommendation 7:**  
*Treasury should dispense with rating agency determinations in connection with TALE and require a security-by-security screening for each legacy RMBS. Treasury should refuse to participate if the program is not designed to that RMBS, whether new or legacy, will be rejected or not. Treasury should also require that the program be subject to the same underwriting standards as in categories that have been proven to be riddled with fraud, including certain undocumented subprime residential mortgages (i.e., "tar loans").*

**Treasury's Response**

A decision has not been reached on whether to include RMBS as eligible collateral in TALE. To the extent the Federal Reserve decides to move forward with the proposed expansion, Treasury will work closely with the FRBNY to ensure risk management

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directly to TALE borrowers. However, Treasury has worked closely with the FRBNY in the development of controls and procedures for the program.

Treasury shares the FRBNY's view that providing the oversight agencies access to the loan files and records of participants would discourage participation in the TALE program and is therefore not the best way to address the underlying concerns raised by this recommendation. Treasury has instead worked with the FRBNY to develop appropriate controls in light of the nature of the program. In this regard, the FRBNY has included a number of oversight-related provisions in the TALE transaction agreements that apply to TALE borrowers, including the following:

- A borrower acceptance standard and an assurance program related to borrower eligibility requirements.
- On-site inspection rights over borrowers and the right to reject a borrower for any reason.
- The right to review all loan files held by the custodian pertaining to each borrower.
- If a borrower who has participated in the program is found to be ineligible or is found to have knowingly breached a representation related to the eligibility of the collateral, the non-recourse feature of the loan becomes inapplicable and the borrower must repay the loan.
- To assist FRBNY in screening borrowers, primary dealers are required to apply their internal customer identification program and due diligence procedures to each borrower and escalate information relating to those borrowers assessed as high risk to FRBNY.

In addition to these fraud prevention requirements, FRBNY is establishing an inspection program in order to ensure that the primary dealers are faithfully carrying out their responsibilities under TALE.

**SIGTARP Recommendation 8:**  
*Treasury and the Federal Reserve should provide to SIGTARP, for public disclosure in SIGTARP's quarterly reports, the identities of the borrowers who surrender collateral in TALE.*

**Treasury's Response**

As noted in the response to recommendation 4, while Treasury has worked with the FRBNY to develop TALE and to develop appropriate controls and oversight measures,

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- The CMBS issuer and CMBS sponsor must provide an indemnity certification, which protects FRBNY and Treasury from any losses resulting from a contractual breach of representations and warranties specified in the transaction document.

#### Credit Loss Protection Requirements

- TALF borrowers are required to supply risk capital in the form of haircuts that will provide the first loss protection before usage of U.S. Government funds. TALF borrowers must be required to investigate the quality of the underlying securities and underwriting standards.
- TALF haircut methodology is risk sensitive across asset classes and maturities. Rigorous analytical studies by both FRBNY and Treasury's outside advisor project minimal credit loss even under stressed scenarios.

#### Excess Proceeds and Credit Loss Protection at the TALF LLC Level

With respect to the TALF LLC, in which Treasury will provide a \$20 billion guarantee, the following mechanisms have been put in place which govern Treasury's relationship with TALF and TALF LLC, including:

- A portion of the excess loan spread paid by TALF borrowers will pass to the SPV and accumulate to provide TALF LLC with cushion to any potential losses that may occur if collateral is put to TALF LLC and subsequently sold for a loss.
- Treasury has the right to approve or disapprove any modifications to the TALF loan haircuts or loan fee charged to TALF borrowers.
- Treasury has access to information and reports regarding TALF loans outstanding and underlying collateral in addition to TALF LLC financial reporting and notices.
- Treasury has the right to monitor the FRBNY's internal controls and compliance measures for TALF.

#### SIGTARP Recommendation 9:

*Treasury should require significantly higher haircuts for all MBS, with particularly high haircuts for legacy RMBS, or other equally effective mitigation efforts.*

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measures are in place, including requiring a security-by-security screening of each legacy RMBS.

Treasury, in collaboration with the FRBNY and the Federal Reserve, has developed a number of provisions for the CMBS program that will help protect the government from potential losses. Treasury is also reviewing the program to identify areas of divergence on rating agency methodologies for eligible CMBS. In addition to agency ratings, the TALF program employs other safeguards to protect taxpayer interests, including interest rate premiums and risk-based collateral haircuts. Other fraud prevention measures include the use of a collateral monitor who will independently verify the information reported and conduct at arm's length and outside the transactions are occurring at market prices.

#### SIGTARP Recommendation 8:

*Treasury should require enhanced collateral and fraud and credit protection provisions, specific to all MBS to allow participation in an expanded TALF, including minimum underwriting standards, and other fraud prevention measures.*

#### Treasury's Response

A decision has not been reached on whether to include RMBS as eligible collateral in TALF. To the extent the Federal Reserve expands TALF to include RMBS, Treasury will continue to work with the FRBNY to ensure appropriate anti-fraud and credit protection provisions are in place.

Treasury continues to collaborate with the FRBNY on anti-fraud and credit protection provisions for each new eligible asset class under TALF, including provisions for the RMBS program. Treasury will continue to work with the FRBNY to ensure that the program has substantial credit support for TALF. Additionally, FRBNY has hired a collateral monitor to review each CMBS proposed as collateral. Treasury and the Federal Reserve designed the criteria that the collateral monitor will use in its evaluations.

Other anti-fraud and credit protection provisions for the CMBS program under TALF include the following areas:

#### Fraud Prevention Requirements

- The CMBS issuer must provide a certification, in connection with the transaction that the CMBS is TALF eligible, the nationally recognized certified independent accounting firm has certified that the CMBS is TALF eligible, and that the issuer has not made any untrue statements of material fact to an NRSRO to obtain the credit rating of the ABS.

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**TREASURY'S RESPONSE**

OFS has made significant progress in staffing its compliance functions, although there are still a number of compliance positions to be filled. OFS has posted job descriptions and is reviewing resumes and evaluating interviews to fill compliance positions at all levels in the organization. When fully staffed, the compliance department will have senior compliance professionals and supporting teams overseeing each TARP program, a compliance manager for each program, and a team overseeing conflicts issues involving counterparties and financial agents.

In the meantime, the compliance staff is receiving assistance from other OFS personnel, including the legal department, to ensure that TARP participants are meeting their preservation and investment needs, to ensure that TARP participants are meeting their responsibilities under the statutes, rules and investment agreements. In addition, OFS is using financial agents and contractors to provide substantive expertise and program monitoring services under the direction of the compliance staff.

**SIGTARP Recommendation 12:**

*Treasury should require CJP participants to (i) establish an internal control to monitor their compliance with the requirements of the TARP program, (ii) submit a report to OFS, and (iii) notify OFS of compliance, under the penalty of criminal sanction, that the report is accurate; the same criteria of internal controls and regular certified reports should be applied to all conditions imposed on CJP participants; Treasury should require CJP participants to acknowledge explicitly the jurisdiction and authority of SIGTARP and other oversight bodies, as appropriate, to enforce conditions contained in the agreement.*

**Treasury's Response:**

Treasury is in the process of finalizing the CAP documents, the drafts of which incorporate most of the suggestions made by SIGTARP. With respect to the reporting of the use of TARP funds, as discussed above, this program is designed to increase the capital cushion of banks so that they are in a position to continue lending to creditworthy businesses and households. The program is designed to be a credit line, not a monthly lending source to Treasury. The reports will track loans out by category, show how many new loans are provided to businesses and consumers, and show how many asset-backed and mortgage-backed securities are purchased on a monthly basis. To provide context for the raw data, institutions will be required to include a narrative description of the lending activity and the underlying assets. Treasury will also require monthly reports on the amount of lending activity and the underlying assets. In addition, they will be required to compare lending activity each month to a rigorous estimate of what their lending would have been in the absence of

**TREASURY'S RESPONSE**

A decision has not been reached on whether to include RMBS as eligible collateral in TALF. To the extent any future expansion of TALF includes RMBS, Treasury will work with the FRBNY to develop and enhance risk management protocols for haircuts.

As with previous asset classes, the CMBS program under TALE employs conservative haircuts to address the risk that the collateral may decline in value and ensure that investors have an equity stake in the transaction. CMBS haircuts will be calculated against par, but the FRBNY applies that haircut to the current discount price of legacy CMBS securities, thus resulting in a larger percentage haircut and greater protection against credit loss for the more discounted securities.

**SIGTARP Recommendation 10:**

*Treasury should address the confusion and uncertainty on executive compensation by immediately issuing the required regulations.*

**TREASURY'S RESPONSE**

Treasury published an Interim Final Rule on executive compensation which can be found in the June 15, 2009 edition of the Federal Register. The Department of Treasury issued a press release, conducted a press conference regarding the announcement of the Special Master for Executive Compensation, and the newly appointed Special Master has begun to communicate with TARP participants to implement the rule.

**SIGTARP Recommendation 11:**

*Treasury should significantly increase the staffing levels of OFS Compliance and ensure the timely development and implementation of an integrated risk management and compliance program.*

- For those applicants selected as finalists, Treasury developed extensive legal and compliance diligence questionnaires that addressed detailed questions regarding governance and conflicts of interest issues, including:
    - Internal audit methodology, accounting policies/procedures and internal controls;
    - Mechanisms in place to identify, track, eliminate, mitigate, and monitor organizational and personal conflicts of interest;
    - Policies and procedures regarding affiliates, "round tripping," valuation, trade allocations and handling material non-public-sensitive information;
    - Responsibilities, authorities and independence of the Chief Compliance Officer; and
    - Other governance and management policies and procedures.
  - Treasury evaluated each finalist's responses for thoughtfulness, feasibility, and completeness and benchmarked these responses across several key compliance and conflicts related metrics;
  - Treasury then compiled subsequent legal, governance, and conflicts of interest questions for each finalist, as necessary; and
  - Treasury discussed several key questions with finalists during in-person presentations made to Treasury's officers. A representative from SIGTARP was invited to attend and observe and was present at most of these meetings.
- After completion of the evaluation process, Treasury held numerous discussions focused specifically on conflict of interest issues with representatives from potential PPIF fund managers, the SIGTARP staff, and the FBRNY, including FBRNY's Chief Compliance Officer, several professionals in compliance and risk departments, and other individuals responsible for the development of the governance-related portions of FBRNY's recovery related program. As part of this process,
- Treasury also had a comprehensive, multi-hour, in-person discussion with FBRNY personnel at its New York headquarters to address governance issues. The meeting was moderated by Treasury's Chief Compliance Officer and FBRNY's Chief Compliance Officer of OPS. A representative from the SIGTARP also attended these meetings.

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government assistance. CAP participants will also be required to acknowledge the jurisdiction of the oversight bodies, including SIGTARP.

#### SIGTARP Recommendation 13:

*Treasury should improve asset conflict-of-interest rules upon PPIF managers across all programs that specifically address whether and to what extent the managers can (i) invest PPIF funds in legacy assets that they hold or manage on behalf of themselves or their clients or (ii) conduct PPIF transactions with entities in which they have invested on behalf of themselves or others. SIGTARP also recommended that Treasury should require PPIF managers to disclose to the marketplace who have the expertise to make them effective asset managers but who have complex conflict-of-interest issues as a result) and hiring managers who are not in the market at all (who have less expertise but also no conflicts); however, Treasury should at least consider whether its final manager requirements address the serious conflict issues. If they very well be that they do not, Treasury should consider whether it can require PPIF managers to disclose the kinds of legacy assets that the PPIFs are purchasing. This may, in turn, significantly limit what entities should be making PPIF investment decisions.*

#### Treasury's Response

Treasury agrees with SIGTARP on the importance of strict conflicts of interest rules and the need to improve them. Treasury is currently reviewing the comments and will use the feedback to inform the development of the PPIF. Treasury has focused on the need for a strong set of conflict of interest rules and ethical guidelines. Treasury's development process that included extensive interaction with the SIGTARP staff, as well as with participating managers and the compliance professionals at the Federal Reserve Bank of New York (FBRNY).

It may be helpful to summarize the process Treasury followed to investigate and mitigate actual and potential conflicts of interest that could affect the performance of PPIF fund managers. Treasury worked closely with the SIGTARP in this process, which included the following steps:

- Treasury required applicants to identify all conflicts of interest and how they would adapt to avoid or mitigate those conflicts in its publicly-released application for prospective PPIF fund managers.
- Treasury assessed each potential PPIF fund manager's response for thoroughness (noting any deficiencies) and identified best practices with respect to governance and conflicts mitigation controls;

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To address the proprietary interests and/or interests potential PPPF fund managers hold for other clients in Eligible Assets, Treasury will require PPPF fund managers to:

- Be SEC-registered as an Investment Advisor (all recommended pre-qualified PPPF fund managers are);
- Have a trade allocation policy approved by Treasury and report all positions in Eligible Assets (PPPF, non-PPPF funds) to Treasury on an on-going basis;
- Require a PPPF fund manager to invest a minimum of \$20 million in the PPPF fund and allow co-investment by PPPF fund manager staff and employees in the PPPF; they manage to better align incentives;
- Require a PPPF fund manager to demonstrate that its compensation or fees aligns the economic interests of Key Persons with the interests of investors in the PPPF;
- Permit Treasury and SIGTARP to conduct annual and ad hoc audits of compliance with all policies;
- Maintain an Independent Compliance Department that keeps an Eligible Assets Watch List that includes information on Eligible Assets held across a PPPF fund manager's funds in addition to the PPPF;
- Disclose to Treasury and SIGTARP actual and potential conflicts of interest; and
- Obtain a Type II SAS 70 report and ensure independent third-party verification of its valuations, returns calculations, and internal controls.

With respect to conflicts with PPPF fund manager affiliates holding or servicing Eligible Assets, Treasury will require PPPF fund managers to:

- Not acquire Eligible Assets from or sell Eligible Assets to: (i) its affiliates; (ii) any other PPPF managed by a different PPPF fund manager (as defined in the definitive documentation); or (iii) any investor that has invested 10% or more of the aggregate private capital raised by the PPPF; and
- Ensure all PPPF transactions must be at arm's length, commercially reasonable, and on terms no less favorable to the PPPF than in transactions with unrelated parties.

With respect to conflicts with PPPF fund manager placement agents and broker-dealer relationships, Treasury will require that:

- Treasury took into consideration information obtained from all of these discussions in developing the conflict rules and ethical guidelines. Throughout this process, Treasury communicated closely with the SIGTARP. Drafts of the term sheets and rules were shared and discussed with SIGTARP, and Treasury benefited from SIGTARP's involvement and suggestions.

This process resulted in the development of conflict standards and procedures that we believe will ensure that the PPPF can attract private capital and investment expertise to markets that have been almost entirely closed to investors. Treasury and SIGTARP agree that we fully believe these standards and procedures incorporate almost all of the SIGTARP's suggestions. All PPPF fund managers will be required to adopt these standards and procedures—known as “Ethical Standards and Conflicts of Interest Rules” (the “Rules”). These measures include, but are not limited to:

- Adoption of the following policies and associated compliance procedures which must be approved by Treasury and any identified violators reported to Treasury and SIGTARP:
  - Allocation and valuation policies which must comply with the Investment Advisers Act of 1940, as amended, in all material respects;
  - “Arm’s length” transactions with affiliate policy;
  - Prohibition of use of affiliated broker-dealers to execute transactions; and,
  - Code of ethics and associated personal trading policy;
- Investment of a minimum of 20 million of the General Partner’s own capital in the PPPF;
- Establishment of “watch list” and associated compliance procedures;
- Reporting to Treasury of any information in the PPPF fund manager’s possession regarding the beneficial owners in equity of a PPPF in their capacity as beneficial owners;
- Reporting to Treasury of 10 largest positions of the PPPF within 15 days after the end of each calendar quarter (and public disclosure of such positions at such time as Treasury determines that such disclosure will not harm the ongoing operations of the PPPF); and,
- Retention of an independent annual internal controls and financial audit.





and "Ethical Standards and Conflicts of Interest for Public/Private Investment Fund Managers." Treasury has further required each PPPF fund manager to disclose to Treasury any information in the PPPF fund manager's possession regarding the beneficial owners in equity of a PPPF in their capacity as beneficial owners.

Treasury will not require public disclosure of all transactions undertaken in the PPPF. However, as required under Ensign, each PPPF fund manager will be required to make a quarterly report to the Secretary of the Treasury that discloses the ten largest positions of such PPPF and these reports will be publicly disclosed in such time as Treasury determines that such disclosures will not harm the ongoing business operations of the PPPF.

Treasury and SIGTARP will be able to review all trades in Eligible Assets by the PPPF and any other fund manager by the PPPF and any other fund manager. Treasury and SIGTARP have stated that they can provide daily access to this information should Treasury or SIGTARP require it).

Treasury agrees with SIGTARP with respect to access to records and will impose a "most-favored-nations clause," requiring that the fund managers treat the PPPF's and the PPPF fund managers will thus be required to provide access to such books and records to Treasury and the oversight bodies (including SIGTARP) and be available to discuss the PPPF and its activities at the request of Treasury.

#### SIGTARP Recommendation 15:

*Treasury should require PPPF managers to provide PPPF equity stakeholders (including TARP) "most-favored-nations clauses," requiring that the fund managers treat the PPPF's and the PPPF fund managers will thus be required to provide access to such books and records to Treasury and the oversight bodies (including SIGTARP) and be available to discuss the PPPF and its activities at the request of Treasury.*

#### Treasury's Response:

Treasury has included "most-favored-nations" clauses in the PPPF term sheets in which the PPPF will be treated in a manner more favorable than the rights and benefits established in favor of UST by the Partnership Agreement, other than any rights or benefits established in favor of any investor in the Private Vehicles by reason of the fact that such investor is subject to any laws, rules or regulations to which UST is not also subject.

Treasury will also require PPPF fund managers to:

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Finally, Treasury's Office of Financial Stability has strong compliance and risk capabilities to ensure that recipients of TARP funding comply with their obligations under EESA, the transaction documents related to the TARP funding and applicable rules and regulations. Treasury is in the process of developing its compliance and risk capabilities. Treasury will devote whatever resources are necessary to ensure that the compliance and risk regime it has developed for PPPF is fully implemented. The compliance function as it pertains to PPPF will include not only Treasury employees but third party professional advisors, including advisors to monitor trading and allocation activity in legacy securities, and Treasury employees and advisors to monitor trading and allocation activity in new securities. Treasury's compliance function within each PPPF as well as the ongoing, independent audit function that is required to be performed on all PPPF fund managers. Treasury compliance staff will also maintain regular dialogue with each PPPF fund manager's compliance department. It is only through such robust communication that we can ensure the highest level of transparency. We look forward to receiving continued input from SIGTARP with respect to the design, staffing, and operation of this function.

#### SIGTARP Recommendation 14:

*Treasury should mandate transparency with respect to the participation and management of PPPFs. This should include disclosure of the beneficial owners of all of the private equity stakes in the PPPFs and of all transactions undertaken in them. In addition to the reporting requirements contained in the PPPF term sheets, Treasury should mandate disclosure of the valuation of all assets. To the extent that PPPF managers are permitted to hold or engage in transactions in the same securities that they are buying and selling in the PPPFs, Treasury should require PPPF managers to report to Treasury on any and all holdings and transactions in the same type of legacy assets on their own behalf or on behalf of any other person, in accordance with the reporting requirements of the PPPF's books and records, as set forth in the term sheets. Treasury should impose a requirement that PPPF managers retain all books and records pertaining in any way to the PPPF (including all e-mails, instant messages, and all other documents), and permit SIGTARP and other oversight entities access to the fund manager's books and records and employees, upon request.*

#### Treasury's Response:

Treasury agrees with the need for transparency with respect to the participation in and management of PPPFs and has worked with the SIGTARP to ensure this. Treasury has sought to develop measures that achieve this goal while still ensuring that the program succeeds in attracting wide participation from private investors. As required under Section 402 of the Helping Families Save Their Homes Act and Section 102 of the American Recovery and Reinvestment Act of 2009, Treasury has included in the term sheets of PPPF or none of the beneficial owners of Treasury's term sheets

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**SIGTARP Recommendation 17:** *Securities PPIFs do invest in TALF, unless significant mitigating measures are included to address these dangers. These might include prohibiting the use of TALF leverage if the PPIF invests through TALF, or proportionately increasing haircuts for PPIFs that do so.*

**Treasury's Response**

Treasury and the Federal Reserve have spent considerable time analyzing these concerns and believe that, subject to implementing appropriate additional controls, the use of TALF by PPIFs is a prudent investment. Treasury believes that the additional leverage TALF offers to a PPIF creates the need to consider additional controls. While the Federal Reserve and Treasury are currently working on details of program interaction, the FRBNY and TALF have agreed that the FRBNY will allow PPIFs to access TALF subject to the TALF haircuts being adjusted to adequately reflect the additional leverage. Treasury's debt will not exceed the total amount of TALF debt that would be available leveraging the PPIF equity alone. In addition, there will be a total leverage cap of 5.0x to ensure that all PPIFs have adequate equity capital at risk. It is expected that, at closing, all PPIF fund managers will utilize debt capital from Treasury and the FRBNY. Treasury will ensure that all PPIF fund managers are prohibited from utilizing TALF or third party debt financing if Treasury debt capital comprises more than 50% of the aggregate equity capital commitments of the PPIF. Moreover, Treasury's debt investment would be priced to reflect the additional risk associated with higher leverage.

In addition, as noted earlier, a decision has not been reached on whether to include RMBS as eligible collateral for TALF.

**SIGTARP Recommendation 18:** *All TALF modeling and decisions, whether on haircuts or any other credit or fraud loss mechanisms, should account for potential losses to Government interests broadly, including TARP funds, and not just potential losses in the Federal Reserve.*

**Treasury's Response**

Treasury, the Federal Reserve, and FRBNY have spent considerable time modeling and analyzing the benefits and credit exposure for TALF collateral (both current and proposed classes of assets). In order to protect the taxpayer, these models and analyses take into account the potential exposure to the Government broadly. Treasury, the Federal Reserve, and FRBNY believe

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- Acknowledge their fiduciary duty to Treasury in addition to private investors; and
- Adhere to rigorous code of ethics policies both prior to closing and thereafter, which will be reviewed by the Office of Financial Stability's risk, compliance and legal departments.

Treasury will also require PPIF fund managers to establish and abide by a code of ethics policy that will address, but not be limited to:

- Handling of material nonpublic information;
- Personal trading;
- Outside business affiliations; and
- Giving and accepting gifts and entertainment.

**SIGTARP Recommendation 16:**

*In order to prevent money laundering and the participation of actors prone to abusing the system, Treasury should require that all PPIF fund managers have stringent investor-screening procedures, including comprehensive "Know Your Customer" requirements at least as rigorous as that of a commercial bank. Treasury should also require that all PPIF fund managers have the ability to identify the identities of all the beneficial owners of the private interests in the fund so that Treasury can do appropriate diligence to ensure that investors in the funds are legitimate.*

**Treasury's Response**

To prevent money laundering and the participation of actors prone to abusing the system, Treasury will require that all PPIF fund managers have stringent investor-screening procedures, including comprehensive "Know Your Customer" regulations, OFAC sanctions and regulations and all relevant federal securities screening laws and anti-money laundering obligations. In addition, PPIF fund managers will be required to provide Treasury any information in the PPIF fund manager's possession regarding the beneficial owners in equity of a PPIF in their capacity as beneficial owners.

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**Treasurer's Response**  
 Treasury has implemented standard guidelines for the HAMP program to ensure the program achieves its goals of stemming foreclosures without causing undue burden to borrowers or excessive costs to servicers. The program provides awareness, information, and education to borrowers regarding, for instance:

- Warnings of hidden fees,
  - Reduction of monthly payments, and
  - Principled reduction incentive.
- Borrower education is provided both verbally and in written form through:
- Published marketing materials and program guidelines on MakingHomeAffordable.gov website,
  - Call center counselors, and
  - Outreach programs.

Treasury is currently drafting standard language that highlights these warnings and provides more information to borrowers. Treasury will also ensure that the standard is adopted promptly to borrowers in the bankruptcy affidavit is the disclosure of the penalties associated with fraud.

In addition, Treasury will implement additional anti-fraud protections to verify that applied to borrowers and investors, as appropriate, as part of the compliance reviews of servicers. Freddie Mac will also employ testing procedures and data mining techniques, including the use of third-party anti-fraud tools, to help identify and report non-compliance as well as potential fraudulent practices by servicers.

Other procedures recommended by SIGTARP, such as obtaining notarized signatures and thumbprints, are not part of the current standard practice for mortgage modifications, and would cause undue burdens on borrowers and servicers, thereby defeating the objectives of the program.

**SIGTARP Recommendation 21:**  
 Treasury should require that servicers, third party information be obtained to confirm an applicant's income for mortgage modification payments are made. Treasury should require servicers to (1) compare the income reported on their initial mortgage application with the income reported on the modification application, and, if they differ significantly, require an

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the current haircut levels and other modifying decisions are appropriate for the borrower. Treasury and FRENZ will continue to use the entire Government exposure methodology for additional classes of assets for TALE.

**SIGTARP Recommendation 19:**  
 Before finding a mortgage modification, Treasury should require the servicer to submit third-party verified evidence that the applicant is residing in the subject property.

**Treasurer's Response**  
 The published servicer guidelines of the HAMP program address this concern. Servicers sources including matching addresses to printed checks received from borrowers, noting when mail sent to the property address is returned as undeliverable, and checking against tax returns, credit reports, paystubs, and utility bills. This third-party verification must be retained by the servicer in the case file and submitted to Treasury or its agent upon requests or during a mandatory compliance audit.

Freddie Mac will review documents received by the servicers for compliance with program guidelines. In addition, Freddie Mac is in the process of investigating the use of third party data to determine occupancy during loan file reviews as well as part of data analysis of servicer data.

**SIGTARP Recommendation 20:**  
 Treasury should be adjusted to verify the identity of the participants in the transaction and to address the potential for servicers to steal from individuals by receiving Government subsidies without applying them for the benefit of the homeowner. Closing-like procedure conducted would include (1) a closing warning sheet that would warn the applicant of the consequences of fraud, (2) the notarized signatures of the borrower, (3) the signatures of the servicer, (4) the signatures of the lender, (5) the signatures of all participants in the transaction, (6) verbal and written warnings regarding hidden fees and payments so that applicants are made fully aware of, (7) the benefits to which they are entitled under the program to prevent a corrupt servicer from collecting payments from the government and not passing the full amount of the subsidies to the borrower, and (8) the fact that no fee should be charged for the modification.

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On June 25, 2009, a press conference in Miami kicked off a nationwide campaign promoting the MHA Program to borrowers seeking eligibility information and empowering local partners to connect with these borrowers. The press conference was held at the Department of Housing and Urban Development and the Secretary of the Department of Housing and Urban Development were quoted in the press release on the need for the outreach effort to educate homeowners on foreclosure prevention and the importance of the trusted advisors in the communities. The outreach plan focuses on 40 markets hardest hit by foreclosure in large metropolitan areas. The plan includes a series of market-specific foreclosure prevention messaging. Typically, each market will hold a series of events, with varying degrees of frequency, such as: 1) national partners and local officials to kick off the events with a press release and organize neighborhood canvassing to promote the HPOF hotline, MHA and consumer outreach events; 2) partners and local officials to hold "Train-the-Trainer" events for servicers, counselors and local officials; and 3) partners to use MHA materials and "Take Action" folders to drive borrowers to consumer outreach events. The success of each market campaign will be measured by the number of borrowers who attended the outreach event as well as the number of calls about how borrowers learned of the event, increased calls to the hotline, and increased hits to the MHA website from that particular market.

Homeownership Preservation Office's (HPO) goal is to enhance a market's competitive edge by showing its present foreclosure or to transition to an alternate solution if they are not eligible for modification. Treasury's HPO is the liaison for all of Treasury to all outreach partners such as: Fannie Mae, Freddie Mac, White House Office of Public Engagement, HUD, Federal Trade Commission, Department of Justice, Federal Reserve, Department of Education, Department of Labor, Neighborhood Assistance Corporation of America, National Urban League, National Council of La Raza. HPO is partnering with NeighborWorks and Fannie Mae to complete an AllCouncil campaign in September.

#### SIGTARP Recommendation 24:

*Treasury should require its agents to keep track of the names and identifying information for each participant in each mortgage modification transaction and to maintain a database of such information. Not only would such a database assist law enforcement in the detection and apprehension of fraudsters, but it would also assist in fraud prevention.*

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*explanation and verifiable documentation of the change in income, and (2) require third-party verification of employment.*

#### Treasury's Response

Servicers are required to verify borrower income using tax returns, credit reports and other third party data sources. This verification must be retained by the servicer in the case file and provided to Treasury or its agent upon request or during a compliance audit. In many cases, the initial loan applications will not be in the servicer's files. The data sources that Treasury and Freddie Mac also include validation of applicant's income using third-party sources where available.

#### SIGTARP Recommendation 25:

*Treasury should defer payment of the \$1,000 incentive to the servicer until after the homeowner has verifiably made a minimum number of payments under the mortgage modification program.*

#### Treasury's Response

This is consistent with how Treasury has designed the EAAMP program. Under the EAAMP program, servicers are not eligible to receive the \$1,000 upfront incentive until the borrower has made the full payment of the first month's payment. Additionally, the required number of payments under the trial modification.

#### SIGTARP Recommendation 26:

*Treasury should proactively educate homeowners about the nature of the program, warn them about these predators, and publicize that no fee is necessary to participate in the program.*

#### Treasury's Response

Treasury is taking important actions to educate homeowners about the Making Home Affordable MHA Program. First, the MHA website prominently features a Beware of Foreclosure Rescue Scams warning on its homepage which highlights that there is no fee associated with getting help through MHA and includes a link to more in-depth guidance for homeowners to avoid scams. In addition, the website is updated frequently with new marketing materials, guidelines, FAQs, events and resources for those seeking help.

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promoting financial stability. We look forward to continuing to work with you and your team as we move forward.

Sincerely,



Herbert M. Allison, Jr.  
Assistant Secretary for Financial Stability

but or will execute alternative approaches that we believe address some of the issues raised in your recommendations. The steps we have taken and the progress we have made in this regard are detailed in our July 2, 2009 memorandum in response to the recommendations in your prior correspondence. We also have responded to your June 23, 2009 letter regarding the terms, both of which are attached in this Appendix entitled, "Correspondence Regarding SIGTARP Recommendations."

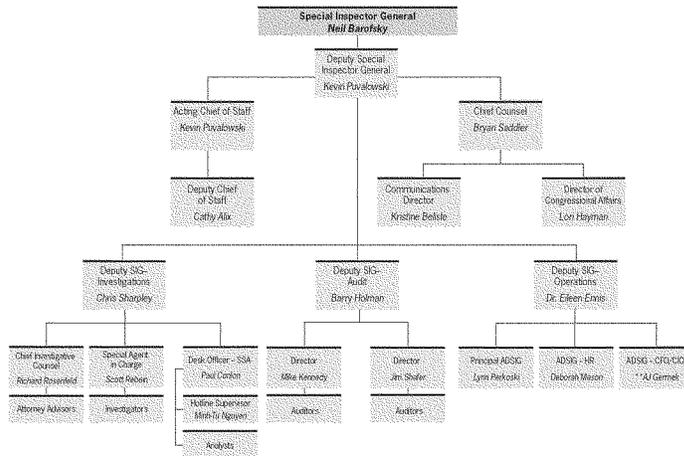
In order to ensure that SIGTARP's recommendations meet thoroughly addressed and considered and that we took full advantage of SIGTARP's expertise in fraud prevention and other areas, Treasury staff went to substantial lengths to work with your team, particularly with respect to PFP. In addition to the many meetings we had with you and your staff and receive your comments, we also invited you and your staff to participate in our interviews with prospective fund managers, provided successive drafts of PFP term sheets and conflict procedures for your review and comments during the drafting and review process, and provided you with a copy of the final PFP term sheets and conflict procedures in order to be certain we had received, thoroughly considered, and whenever possible acted upon your comments.

The interaction between Treasury staff and SIGTARP staff helped to improve PFP. While many of your recommendations coincided with actions that had been under consideration for some time, some of your recommendations – particularly those related to fraud prevention – led us to address issues that we had not previously considered. In some cases, we might have done otherwise. Both Treasury and the taxpayers have benefited from your input.

Our primary differences with your team relate to your recommendation that we require each of our employees to be covered by the PFP. We believe that this recommendation is not in the best interests of the fund manager. While we respect the concerns that underlie your recommendations, we believe they are better addressed through other requirements that we have incorporated in our PFP conflict and compliance processes. For example, our requirement that the fund manager maintain a list of all employees, including those who are not covered by the entire fund complex given us (and SIGTARP) the ability to spot and investigate unusual trading patterns, suspicious transactions and other indications of fraud, collusion or other bad behavior. We also require the PFP to verify the accuracy of the information provided to us. We addressed by our requirement that the manager maintain and adhere to an allocation policy that requires all transactions involving legacy securities to be allocated fairly among all of the investors in the PFP. We also require the PFP to maintain and adhere to an allocation policy to invest their own capital in the PFP and to demonstrate that their compensation systems align the financial interests of the personnel who manage the PFP with the interests of the PFP investors. We also require the PFP to maintain and adhere to a policy that requires the PFP to take steps to protect taxpayers without imposing the significant costs of requiring a segregated investment team.

We appreciate the open and collaborative relationship with you and your team, and have strived to achieve the highest standard for protecting taxpayers while carrying out our mandate of

ORGANIZATIONAL CHART



Note: SIGTARP organizational chart as of 6/30/2009.

\*\* Debatel

April 2, 2009

Saddler, Bryan

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**From:** Morse, Duane  
**Sent:** Thursday, April 02, 2009 4:29 PM  
**To:** Saddler, Bryan  
**Cc:** Morse, Duane  
**Subject:** Attorney-Client Privilege

Bryan,

This is to confirm our conversation this morning about attorney-client privilege. The background of that conversation is that, from time to time, SIGTARP has requested information and documents from TARP that are protected by the attorney-client privilege. TARP is willing to provide those documents and that information to SIGTARP provided that, by doing so, it is not waiving the attorney-client privilege as to third parties. You agreed with me that, because SIGTARP and TARP are both parts of the Treasury Department, disclosure of attorney-client privileged documents and information to SIGTARP does not constitute a waiver of the privilege. You also said that, as long as attorney-client privileged documents and information provided to SIGTARP are clearly identified as such, SIGTARP will endeavor to protect them from disclosure to parties outside of Treasury. Notwithstanding the foregoing,

- (i) The undertaking to protect against disclosure of documents and information identified by TARP as attorney-client privileged applies only to the extent that those documents and that information are actually within the scope of the privilege. While we did not discuss how to deal with disagreements about whether the privilege applies, I propose that SIGTARP and TARP discuss any such disagreement and attempt to come to a consensus on whether the document or information should be treated as attorney-client privileged. If we cannot agree, we should submit the issue to the Justice Department's Office of Legal Counsel for resolution, which will be binding on both parties.
- (ii) SIGTARP's agreement to protect privileged documents and information from disclosure is subject to any limitations on the scope of the protection afforded by the attorney-client privilege under applicable law.

If this e-mail accurately describes our conversation, please confirm by replying to this e-mail. If you disagree with anything I have written, or believe I have not captured all of the nuances of our discussion, please let me know how you think the foregoing needs to be modified to make it acceptable to you.

Thanks, Duane

Duane D. Morse  
Chief Counsel - Office of Financial Stability  
Department of the Treasury



April 3, 2009

**Saddler, Bryan**

**From:** Knight, Bernard Jr.  
**Sent:** Friday, April 03, 2009 5:21 AM  
**To:** Barofsky, Neil  
**Cc:** Monborne, Mark; Lepley, Richard; Mahar, Mike; Briskin, Michael; Yoo, Julia; Puvalowski, Kevin; Saddler, Bryan; Holman, Barry  
**Subject:** Re:

Neil

Thanks for your email. Sorry if my email was unclear. I did not say nor did I mean to imply that you could not go forward as planned with your audit(s). Also, I hope that it is clear in my message that we have not sent the request for guidance to OLC. As we discussed in our telephone conversation, we wanted to have the opportunity to discuss the issue with you first and thought that sharing our legal analysis with you first would be helpful to both of us. The answer to the question presented is not squarely addressed in EESA and our thought is that it would be helpful to both of our offices to obtain more clarity on the right answer.

We have a good working relationship with your office and I very much appreciate that. We also will cooperate fully with your audit(s).

Please call me if you have any concerns.

Bernie

**From:** Barofsky, Neil  
**To:** Knight, Bernard Jr.  
**Cc:** Monborne, Mark; Lepley, Richard; Maher, Mike; Briskin, Michael; Yoo, Julia; Puvalowski, Kevin; Saddler, Bryan; Holman, Barry  
**Sent:** Thu Apr 02 19:52:31 2009  
**Subject:** RE:

Bernie – I am going to meet with counsel to discuss a more formal response. However, I am very concerned that your request to OLC will unnecessarily bog down our audit, which is supposed to include an interview of OGC staff tomorrow morning. As we have repeatedly stated, we believe that we are organizationally within the Treasury Department (just look at our seal), and have not heard any real argument to the contrary, irrespective of the more ambiguous (and, as we discussed, largely irrelevant) "supervision" issue. Indeed, until now, Treasury (including your office) has certainly treated us, in every way imaginable, as being within the Department. Moreover, even in the incredibly unlikely event that someone opined that we are not in Treasury, we would still be entitled to privileged information. Under 121 of EESA (and section 6(a)(3) of the IG Act, which is expressly incorporated into section 121 of the EESA) the disclosure of any records that we request is compelled, and compelled disclosure of privileged documents does not waive the privilege. Equity Analytics, LLC v. Timothy D. Lundin, 248 F.R.D. 331, 334 (D.D.C. 2008); In re Parmalat Securities Litigation, 2006 U.S. Dist. LEXIS 88629 (S.D.N.Y. 2006); Duttie v. Bandler & Kass, 127 F.R.D. 48, 56 n.5 (S.D.N.Y. 1989) (citing S.E.C. v. Forma, 117 F.R.D. 516, 523 (S.D.N.Y. 1987); Teachers Insurance and Annuity Association of America v. Shamrock Broadcasting Co., 521 F. Supp. 638, 641-42 (S.D.N.Y. 1981)). I think it would be extremely unfortunate if I had to report to Congress (and they do ask regularly) that we are unable to complete our audit in a timely manner because of what they might perceive (even if unfairly) as legal maneuvering by Treasury on an issue with no practical effect. For these reasons, we think that your request to OLC is unnecessary, and we hope that the interview tomorrow morning will go forward without incident.

**From:** Knight, Bernard Jr.  
**Sent:** Thursday, April 02, 2009 1:54 PM  
**To:** Barofsky, Neil  
**Cc:** Monborne, Mark; Lepley, Richard; Maher, Mike; Bristkin, Michael; Yoo, Julia  
**Subject:**

Neil,

As we discussed in our telephone conversation, below is our draft request that we would like to send to the Office of Legal Counsel at Justice. The career lawyers working with your office believe that it would be beneficial for both of our offices to obtain additional clarity on our relationship. In light of the pending audits/investigations, we would appreciate your views as soon as possible. Thanks for your assistance.

Here is the proposed request:

OLC's continued advice to Treasury has greatly facilitated the implementation of the Administration's new programs to address the financial crisis. The latest legal conundrum involves the correct location of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) in the U.S. Government. As discussed below, SIGTARP's status is important for a number of reasons, but the most pressing question is whether providing Treasury information and documents to a SIGTARP not located in the Treasury Department would waive any applicable privileges. The SIGTARP is established by section 121 of the Emergency Economic Stabilization Act, Pub. L. 110-343 (EESA), which provides that the SIGTARP is appointed by the President, and is removable by the President in accordance with section 3(b) of the Inspector General Act of 1978 (IG Act). Because SIGTARP is appointed by, and can be removed by, the President, and because EESA does not otherwise purport to subject SIGTARP to direct Congressional control, it seems clear SIGTARP is within the Executive Branch. Cf. *Bowsher v. Synar*, 478 U.S. 714, 727-732 (1986) (holding that the Comptroller General is subject to congressional control because he can be removed only on the initiative of Congress). EESA, however, is silent on whether SIGTARP is in the Department of the Treasury and reports to the Secretary of the Treasury (Secretary). By contrast, Treasury's Office of Inspector General and Office of Treasury Inspector General for Tax Administration are expressly part of Treasury under section 2(b) of the IG Act and subject to the Secretary's general supervision under section 3(a) of the IG Act. With respect to other special inspectors general, Congress expressly provided that the Special Inspector General for Afghanistan Reconstruction and the Special Inspector General for Iraq Reconstruction "shall report directly to, and be under the general supervision of, the Secretary of State and the Secretary of Defense." IG Act, § 8G note.

We note that a provision of the IG Act, which is incorporated by reference in the EESA, suggests that SIGTARP reports generally to the Secretary. EESA defines the SIGTARP's authorities largely by reference to the IG Act. The IG Act provides for Inspectors General in certain "establishment[s]," defined to include several Cabinet Departments (including Treasury) and certain other agencies. IG Act, § 12(2). IGS directly covered by the IG Act are required to "report to and be under the general supervision of the head of the establishment involved [or the officer next in rank]." IG Act, § 3(a). The head of the establishment is prohibited from prohibiting or preventing audits, investigations, or the issuance of subpoenas. *Id.*

EESA provides that in addition to certain enumerated duties, the SIGTARP "shall . . . have the duties and responsibilities of inspectors general under the [IG Act]." EESA § 121(c)(3). These duties and responsibilities could be read to include those under section 3(a) of the IG Act to report to and be under the general supervision of the head of the establishment involved. Under EESA, as enacted, SIGTARP's duties relate only to actions of and programs established by the Secretary of the Treasury. Thus, the "establishment involved," to whose head SIGTARP would report, could be reasonably considered to be Treasury. However, S. 383, currently pending signature by the President, would expand SIGTARP's authority to encompass most activities undertaken under EESA Title I (with certain specific exceptions). SIGTARP's new authority could appear to include review of

actions undertaken by the Federal Reserve Board, the Federal Housing Finance Agency, the SEC, the FDIC, HUD, the National Credit Union Association, and possibly other Federal agencies. Especially given EESA's somewhat oblique reference to Section 3(a) of the IG Act, the addition of jurisdiction over the activities of these other agencies might cut against a view that SIGTARP reports to the Treasury Secretary as the head of the "establishment involved."

Although the issue of SIGTARP's reporting relationship under the existing EESA provision has not, to our knowledge, been definitively resolved, SIGTARP does have numerous other ties to Treasury. Treasury provides office space and administrative support to SIGTARP. SIGTARP has recently drafted (but not yet published) a Federal Register publication amending the Department's FOIA and Privacy Act regulations to cover SIGTARP records and systems of records. This draft Federal Register notice refers to SIGTARP as "an independent office of the Department of the Treasury." Finally, while SIGTARP is expressly tasked with submitting reports to Congress, we note that this is not an uncommon requirement.

We also note that a determination with respect to the SIGTARP's status, including its reporting obligations, has implications for a number of other legal questions. Of immediate importance is the question of whether providing Treasury information and documents to a SIGTARP not located in the Treasury Department would waive any applicable privileges. Additionally, it is not clear that SIGTARP would be a "Head[] of Department[]" under the appointments clause of the Constitution. See 20 U.S. Op. Off. Legal Counsel 124 at page 18. Thus there may be an issue as to whether SIGTARP would have authority to appoint inferior officers of the United States. Similarly, it would not be clear whether SIGTARP would be an "Executive department" authorized to issue regulations under the housekeeping statute, 5 U.S.C. § 301.

For these reasons, we request OLC's position on whether SIGTARP is part of the Treasury and, accordingly, reports to the Secretary. Further, if OLC concludes that SIGTARP is not part of the Treasury, we request advice on the issue of whether providing Treasury information and documents to SIGTARP would waive any applicable privileges.

Bernard J. Knight, Jr.  
Assistant General Counsel  
(General Law, Ethics & Regulation)  
and Designated Agency Ethics Official  
U.S. Department of Treasury

April 15, 2009

Saddler, Bryan

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**From:** Knight, Bernard Jr.  
**Sent:** Wednesday, April 15, 2009 3:14 PM  
**To:** 'Barron, David'; 'Koffsky, Daniel L.'  
**Cc:** Monborne, Mark; Schaffer, Laurie; Lepley, Richard; Maher, Mike; Bieger, Peter; Briskin, Michael; Saddler, Bryan  
**Subject:** SIGTARP  
**Attachments:** SIGTARP Position.pdf

David & Dan,

OLC's continued advice to Treasury has greatly facilitated the implementation of the Administration's new programs to address the financial crisis. The current issue involves the location and reporting relationship of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) in the U.S. Government. As discussed below, the SIGTARP's status is important for a number of reasons, but the most pressing question is whether providing Treasury information and documents to a SIGTARP not located in the Treasury Department or supervised by the Secretary of the Treasury (Secretary) would waive any applicable privileges.

The SIGTARP is established by section 121 of the Emergency Economic Stabilization Act, Pub. L. No. 110-343 (EESA), which provides that the SIGTARP is appointed by the President and is removable by the President in accordance with section 3(b) of the Inspector General Act of 1978 (IG Act). Because the SIGTARP is appointed by, and can be removed by, the President, and because EESA does not otherwise purport to subject the SIGTARP to direct Congressional control, the SIGTARP arguably is within the Executive Branch. See *Bowsher v. Synar*, 478 U.S. 714, 727-732 (1986) (holding that the Comptroller General is subject to congressional control because he can be removed only on the initiative of Congress). We note, however, that the enhanced role for the SIGTARP provided in enrolled bill S. 383 (discussed below) and EESA's changes or additions to IG Act requirements (e.g., EESA's provision for quarterly SIGTARP reports directly to Congress and for certain reports directly to Congress under section 121(e)(4)(b) as opposed to the head of the establishment under section 6(b)(2) of the IG Act) may suggest otherwise. In addition, recent amendments to the IG Act (Pub. L. No. 110-409), which were enacted shortly after EESA, seek to expand the independence of inspectors general and include a requirement that the President provide written reasons to Congress for removals or transfers of inspectors general at least 30-days in advance. Moreover, in EESA's legislative history, Senator Baucus said: "I designed the office of this inspector general to be truly independent. . . . I designed this inspector general to be accountable only to Congress and to the American taxpayer." Congressional Record at S10218 (Oct. 1, 2008). The statutory text of EESA is silent on whether the SIGTARP is in the Department of the Treasury and reports to the Secretary. By contrast, Treasury's Office of Inspector General and Office of Treasury Inspector General for Tax Administration are expressly part of Treasury under section 2(b) of the IG Act and subject to the Secretary's general supervision under section 3(a) of the IG Act. With respect to other special inspectors general, Congress expressly provided that the Special Inspector General for Afghanistan Reconstruction and the Special Inspector General for Iraq Reconstruction "shall report directly to, and be under the general supervision of, the Secretary of State and the Secretary of Defense." IG Act, § 8G note.

We note that a provision of the IG Act, which arguably is incorporated by reference in EESA, could suggest that the SIGTARP reports generally to the Secretary. EESA defines the SIGTARP's authorities largely by reference to the IG Act. The IG Act provides for inspectors general in certain "establishment[s]," defined to include several Cabinet Departments (including Treasury) and certain other agencies. IG Act, § 12(2). Inspectors General directly covered by the IG Act are required to "report to and be under the general supervision of the head of the establishment involved [or the officer next in rank]." IG Act, § 3(a). The head of

the establishment is prohibited from prohibiting or preventing audits, investigations, or the issuance of subpoenas. *Id.*

EESA provides that in addition to certain enumerated duties, the SIGTARP "shall . . . have the duties and responsibilities of inspectors general under the [IG Act]." EESA § 121(c)(3). These duties and responsibilities could be read to include those under section 3(a) of the IG Act to report to and be under the general supervision of the head of the establishment involved. Under EESA, as enacted, the SIGTARP's duties relate only to actions of and programs established by the Secretary of the Treasury. Thus, the "establishment involved," to whose head the SIGTARP would report, could be reasonably considered to be Treasury. However, S. 383, currently pending signature by the President, would expand the SIGTARP's authority to encompass most activities undertaken under EESA Title I (with certain specific exceptions). The SIGTARP's new authority could appear to include review of actions undertaken by the Federal Reserve Board, the Federal Housing Finance Agency, the SEC, the FDIC, HUD, the National Credit Union Association, and possibly other Federal agencies. Especially given EESA's somewhat oblique reference to Section 3(a) of the IG Act, the addition of jurisdiction over the activities of these other agencies might cut against a view that the SIGTARP reports to the Treasury Secretary as the head of the "establishment involved." In addition, S. 383 would expressly give the SIGTARP authority to conduct, supervise, and coordinate investigations and audits as he determines appropriate and would require the Secretary to certify to Congress that no action is necessary or appropriate if the Secretary does not address deficiencies identified by the SIGTARP.

In considering the reporting relationship issue under the existing EESA provision, we note the ties between the SIGTARP and Treasury. Treasury provides office space and administrative support to the SIGTARP. The SIGTARP has recently drafted (but not yet published) a Federal Register publication amending the Department's FOIA and Privacy Act regulations to cover SIGTARP records and systems of records. This draft Federal Register notice refers to the SIGTARP as "an independent office of the Department of the Treasury." Finally, while the SIGTARP is expressly tasked with submitting reports to Congress, we note that submitting reports is not an uncommon requirement (although the reporting requirements in the IG Act often appear to be to or through the head of an establishment).

A determination with respect to the SIGTARP's status, including whether he's under the Secretary's supervision, has implications for a number of other legal questions. Of immediate importance is the question of whether providing Treasury information and documents to a SIGTARP not located in the Treasury Department or subject to the Secretary's supervision would waive any applicable privileges. We note that there is a body of case law that supports the proposition that privileged information that is compelled retains its privileged nature. Additionally, it is not clear that the SIGTARP would be a "Head[] of Department[]" under the appointments clause of the Constitution. See 20 U.S. Op. Off. Legal Counsel 124 at page 18. Thus there may be an issue as to whether the SIGTARP would have authority to appoint inferior officers of the United States. Similarly, it would not be clear whether the SIGTARP would be an "Executive department" whose head is authorized to issue regulations under the housekeeping statute, 5 U.S.C. § 301.

We have shared our concerns with the SIGTARP. The SIGTARP's view (attached) is that he is within the Treasury Department, but is not subject to supervision by the Secretary. We are not certain that location within the Treasury Department is meaningful absent supervision by the Secretary, assuming such an arrangement is even legally tenable. 31 U.S.C. § 301(b) provides that the Secretary is the head of the Department of the Treasury, and numerous laws confer responsibilities and duties on the head of an agency. It is not clear whether the Secretary can fully perform his duties as agency head if he does not supervise the SIGTARP, nor is it clear that the SIGTARP can avail himself of authorities conferred on heads of agencies if the SIGTARP is not subordinate to the Secretary. Indeed, both the appointments clause and the housekeeping statute described in the preceding paragraph confer authority on the agency head; it is not clear that the SIGTARP could avail itself of those authorities if it were within Treasury but did not report the Secretary. Moreover, to the extent that release of documents outside the Treasury Department might waive applicable privileges (the SIGTARP only

addresses the attorney-client privilege, but there may be other privileges at issue), their release to a SIGTARP technically within the Department but entirely beyond the control of the Secretary may have the same effect.

For these reasons, we request OLC's position on whether the SIGTARP is part of Treasury and under the Secretary's general supervision. Further, if OLC concludes that the SIGTARP is not part of Treasury or is not under the Secretary's general supervision, we request advice on the issue of whether providing Treasury information and documents to the SIGTARP would waive any applicable privileges.

Thank you for your assistance with this issue. The Counsel to the SIGTARP, Bryan Saddler, is copied on this email. Please call me if you have any questions.

Bernard J. Knight, Jr.  
Assistant General Counsel  
(General Law, Ethics & Regulation)  
and Designated Agency Ethics Official  
U.S. Department of Treasury  


OFFICE OF THE SPECIAL INSPECTOR GENERAL  
TROUBLED ASSET RELIEF PROGRAM  
1500 Pennsylvania Ave., NW, Suite 1064  
Washington, D.C. 20220

April 7, 2009

MEMORANDUM FOR: BERNARD KNIGHT, Jr., Acting General Counsel

FROM: NEIL M. BAROFSKY, Special Inspector General 

SUBJECT: SIGTARP's Position Within Treasury

This responds to your April 2, 2009 e-mail concerning your intention to seek a legal opinion from the Office of Legal Counsel (OLC), Department of Justice, regarding the position of the Office of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) within the Federal government. Specifically, you advised that you desire OLC's opinion about: (1) whether SIGTARP exists within the Department of the Treasury; (2) whether the Secretary of the Treasury has supervisory authority with respect to SIGTARP; and (3) assuming the answer to the first question is in the negative, whether providing Treasury's attorney-client privileged materials to SIGTARP effectively waives the privilege.

SIGTARP does not object to your plan to seek guidance from OLC; however, as discussed below, SIGTARP believes that the Emergency Economic Stability Act of 2008 (EESA), Pub. Law No. 110-343, provides that SIGTARP is an independent entity within Treasury, that SIGTARP is not subject to the Secretary's supervision, and that attorney-client privilege is not a bar to SIGTARP's access to Treasury's records or information. Further, I respectfully request that your communication to OLC refer to this memorandum and include it as an appendix.

SIGTARP Is An Independent Entity Within Treasury

Turning to your question about SIGTARP's position in the government, as I understand your position: (1) you acknowledge that SIGTARP is within the Executive Branch because I am appointed, and may be removed, by the President, and SIGTARP is not otherwise under Congressional control;<sup>1</sup> but (2) you question SIGTARP's position within the Executive Branch.

<sup>1</sup> We agree with this proposition, but hasten to add that SIGTARP has a quarterly reporting responsibility to Congress. See 12 U.S.C. § 5231(f). However, like with other Inspectors General and their semi-annual reporting responsibilities, see 5 U.S.C. App. 3 § 5, this does not render SIGTARP part of the Legislative Branch, see, e.g., *NASA v. Fed. Labor Relations Auth.*, 527 U.S. 229 (1999).

Section 121 of EESA, as amended,<sup>2</sup> sets forth numerous connections between SIGTARP and Treasury: (1) the SIGTARP name set forth at section 121(a) of EESA is taken directly from the program that Treasury is authorized to create and implement at section 101(a)(1) of EESA; (2) SIGTARP's authority as originally described by section 121(c)(1) of EESA related exclusively to Treasury's authorities under sections 101 and 102 of EESA; (3) SIGTARP is required by section 121(c)(3) of EESA<sup>3</sup> to keep Treasury, as well as Congress, informed concerning fraud and other serious problems, abuses, and deficiencies in the TARP program; (4) section 121(f) of EESA, as amended, appears to contemplate that all SIGTARP audits will be addressed to the Secretary of Treasury, who must implement SIGTARP recommendations or certify to Congress why the recommended action is not necessary;<sup>4</sup> (5) Treasury is SIGTARP's source of funding, *see* 12 U.S.C. § 5231(j); and (6) Congress codified SIGTARP's authorizing legislation, section 121 of EESA, within chapter 52 of title 12 of the United States Code, as opposed to within the third appendix to title 5 where the IG Act is codified. Further, as you note in your request for an opinion, Treasury and SIGTARP have thus far operated as if SIGTARP is an independent entity within Treasury: (1) Treasury has provided SIGTARP space, equipment, and services, pursuant to section 6(e) of the IG Act; (2) Treasury circulated to SIGTARP for comment a draft Treasury Order 117-01, which plainly stated "[t]here is within the Department of Treasury an Office of Special Inspector General for the Troubled Asset Relief Program;" and (3) SIGTARP circulated to Treasury a delegation of subpoena authority, a regulation, and a systems of records notice, all of which noted that SIGTARP is part of Treasury, and your office has concurred on the first two of these.<sup>5</sup>

#### SIGTARP Is Not Subject to Secretarial Supervision

Regarding supervision: (1) you note that the Treasury Inspector General and the Special Inspectors General for Iraq and Afghanistan Reconstruction are subject to express Secretarial supervision provisions; and (2) you aver that EESA, by its incorporation of the IG Act "duties and responsibilities," implies that SIGTARP is subject to the Secretary's supervision. We do not share your conclusion.

Initially, your comparison of SIGTARP to the Treasury Inspector General and the Special Inspectors General for Iraq and Afghanistan Reconstruction, is inapposite. While you accurately point out that Congress expressly placed the Treasury Inspector General and the Special Inspectors General for Iraq and Afghanistan Reconstruction under the supervision of the Secretary of Treasury and the Secretaries of State and Defense, respectively, *see* 5 U.S.C. App. 3 §§ 3(a), 8D, and 11(2); Pub. Law No. 108-106 § 3001(e); Pub. Law No. 110-1229(e), by so

<sup>2</sup> As you are aware S.383 was enrolled on March 25, 2009. We understand that Treasury has recommended the President sign the bill, and, thus, for purposes of this memorandum we assume that S.383 has been enacted.

<sup>3</sup> Section 121(c)(3) incorporates section 4(a)(5) of the Inspector General Act of 1978 (IG Act), 5 U.S.C. App. 3 § 4(a)(5).

<sup>4</sup> It is SIGTARP's intention to copy Congress on all audit reports.

<sup>5</sup> The systems of records notice has yet to be circulated to your office.

doing Congress demonstrated its ability to assign supervisory authorities to Inspectors General, Special or otherwise, when it intends to do so. Indeed, in the case of the Treasury Inspector General, in section 8D of the IG Act, Congress gave the Secretary the extraordinary power to stop audits and investigations;<sup>6</sup> in the case of the Special Inspectors General for Iraq and Afghanistan Reconstruction, Congress granted dual supervisory authority to the Secretaries of State and Defense. *Id.* Given that Congress knows how to assign supervisory duties, the omission of this language in EESA signifies its clear intention to preserve SIGTARP's independence and not subject us to the Secretary's ability to shut down an audit or investigation.<sup>7</sup> Indeed, the legislative architect of section 121 of EESA, Senator Max Baucus, so stated in his statement in support of EESA's enactment, "I designed the office of this inspector general to be truly independent," and not report to the Secretary. See Congressional Record, p. S10218 (Oct. 1, 2008).

Next, the "duties and responsibilities" under the IG Act, which EESA specifically impose upon SIGTARP, do not include sections 3(a) or 8D.<sup>8</sup> Congress did not create SIGTARP within the IG Act; it placed us within chapter 52 of title 12 of the United States Code. Moreover, section 121 of EESA did not incorporate the entirety of the IG Act but rather only incorporated specifically referenced provisions: 3(b), 3(e), 4(b) and 6.<sup>9</sup> To be sure, section 121(c)(3) of EESA provides, "the Inspector General shall also have the duties and responsibilities of inspectors general under the Inspector General Act of 1978", but this does not suggest incorporation of section 8D. Section 8D does not relate to "inspectors general," it – like sections 8, 8A, 8B, 8C, 8E, 8F, 8I, and 8K of the IG Act – relates to a single Inspector General: the Treasury Inspector General. See 5 U.S.C. App. 3 § 8D; see also 5 U.S.C. App. 3 §§ 8, 8A, 8B, 8C, 8E, 8F, 8I, and 8K. Nor does it suggest incorporation of section 3(a). Section 3(a) provides for the appointment of Inspectors General; establishes the supervision of Inspectors General; and limits the supervisory power with respect to individual audits and investigations. The first of these issues is controlled directly by section 121(b) of EESA, and the inter-related latter two (*i.e.*, if there is no supervision, then there is no need for limitations on supervision) do not involve SIGTARP duties or responsibilities. Supervision by a third party, and limitations on that

<sup>6</sup> See 5 U.S.C. App. 3 § 8D(a). EESA does not include constraints similar to those imposed upon the Treasury Inspector General, whose activities can be limited by a Secretarial determination that his activity may involve "deliberations and decisions on policy matters, including documented information used as a basis for making policy decisions" that the Secretary would prefer remain confidential. *Id.*

<sup>7</sup> Indeed, if Congress wanted the Secretary to supervise the internal oversight of the TARP program, then Congress did not need to create SIGTARP. The Treasury Inspector General, which had plenary audit and investigative authority with respect to Treasury's programs, already existed, and Congress could have simply increased funding for that Office.

<sup>8</sup> Likewise, they do not include section 5 of the IG Act. Nonetheless, as a matter of policy, SIGTARP has decided to adopt the reporting topics of section 5(a), and include them in appendices to our quarterly reports for the second and fourth quarters.

<sup>9</sup> The maxim of statutory construction, *inclusio unius est exclusio alterius*, holds that if a statute or rule expressly includes, recites or enumerates matters, then matters that are not so included, recited or enumerated are excluded. See, e.g., *Campo v. Allstate Ins. Co.*, 2009 U.S. App. LEXIS 5460 (5<sup>th</sup> Cir. Mar. 17, 2009).

supervision, simply do not constitute "duties and responsibilities" of SIGTARP. More importantly, in the context of the IG Act, "duties and responsibilities" of Inspectors General are expressly established at section 4(a), not 3(a) or 8D. Section 4 of the IG Act is entitled, "Duties and responsibilities; report of criminal violations to Attorney General," and section 4(a) begins, "it shall be the duty and responsibility of each Inspector General . . . ." Additionally, the legislative history underlying the IG Act, fully supports the proposition that "duties and responsibilities" of Inspectors General are located at section 4(a), not 3(a) or 8D. See H.R. Rep. No. 95-584 pp. 11-13; and Sen. Report No. 95-1071 p. 27 ("Section 4 sets forth the duties and responsibilities of the Inspector and Auditor General"). A more expansive construction of EESA to include incorporation of sections 3(a) and 8D is simply not warranted in light of the express language and the obvious legislative intent described above.

Attorney-Client Privilege Is Not A Bar To SIGTARP's Access To Treasury Information

With respect to your concern about attorney-client privilege, the existence of an applicable privilege does not relieve Treasury from its responsibility under EESA, as amended, and the IG Act to cooperate with SIGTARP and produce records and information deemed necessary to the accomplishment of SIGTARP's mission. Section 121(c)(4)(A) of EESA, as amended, authorizes SIGTARP "to conduct, supervise, and coordinate an audit or investigation of any action taken under [EESA] as the Special Inspector General determines appropriate." Further, pursuant to sections 6(a)(1) and 6(a)(3) of the IG Act, which are expressly incorporated into EESA by section 121(c)(3), SIGTARP is guaranteed "access to all records, reports, audits, reviews, documents, papers, recommendations, or other material available to" Treasury and is authorized "to request such information or assistance as may be necessary" to satisfy our responsibilities. Moreover, in the latter regard, Treasury -- "insofar as is practicable and not in contravention of any existing law" -- is required to cooperate with SIGTARP, see 12 U.S.C. § 5231(e)(4)(A), and, in the event that it fails to do so, SIGTARP is required immediately to report to Congress, see 12 U.S.C. § 5231(e)(4)(B). Neither EESA nor the IG Act include an exception for privileged materials. Thus, it seems fairly certain that SIGTARP statutorily has unfettered access to Treasury's privileged as well as non-privileged documents and information.

Additionally, it may be reasonably argued that SIGTARP's compelled access via EESA and the IG Act renders Treasury's compliance with SIGTARP's access demands "involuntary." As you know, waivers of the attorney-client privilege are not effective if they are "involuntary." See Equity Analytics, LLC v. Lundin, 248 F.R.D. 331, 334 (D.D.C. 2008); *in re Parmalat Securities Litigation*, 2006 LEXIS 88629 (S.D.N.Y. 2006); Duttie v. Bander & Kass, 127 F.R.D. 46, 56 n. 5 (S.D.N.Y. 1989) (citing S.E.C. v. Forma, 117 F.R.D. 516, 523 (S.D.N.Y. 1987) Teachers Ins. And Annuity Assoc. of Am. v. Shamrock Broadcasting Co., 521 F.Supp. 638, 641-42 (S.D.N.Y. 1981).

Thank you for consulting with us concerning your intention to seek OLC guidance. Please contact me or my Chief Counsel, Bryan Saddler, if you have any questions regarding this memorandum.

May 11, 2009

**Saddler, Bryan**

**From:** Saddler, Bryan  
**Sent:** Monday, May 11, 2009 2:45 PM  
**To:** Knight, Bernard Jr.  
**Subject:** RE: SIGTARP

Yes thanks.

-----Original Message-----

**From:** Knight, Bernard Jr.  
**Sent:** Monday, May 11, 2009 2:44 PM  
**To:** Saddler, Bryan  
**Cc:** 'Barron, David'; 'Koffsky, Daniel L'  
**Subject:** SIGTARP

Bryan,

I sent this follow-up to OLC a few minutes ago and forgot to copy you. Hope all is going well.

Bernard J. Knight, Jr.  
 Assistant General Counsel  
 (General Law, Ethics & Regulation)  
 and Designated Agency Ethics Official  
 U.S. Department of Treasury

-----Original Message-----

**From:** Knight, Bernard Jr.  
**Sent:** Monday, May 11, 2009 2:28 PM  
**To:** Barron, David  
**Cc:** 'Koffsky, Daniel L'; Kedem, Allon; Anderson, Trisha; Madison, George; Lepley, Richard; Briskin, Michael; Yoo, Julia; Schaffer, Laurie; Bieger, Peter; Albrecht, Stephen  
**Subject:** SIGTARP

David,

We are responding to your email asking us for further analysis on some of the issues that we presented in our original email regarding the SIGTARP. For the reasons discussed in our April 15 email, the question of SIGTARP's specific location within the Executive Branch is a difficult one, but resolution of this issue is important. Among other things, it is a prerequisite to resolution of a potential dispute between the Secretary and SIGTARP over whether privileged documents provided to SIGTARP may be disclosed. We disagree with SIGTARP's assertion that it is located within Treasury but not subject to supervision by the Secretary, as discussed further below.

As we discussed in our earlier email, we believe one of the strongest arguments that SIGTARP is subject to the general supervision of the Secretary is that supervision by the Secretary under section 3(a) of the IG Act is a "dut[y]" or "responsibilit[y]" of inspectors general imposed upon SIGTARP by EESA § 121(c)(3). The fact that § 4(a) of the IG Act expressly sets forth certain duties and responsibilities of IGs does not compel the conclusion that Congress intended EESA § 121(c)(3) to confer only those duties and responsibilities. Congress's general reference to "duties and responsibilities . . . under the [IG] Act," rather than a

specific reference to § 4(a), suggests that § 121(c)(3) was intended to encompass the entire IG Act, especially given EESA's references to other specific subsections of the IG Act when reference to specific subsections is intended. Thus, there is no compelling reason to conclude that only the duties and responsibilities of section 4(a) of the IG Act apply to SIGTARP, and not those of other sections of the IG Act such as subsections 4(c), 4(d), or 7(b). In particular, the legislative history for section 3(a) of the IG Act describes an additional responsibility for inspectors general as follows: "Generally, the committee envisions that if the agency head asked the Inspector and Auditor General to perform an audit or an investigation or to look at certain areas of agency operations during a certain year, the Inspector and Auditor General should do so, assuming staff resources were adequate." S. Rep. No. 95-1071, at 26 (1978).

SIGTARP's April 7 memo quotes Senator Baucus' statement as to the independence of SIGTARP somewhat out of context. The full statement is that "I designed the office of this inspector general to be truly independent, with the necessary resources to fight for every taxpayer dollar. I designed this inspector general to be accountable only to Congress and to the American taxpayer." Congressional Record p. S10218 (Oct. 1, 2008). Given that EESA makes SIGTARP subject to removal by the President, this statement cannot be taken literally. As such, it is of questionable utility in determining whether Congress intended SIGTARP to be under the supervision of the Secretary or the direct supervision of the President.

We are unaware of any precedent for an arrangement whereby an IG would be located "within" an agency but not subject to supervision by the agency head. Nothing in EESA suggests that this is what Congress intended for SIGTARP. Indeed, it is only through reference to § 3(a) of the IG Act that there is support for the conclusion that SIGTARP is located within the Treasury Department. The provisions of the IG Act that EESA incorporates in creating SIGTARP are premised on the concept of having inspectors general not only located within an establishment, such as Treasury, but also reporting to the "head" of the establishment.

Neither EESA nor the IG Act establishes inspectors general as independent additional heads within an establishment, and such an interpretation would create serious, if not irresolvable, conflicts with other statutes. In addition to the definition of "head of the establishment" under section 12(1) of the IG Act (which includes the Treasury Secretary and does not include inspectors general), 31 U.S.C. § 301(b) establishes the Secretary as the head of the Department of the Treasury. 31 U.S.C. § 321(c) generally vests the duties and powers of "officers and employees" of the Department in the Secretary, with three express exceptions for administrative law judges, the Comptroller of the Currency, and the Director of the Office of Thrift Supervision. The IG Act also provides certain protection for the independence of inspectors general, as discussed below. (The heads of the Office of the Comptroller of the Currency and Office of Thrift Supervision have considerable autonomy, but both are expressly made subject to the "general directions" or "general oversight" of the Secretary. 12 U.S.C. §§ 1, 1462a(b)(1)). Moreover, section 6(d) of the IG Act specifies certain limited instances in which offices of inspectors general can be treated as separate agencies and in which inspectors general can exercise the powers of an agency head. EESA section 121(d)(1) confers these section 6(d) authorities on SIGTARP, which would be unnecessary if SIGTARP had other similar authority. Accordingly, we do not believe that SIGTARP generally possesses the authorities of an agency head.

In fact, reading EESA as incorporating § 3(a) of the IG Act with its grant of supervisory authority to the Secretary and concomitant restrictions on that authority helps preserve SIGTARP's autonomy. If EESA § 121(c)(3) is read to incorporate § 3(a) of the IG Act, as we think it should be, the Secretary's authority under 31 U.S.C. §§ 301(b) and 321(c) is subject to the limitations contained in the more specific IG Act. If § 3(a) does not apply, yet SIGTARP is within the Treasury Department, 31 U.S.C. §§ 301(b) and 321(c) would, on their face, subject SIGTARP to plenary supervision by the Secretary. Since it is unlikely that Congress intended such a result, either § 3(a) must apply or it must be assumed that EESA repealed sections 301(b) and 321(c) by implication with respect to SIGTARP, despite the fact

that nothing in EESA either places SIGTARP within Treasury or addresses his supervision. As a legal matter, such a conclusion would be difficult to reach. See generally *Radzanower v. Touche Ross & Co.*, 426 U.S. 148, 154 (1976) (discussing doctrine disfavoring repeals by implication); *Morton v. Mancari*, 417 U.S. 535, 549-51 (1974) (same).

Moreover, if SIGTARP is not under the Treasury Secretary's general supervision, it is uncertain whether the Treasury Secretary could delegate certain duties and powers that he can delegate to inspectors general under his supervision. For example, various statutory powers apply only to heads of Executive agencies as defined in 5 U.S.C. § 105.2 Two that we readily located are the authority to pay training expenses (see 5 U.S.C. §§ 4101, 4109), and the authority to pay employee awards (see 5 U.S.C. §§ 4501(1), 4503, 4505a(a)(2)).<sup>3</sup> SIGTARP, of course, would be no different than other Treasury inspectors general in not being directly granted these powers. Treasury routinely delegates powers of this sort to bureau heads and to its inspectors general. It does not follow, however, that the Secretary would have the power to delegate such powers to a SIGTARP over whom he had no supervisory power. 31 U.S.C. § 321(b)(2) permits the Secretary to delegate powers to "another officer or employee of the Department of the Treasury," but it is not clear that a non-subordinate SIGTARP would qualify to receive such a delegation. It is questionable whether an individual who is not supervised by the Secretary, and therefore is not in an employment relationship with him, could be an "employee"; potentially, a similar employment relationship would be required to be an "officer" of the Department.

Even if legal authority to delegate such powers to a non-subordinate SIGTARP exists, delegation of powers with no authority to oversee their application raises a potentially significant policy concern. This concern might lead Treasury to refrain from delegating certain powers, or to make only limited delegations subject to significant restrictions. The requirement for such delegations demonstrates another reason why placing SIGTARP within Treasury, but not under supervision of the Secretary, would not guarantee complete independence.

For the reasons discussed above, section 121(c)(3) of EESA should be read to apply to SIGTARP the provision for general supervision by the Treasury Secretary under § 3(a) of the IG Act. If OLC finds that this reading does not have sufficient support in the statute, then we believe that OLC should conclude that SIGTARP is not within the Department.

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 FN 1: Footnote 8 of SIGTARP's April 7 memo asserts that SIGTARP is not subject to the semiannual reporting requirements of § 5 of the IG Act, but plans to include information on the topics covered by § 5(a) as appendices to its reports on the second and fourth quarters. An argument could be made that submitting the reports required by § 5(a) is a duty of inspectors general under the IG Act made applicable to SIGTARP through EESA. However, literal application of § 5(a) would require SIGTARP to submit the reports to Treasury under § 5(b), with no corresponding duty for Treasury to forward them to Congress. Although § 121 of EESA applies IG Act duties and responsibilities to SIGTARP, § 121 does not purport to impose upon Treasury additional IG Act duties or responsibilities with respect to SIGTARP, such as those in § 5(b) of the IG Act. Regardless of whether the § 5 reporting requirements apply to SIGTARP, it appears that inclusion of applicable topics covered by § 5(a) in the separately required and publicly available SIGTARP reports for the second and fourth quarters would satisfy any § 5(a) or (b) reporting requirement for SIGTARP.

FN 2: If SIGTARP is within the Treasury Department, it cannot be an "Executive agency" as defined in 5 U.S.C. § 105. Under that statute, "Executive agency" includes executive departments, Government corporations, and independent establishments. The Treasury Department is defined by 5 U.S.C. § 101 as an Executive department; SIGTARP is not. Under 5 U.S.C. § 104(1), an "independent establishment" does not include an Executive branch establishment that is an Executive department "or part thereof." Thus, SIGTARP cannot be an independent establishment if it is within the Treasury Department. Because SIGTARP would

therefore be neither an Executive department nor an independent establishment (and obviously is not a Government corporation), it would not be an Executive agency.

FN 3: Section 6(d) of the IG Act has recently been amended to designate IGs as heads of agencies with respect to certain Title 5 statutory provisions, but not with respect to those cited in this paragraph

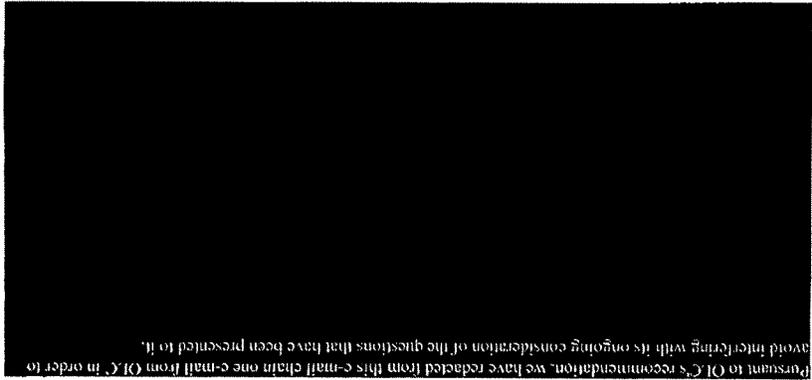
Bernard J. Knight, Jr.  
Assistant General Counsel  
(General Law, Ethics & Regulation)  
and Designated Agency Ethics Official  
U.S. Department of Treasury  
[REDACTED]

-----Original Message-----

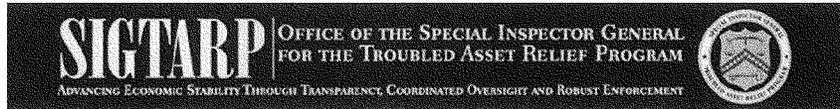
From: [REDACTED]  
Sent: Wednesday, April 22, 2009 12:25 PM  
To: Knight, Bernard Jr.  
Cc: [REDACTED]  
Subject: sigtarp

Pursuant to OLC's recommendation, we have redacted from this e-mail chain one e-mail from OLC in order to avoid interfering with its ongoing consideration of the questions that have been presented to it.

[REDACTED]



Pursuant to OLC's recommendation, we have redacted from this e-mail chain one e-mail from OLC in order to avoid interfering with its ongoing consideration of the questions that have been presented to it.



**SIGTARP SURVEY DEMONSTRATES  
THAT BANKS CAN PROVIDE  
MEANINGFUL INFORMATION ON THEIR  
USE OF TARP FUNDS**

**SIGTARP-09-001  
JULY 20, 2009**



## SIGTARP

Office of the Special Inspector General  
for the Troubled Asset Relief Program

Summary of Report: SIGTARP-09-001

### Why SIGTARP Did This Study

The Troubled Asset Relief Program ("TARP") was created by the Emergency Economic Stabilization Act ("EESA") of 2008, which was enacted on October 3, 2008. TARP provided the Secretary of the Treasury with various authorities to restore the liquidity and stability of the United States financial system and stimulate lending. As of June 15, 2009, the Department of Treasury ("Treasury") has provided about \$330 billion of TARP funds to more than 600 financial institutions.

The Congress and the public frequently ask questions about how TARP funds have been used. Accordingly, the objective of this report was to address how TARP recipients have used the funds received.

In February 2009, SIGTARP sent survey letters to more than 360 financial and other institutions that had completed TARP funding agreements through January 2009. The survey instrument provided for open-ended responses. The goal was to elicit as much information as possible while allowing for different conditions at each bank. This report is limited to survey recipients that participated in the Capital Purchase Program. The review and analysis were confined to the survey responses which included supporting documentation as provided, reported, and certified by the TARP recipients. SIGTARP plans additional work to further assess the actual use of funds. SIGTARP's work was performed in accordance with generally accepted government auditing standards.

### What SIGTARP Recommends

SIGTARP is renewing and expanding on a recommendation previously made that Treasury require TARP recipients to submit periodic reports to Treasury on the uses of TARP funds, including what actions they were able to take that they would not have taken otherwise. The full text of the recommendation is included in the body of the report.

In commenting on a draft of this report, Treasury did not agree with the recommendation. SIGTARP's response to Treasury's position is included in the management comments section of this report.

July 20, 2009

### Survey Demonstrates that Banks Can Provide Meaningful Information on Their Use of TARP Funds

#### What SIGTARP Found

Although most banks reported that they did not segregate or track TARP fund usage on a dollar-for-dollar basis, most banks were able to provide insights into their actual or planned use of TARP funds. Over 98% of survey recipients reported their actual uses of TARP funds.

Many banks reported that TARP funds allowed them to increase lending for residential and commercial loans, small business loans, credit card loans, and other types of lending. Most firms reported multiple and sometimes interrelated uses; a majority of respondents' reported that they used the funds primarily for lending, building capital reserves and investing, as highlighted below.

- More than 80 percent of the respondents cited the use of funds for lending or how it helped them avoid reduced lending. Many banks reported that lending would have been lower without TARP funds or would have come to a standstill.
- More than 40 percent of the respondents reported that they used some TARP funds to help maintain the capital cushions and reserves required by their banking regulators to be able to absorb unanticipated losses.
- Nearly a third of the respondents reported that they used some TARP funds to invest in agency-mortgage backed securities. These actions provided immediate support of the lending and borrowing activities of other banks and positioned the banks for increased lending later.
- A smaller number reported using some TARP funds to repay outstanding loans—some because the TARP funds were a more cost-effective source of funds than their outstanding debt, and some because of pressure from a creditor to use the funds for that purpose.
- Several banks reported using some TARP funds to buy other banks. One reported that this was a cost-effective way to acquire additional deposits that, in turn, would facilitate an even greater amount of lending.
- Some banks reported that they had not yet allocated funds for lending and other activities due to the short time elapsed since the receipt of funds, the weak demand for credit, and the uncertain economic environment.

Although the respondents reported that lending was an important use of funds, their responses generally did not quantify the amount of new lending or the incremental difference in lending based on use of TARP funds. Moreover, their responses represented their use or planned use at a single point in time and could be subject to change depending on economic conditions.

Special Inspector General for the Troubled Asset Relief Program

3/11



**OFFICE OF THE SPECIAL INSPECTOR GENERAL**  
FOR THE TROUBLED ASSET RELIEF PROGRAM  
1801 L STREET, NW  
WASHINGTON, D.C. 20220

July 20, 2009

MEMORANDUM FOR: The Honorable Timothy Geithner, Secretary of the Treasury

SUBJECT: Survey Demonstrates that Banks Can Provide Meaningful  
Information on Their Use of TARP Funds (SIGTARP-09-001)

We are providing this audit report for your use and information. It discusses information on the use of TARP funds by 360 financial institutions participating in Treasury's Capital Purchase Program. The Office of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) conducted this audit, under the authority of Public Law 110-343, as amended. This also incorporates the duties and responsibilities of inspectors general pursuant to the Inspector General Act of 1978, as amended.

We considered comments from the Assistant Secretary of Financial Stability when preparing the final report. The comments are addressed in the report, where applicable, and a copy is included in the Management Comments section of this report.

We appreciate the courtesies extended to the SIGTARP staff. For additional information on this report, please contact Mr. Barry W. Holman at (202-622-4633/[barry.holman@do.treas.gov](mailto:barry.holman@do.treas.gov)).

A handwritten signature in black ink, appearing to read "Neif M. Barofsky".

Neif M. Barofsky  
Special Inspector General  
for the Troubled Asset Relief Program

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## Introduction

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The Emergency Economic Stabilization Act of 2008 (“EESA”)<sup>1</sup> was enacted on October 3, 2008, authorizing the Secretary of the Treasury to establish the Troubled Asset Relief Program (“TARP”) to purchase non-performing or troubled assets from financial institutions. However, given the rapid deterioration of the financial markets in the fall of 2008, Treasury believed it needed to move more swiftly. The result was the decision to inject equity capital into financial institutions under its Capital Purchase Program (“CPP”) as it sought to stabilize financial institutions and markets and to stimulate lending. Subsequently, a number of other initiatives were undertaken. As of June 15, 2009, the Department of Treasury has provided about \$330 billion to more than 600 financial institutions using funds authorized under EESA. Nearly \$200 billion has been devoted to the CPP.

The Congress and the public frequently ask two questions regarding the investments made by the Department of Treasury:

- What have program recipients done with the money they received from Treasury?
- Have the recipients complied with the executive compensation requirements as a condition of receiving the funds?

To address these questions, beginning on February 5, 2009, SIGTARP sent survey letters to 364 financial institutions that had completed TARP funding agreements through January 31, 2009. This report addresses the responses of CPP recipients on the use of funds portion of the survey. SIGTARP will issue a separate report on executive compensation compliance.

## Background

The dramatic correction in the U.S. housing market in recent years precipitated a decline in the price of financial assets that were associated with housing, in particular mortgage-backed securities based on subprime loans.<sup>2</sup> As 2008 progressed, this led to an escalating crisis in the financial markets. Some institutions found themselves so exposed that they were threatened with failure—and some failed—because they were unable to raise needed capital as the value of their portfolios declined. Other financial institutions—ranging from government-sponsored enterprises to the largest of the Wall Street firms—were left holding “toxic” mortgages and/or securities that became increasingly difficult to value, were illiquid, and potentially had little worth. Moreover, investors stopped buying securities backed by mortgages and became reluctant to buy securities backed by many other types of assets. Because of the uncertainty about the financial condition

<sup>1</sup> P.L. 110-343, October 3, 2008.

<sup>2</sup> Subprime loans are designed for borrowers who do not qualify for prime interest rates, such as borrowers who have one or more of the following characteristics: weakened credit histories typically characterized by payment delinquencies, previous charge-offs, judgments, or bankruptcies; low credit scores; high debt-burden ratios; or high loan-to-value ratios. These loans were often not supported by documentation and carried less favorable terms to the borrower such as higher interest rates. Many of these loans were often bundled into residential mortgage-backed securities (“RMBS”) that were sold to investors including banks, hedge funds, insurance companies and retirement fund systems.

and the solvency of financial entities, the fees banks charge each other to borrow money rose dramatically, and inter-bank lending effectively came to a halt.<sup>3</sup> By late Summer 2008, the potential ramifications of the financial crisis included failure of systemically significant financial institutions; increased losses of individual savings; diminished corporate investments; and further tightening of credit that would exacerbate the emerging global economic slowdown.

In response to the financial crisis, EESA was enacted on October 3, 2008. EESA authorizes Treasury to purchase and insure certain types of troubled assets to provide stability and prevent disruptions in the economy and financial system, and to protect taxpayers. The purpose of EESA was to give Treasury authority and facilities to restore liquidity and stability to the U.S. financial system and to ensure that these activities were 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.

EESA gave the Secretary of the Treasury considerable discretion in determining both the type of financial instrument purchased and the institution from which it would be bought. Accordingly, within two weeks of EESA's enactment, as the financial markets and credit markets continued to deteriorate rapidly, Treasury's initial strategy quickly evolved from purchasing troubled assets to injecting capital into financial institutions to encourage them to build capital, increasing the flow of financing to businesses and consumers and supporting the economy. Accordingly, Treasury created the Capital Purchase Program ("CPP") and subsequently expanded the scope of its efforts under EESA to include a number of other program initiatives, such as support to Systemically Significant Failing Institutions, the Targeted Investment Program, and the Automotive Industry Financing Program. This audit report focuses on participants in Treasury's CPP.

The CPP funds were a primary source of new Tier 1 capital available to financial institutions when credit losses were rapidly eating away at the existing capital of many firms and the ability to raise private capital was severely constrained. Given the nationwide decline in real estate values, many banks faced losing the stream of income they had enjoyed from homeowner payments on mortgages. Moreover, they also faced being forced to recognize losses as they foreclosed on properties and found that the resale value of the properties was often dramatically lower than the amount of the loan. Similarly, the market for the mortgage-related securities had also declined, and many of the securities the banks held could no longer be sold in the open market for more than a fraction of what the banks had paid for them.<sup>4</sup>

Banks use their capital funds for multiple purposes. With respect to lending and investing, capital can also have a multiplier effect; one dollar in capital may generate multiple dollars in loans and investments. It can seed lending and investments by combining with and leveraging other sources of funds, such as relatively inexpensive bank deposits. One added dollar of Tier 1 capital can generate the potential for the bank to then issue an additional \$10 in loans, because, based on regulatory rules, a healthy bank that receives \$1 million in TARP funds can then

<sup>3</sup> Without the ability to readily borrow funds, banks were more concerned about retaining cash and somewhat reluctant to lend out funds.

<sup>4</sup> SIGTARP, "Quarterly Report to Congress," April 21, 2009.

borrow up to \$10 million to make new loans to consumers or businesses and still be deemed to be adequately capitalized, as long as the regulator finds that overall capital is sufficient and that the bank is able to absorb losses such as loan defaults. The bank could also leverage capital by using the new capital to buy deposits from other banks, further increasing their ability to issue new loans. For a more complete discussion regarding how banks use capital, see Appendix B.

## Objectives

The audit and survey of TARP recipients was intended to obtain information from the recipients regarding their use of TARP funds. Thus, our specific objective was to determine how TARP recipients have used the funds received.

## Scope

SIGTARP sent the survey to 364 financial institutions that had completed TARP funding agreements through January 31, 2009. The recipients had been approved for funding through the CPP, the Targeted Investment Program (“TIP”), the Systemically Significant Failing Institutions (“SSFI”) program, and the Auto Industry Financing Program (“AIFP”). Over 73 percent of the funding went to eight institutions, as is reflected below in Table 1.

**Table 1: Recipients of SIGTARP Survey by Funding Received**

| Amount of TARP Funds Received  | Number of Firms | Funding Amount (billions) | Percentage of funding |
|--------------------------------|-----------------|---------------------------|-----------------------|
| Greater than \$10 billion      | 8               | \$219.3                   | 73                    |
| \$1 billion to \$9.9 billion   | 19              | \$58.3                    | 20                    |
| \$100 million to \$999 million | 54              | \$14.6                    | 5                     |
| Less than \$100 million        | 283             | \$6.6                     | 2                     |
| <b>Total</b>                   | <b>364</b>      | <b>\$298.8</b>            | <b>100</b>            |

Source: SIGTARP “Quarterly Report to Congress,” April 21, 2009.

Of the 364 firms surveyed, 360 (99 percent) were under the CPP program and directly concentrated on banking; the other four included AIFP or SSFI recipients.<sup>5</sup> Accordingly, for ease of presentation, this report focuses on the 360 CPP recipients. For a list of the 360 banks that SIGTARP surveyed, see Appendix D.

We confined our review and analysis to the survey responses and supporting documentation as provided, reported, and certified by the TARP recipients. Because of the goal to provide insights into the use of funds as quickly as possible, SIGTARP generally did not review information or

<sup>5</sup> The other four firms were AIG, GM, GMAC, and Chrysler. These firms used TARP funds in various ways, such as repaying loans, funding ongoing operations, improving capital ratios to acceptable regulatory levels and continued lending. These firms will be the subject of a future SIGTARP report on the use of funds.

documentation beyond that provided by the respondents.<sup>6</sup> We did not attempt to verify independently the accuracy of the statements made by the banks. Information on lending was provided, but most of the responses did not quantify, on a dollar basis, the amount of lending or the incremental difference in lending resulting from the TARP investment. This report does not encompass or inquire about funds received from other government or non-government sources or the extent to which such funding may have influenced the use of TARP funding.

The survey instrument primarily provided for open-ended responses to elicit in-depth data. This was necessary because the institutions are widely diverse in terms of asset size, geography, institution type, and institution-specific economic factors. As such, this approach permitted a wide range of responses and flexibility with regard to the specific information and supporting documentation provided. This data is not sufficient for statistical inferences; it should be interpreted as more reflective of directional insights rather than statistically valid characterizations of the TARP recipient's use of funds. Because the objective of this report is broad, the open-ended survey elicited differing levels of detail.

Many banks were concerned about business-sensitive information and requested confidentiality of individual survey responses. Accordingly, pursuant to our legal obligations, SIGTARP is unable in this report to attribute any results or comments to a specific institution. However, SIGTARP is in the process of evaluating recipients' claims of confidentiality and will provide copies of the individual responses that will include information provided by the banks to the maximum permitted by law. SIGTARP plans to post the responses, redacted as necessary, on its website within 30 days.

For a more complete discussion of the audit scope and methodology, see Appendix A. For a discussion of how banks use capital, see Appendix B. For a copy of the letter sent to recipients of TARP funds through January 31, 2009, see Appendix C. For a list of TARP CPP recipients, see Appendix D. For tables on reported use of funds by month of disbursement, asset sizes, and amount of funding, see Appendix E. For reported broad benefits of receiving CPP funds, see Appendix F. For the audit team members, see Appendix G. For a copy of comments from the Department of Treasury, see Appendix H.

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<sup>6</sup> SIGTARP plans additional work in this area.

## Banks Were Able To Provide Meaningful Information on Their Use of TARP Funds

Although most banks reported that they did not segregate or track TARP fund usage on a dollar-for-dollar basis, most banks were able to provide insights into their actual or planned use of TARP funds. Over 98 percent of survey recipients reported their actual uses of TARP funds.<sup>7</sup> The banks reported that TARP funds were primarily used for lending, capital reserves, and investments, often citing multiple benefits. However, some banks reported that they had not yet allocated funds for lending or other activities due to the short time that elapsed since the receipt of funds, weakened demand for credit, and the uncertain economic environment. Other firms reported more broadly on the overall benefits of the TARP funding, including actions they were able to undertake or avoid, such as freezing or reducing lending. Nearly 30 percent of respondents reported that their lending levels would have been lower without TARP funds. Table 2 highlights the major uses of funds as reported by the recipients.

**Table 2: Reported Use of CPP Funds**

| Category of Use                 | Number of Institutions | Percentage of Institutions |
|---------------------------------|------------------------|----------------------------|
| Lending                         | 300                    | 83                         |
| Capital Cushion, other reserves | 156                    | 43                         |
| Investments                     | 110                    | 31                         |
| Debt Repayments                 | 52                     | 14                         |
| Acquisitions                    | 15                     | 4                          |

Source: SIGTARP analysis of 360 survey responses.

Note: Numbers and percentages do not total because respondents reported multiple uses of funds.

The responses reflect the multiple uses of funds cited by individual TARP recipients. It is important to note, however, that the numbers shown in Table 2 represent only the uses specifically reported by banks; others may have made similar uses without specifically reporting it. Respondents reported investment activities across all bank asset sizes and amounts of funding received, as outlined in more detail in Appendix E.

### Most Recipients Did Not Segregate TARP Funds from Other Bank Capital

Under the terms of CPP, banks receiving TARP funds were not required to segregate TARP funds or report on their use of such funds. Forty-four respondents, nonetheless, reported that they segregated TARP funds from other bank funds. Approximately half of those respondents recorded the TARP investment on the balance sheet as a discrete component of each bank's

<sup>7</sup> Only six institutions did not report actual uses of TARP funds. Five of those six received TARP funds in January 2009 and reported expected future uses of TARP funds. One intends to return the funds but has not yet done so as of June 15, 2009.

capital. Others cited efforts to segregate physically the funds in a separate account and to manage them separately. One bank stated:

- “[A] separate checking account was established at [the Bank] in to which the TARP funds were deposited. This account is tracked individually on the parent’s books via a specific general ledger account. Thus, all activity is isolated and tracked for dispersals. On a monthly basis, the general ledger balance is reconciled to the account statement.”

More than half of the banks that reported physical segregation of funds, however, stated that segregation was only a temporary measure pending future deployment of the funds.

The majority of recipients reported that they did not segregate TARP funds. They noted that, in accordance with typical banking industry practices, they commingled the TARP funds with their other capital and leveraged the funds to increase lending and/or make investments. Several banks focused on what they perceived to be the impracticality of segregation. However, this did not preclude respondents from providing information on the use of TARP funds. With regard to segregation, one bank stated that it deposited the TARP funds into its Federal Reserve Bank account, which it used to meet general funding needs. The bank noted that from a capital perspective, the TARP preferred shares and related common warrants were clearly visible as discrete components of their overall capital. At the same time, it also noted that, once received, the cash associated with the TARP funding became indistinguishable from any other cash sources. The following quotes provide context on the reasons that some banks did not segregate TARP funds from other bank capital.

- “The capital we received from the U.S. Treasury was not segregated from other funds. We manage from a total balance sheet perspective, and capital investments are typically not segregated. We do not believe that such segregation is common practice in the industry, nor was it required pursuant to the agreements governing the Treasury’s capital purchase.”
- “Upon receipt of the TARP proceeds, [the Bank] did not segregate those funds from other capital funds. We did not and do not believe that earmarking the specific funds is in the best interest of our shareholders and/or borrowing customer. Instead, by adding the TARP funds to our existing, already strong capital base, [the Bank] could effectively deliver on its mission of growing its balance sheet by providing retail and commercial depositors and borrowers in our market competitive financial products and services that foster appropriate, rational growth.”

The majority of recipients did not report any specific actions taken to track use of TARP funds. They reported bank activities that were supported by TARP funds, but did not specify the portion that represented TARP fund investment. Nearly 90 percent of banks reported some activities in this manner. Some banks that reported in this regard were quite general in their responses, such as the following bank comment: “. . .our actual use of TARP funds to date has been . . .to make loans to credit worthy customers, and to facilitate resolution of problem assets on our books.” Others provided more details about company activities, but did not give a dollar amount of TARP funds spent or specify the portion of the activity that represented TARP fund investment.

A few respondents, however, tracked actual lending figures as such. However, one bank, in a far more typical response, described the difficulty in tracking lending as follows:

- “Although banks do use capital to lend, it is more precise to say that banks use capital to *support* their lending. . .it is a cushion against losses, and it is there to support and enable other borrowing in the form of deposit gathering and capital markets borrowing. In this regard, . . .banks actually lend *more* than just the amount of their total capital and their TARP capital investment amounts. . .it is also important to understand that because TARP CPP funds are commingled with other capital, deposits and funds from other sources, it is difficult to state categorically what specific funds are actually being used for, except to say. . .that they are being used for and in support of lending.”

Generally speaking, although there were exceptions, the information provided by the survey respondents regarding the use of funds did not vary significantly among those who reported that they segregated TARP funds from other funding sources and those who reported that they did not segregate TARP funds.

**Lending**

Most recipients reported leveraging the TARP funds to support lending activities by continuing lending or renewing and/or modifying existing loans. Some institutions reported that, without TARP funds, lending activities would have come to a standstill or would have been curtailed. For example, one respondent stated that “had we not received the TARP funds, we may not have been able to fund as many residential loans or our liquidity would have been strained which would have hampered our ability to make future loans.” Although some firms reported general lending efforts and the preservation of lending levels, many institutions further subcategorized their lending initiatives by residential lending, small business loans, credit cards, and other categories, as shown in Table 3. However, the survey and responses did not result in sufficient information to develop an overall aggregate amount of actual lending.

**Table 3: Reported Lending Activities Supported by TARP Funds**

| Lending Activity                | Number of Institutions | Percentage of Institutions |
|---------------------------------|------------------------|----------------------------|
| Residential Mortgage Activities | 103                    | 29                         |
| Commercial Mortgages            | 66                     | 18                         |
| Other Consumer Lending          | 61                     | 17                         |
| Small Business Loans            | 45                     | 13                         |
| Other Business Loans            | 48                     | 13                         |
| Loan Modification               | 34                     | 9                          |
| Credit Cards                    | 8                      | 2                          |
| Student Loans                   | 6                      | 2                          |

Source: SIGTARP analysis of 360 survey responses.  
 Note: Numbers and percentages do not total because respondents reported multiple uses of funds.

The respondents most frequently cited using TARP funds to support origination of residential mortgages, commercial mortgages, and small business loans. About 29 percent of the respondents reported a focus on using TARP funds to support residential mortgages. Additionally, another 9 percent stated that they have used TARP funds for mortgage loan modification initiatives. Various responses cited using TARP funds for commercial mortgage lending (18 percent) and small business lending (13 percent). These are some of SIGTARP's observations related to the categories of lending activities listed in Table 3:

- **Residential lending:** The incidence of residential mortgage lending was even greater when combined with reported loan modifications. Some institutions reported direct use of TARP funds for residential mortgage activities and for bolstering mortgage modification programs. For example, one bank commented that "since receiving TARP in December 2008, the bank has modified about \$3 million of its existing loans to a structure that is sustainable and affordable for troubled borrowers." Another bank reported that it was going to implement a home equity loan program designed to help customers remain in their homes and avoid foreclosure.
- **Commercial lending:** Nearly 20 percent of respondents reported that they used TARP funding for commercial lending activities. Commercial lending, the second most frequently cited category of lending, was broadly distributed across institutions of various sizes. Most often, firms provided general information related to commercial real estate. A few however, provided exact figures; for example, one firm reported funding two loans from TARP proceeds, including a commercial real estate loan for \$820,000.
- **Other consumer lending:** Almost 17 percent of respondents reported deploying TARP funds for other consumer lending activities. When these consumer lending activities were reported more descriptively, the loans were often reported as auto loans, personal loans, or other lines of credit. One recipient reported a renewed focus on consumer lending, stating that they have "reentered the [state] market to expand our consumer automobile lending...and have increased our budgeted 2009 automobile loan production [by \$90 million]. We expect to use the remaining TARP funds to continue to increase our automobile loan production...".
- **Small business lending:** About 13 percent of the institutions—of various sizes and types—reported using some TARP funds to support small business lending. One smaller firm reported that it had used all the CPP funds for various lending activities, including \$500,000 related to small business loans. A larger institution reported lending over \$20 billion in new credit extensions, including commitments and renewals to 8,000 small and mid-sized businesses, governments, and non-profits. Another institution responded more generally, that it is using the TARP capital funds to renew and originate quality SBA loans, in addition to other lending.

### Capital Cushion or Other Reserves

Regulators require banks to maintain certain capital cushion levels to be able to absorb unanticipated losses and to protect against the risk of insolvency. Beyond that, banks may leverage excess capital to engage in lending and investing to serve their customers and generate more income. Many survey responses highlighted the importance of the TARP funds to the bank's capital base, and, by extension, the impact of the funds on lending.

As noted earlier in Table 2, more than 40 percent of banks reported using some TARP funds to generate capital reserves to help the institution remain well-capitalized from a regulatory capital perspective. In citing the use for capital purposes, various recipients emphasized the need to retain capital as a buffer or cushion against loan losses or other unforeseen events in light of the economic instability facing U.S. and international markets. For example, one institution reported that "while some policymakers are encouraging banks to lend more, regulators have announced that they expect banks to maintain significantly higher capital ratios as a buffer against a potentially severe and prolonged recession."

In addition, the respondents also disclosed a variety of other reasons for focusing on strengthening capital. These reasons included concerns about the recessionary economic environment, the anticipation of potential increases in regulatory capital requirements, the need to better position themselves to absorb future credit losses, and preparing for the possibility of continued capital availability constraints in the future. The following responses provide some insights into the importance of having TARP funds to bolster capital reserves:

- **Retain strong capital ratios:** "During the second half of 2008, management became concerned about being able to retain its well capitalized risk based ratios because of the dramatic reduction in expected repayments."
- **Cushion against future losses:** "[I]t was in the best interest of [the Bank's] shareholders for the company to gain additional liquidity and a further capital cushion against the economic uncertainties that lay ahead."
- **Raise new capital otherwise not available in the market:** "Absent an infusion of capital [the Bank] was unable to continue to meet the needs of its retail and commercial customer base. Opportunities to raise capital through private sources are virtually non-existent. Consequently, participating in the TARP enabled [the Bank] to continue to meet its customer needs." Another bank noted that "none of this new lending would have been possible without the additional TARP capital, which helped us maintain our well capitalized rating while continuing our important lending programs."

Some institutions listed measurable impacts of TARP funds on their capital ratios, while others reported in general terms on how the direct infusion of TARP funds bolstered their reserve positions.

### Investments

Some recipients chose to support lending by investing in relatively safe and liquid securities or debt, primarily Government Sponsored Enterprises (GSE), mortgage-backed securities (MBS), agency debt, and municipal securities, as seen in Table 4. According to the banks, these investments provided immediate support of the lending and borrowing activities of other institutions, as described below.

**Table 4: Reported Investment Activities Supported by TARP Funds**

| Investment Activity                              | Number of Institutions | Percentage of Institutions |
|--|------------------------|----------------------------|
| Mortgage-backed Securities (Agency) <sup>8</sup> | 88                     | 24                         |
| Municipal Securities                             | 19                     | 5                          |
| Agency Debt                                      | 10                     | 3                          |
| Mortgage-backed Securities (Non-agency)          | 8                      | 2                          |
| Corporate Debt                                   | 6                      | 2                          |

Source: SIGTARP analysis of 360 survey responses.

Note: Numbers and percentages do not total because respondents reported multiple uses of funds.

Those that invested TARP funds in MBS tended to invest in the so-called “agency” securities—those backed by Ginnie Mae, Fannie Mae, and Freddie Mac; only a few invested in private-label MBS or corporate debt. Many characterized these investments in “agency” MBS and debt as short-term. The recipient rationale for investing in these instruments included:

- the consideration of safety and liquidity
- the reasonableness of the return on the investment
- the favorable regulatory capital treatment of those assets
- the flexibility to use the securities as collateral to secure future loans
- the opportunity to redeploy the cash flows generated from these investments over time to support direct lending and other investment opportunities

One large entity reported that its multi-billion dollar investment in Fannie Mae MBS “helped to provide liquidity to the secondary [mortgage] market<sup>9</sup> when Fannie Mae’s funding costs had

<sup>8</sup> In some cases, the respondent did not report which types of mortgage-backed securities were purchased. In these cases, we captured the response as an agency MBS because those were the most common, and the market for non-agency MBS was virtually frozen during the time period covered by the survey.

increased significantly.” Another recipient that purchased more than \$2 billion of MBS expressed the belief that these purchases assisted in the recovery and stabilization of the MBS market. Many other recipients who expressed similar sentiments stated that investments in MBS help to replenish funds to other lenders so that those lenders, in theory, could continue to originate additional mortgage loans. Others sought to use the cash flows from these investments to support lending. For example, one regional bank that used TARP funds to purchase more than \$80 million in MBS stated that “the intention of this initial use of funds was to invest in high quality, low risk securities issued by [GSEs] to assure a reasonable return on these funds and to establish a series of cash flows that could quickly and easily be redeployed into customer-based commercial, mortgage and consumer loans as local economic conditions warrant.”

Although most recipients that reported investments deployed the TARP funds into mortgage-related investments, a few reported investments in municipal securities with the intent of helping local communities. One recipient strongly emphasized municipal bonds by investing around 14 percent of the TARP funds received in this manner, explaining that investing in municipal bonds will provide much-needed funding for municipalities currently strained by the recession.

### Debt Repayment

About 14 percent of TARP recipients reported using some of the funds to repay outstanding debt obligations. More specifically, the respondents used the funds to reduce short-term borrowing, repay loans to other financial institutions, retire or reduce letters of credit, and/or as replacement financing for higher cost loans. Banks noted these reasons for repaying outstanding debt:

- improving the balance sheet while mitigating their liquidity risk
- external pressure to retire their outstanding debt obligations
- instructed by their creditors to use the TARP funds to pay off their loans
- lack of demand for lending
- to replace their outstanding debt with new, cheaper debt

Many banks were able to provide specific dollar amounts of TARP funds used for this purpose. One bank reported using \$75 million of TARP funds to reduce its short-term borrowings; another used \$55 million to pay down a revolving credit facility.

### Acquisitions

Only 4 percent of institutions reported that they used TARP funds to complete acquisitions. The most common theme emerging from responses related to acquisitions was that they were often completed at FDIC’s encouragement or that the assets were acquired from FDIC. The majority of the responding institutions shared perspectives similar to these:

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<sup>9</sup> A secondary market is created when a bank sells a portion of their loans to a dealer, who pools the loans together and sells portions of the loan pools as securities to investors. The secondary market serves as a source of cash for banks, providing them money to make new loans.

- “We have also cooperated with the FDIC who asked us to commit resources to take on another failed bank...and continue to provide uninterrupted service to 6,400 customers.”
- “Included in the deposit growth is our...purchase of approximately \$180 million of deposits from the FDIC.”
- “Without TARP funds, it is unlikely that the Bank could have assisted the FDIC with the transaction while still meeting credit needs of existing customers.”

Only two institutions reported that their capital levels would have been sufficient to support acquisitions without the TARP injection. One of them planned to acquire a number of bank branches and was specific as to the investment costs and the benefit. Although noting that the acquisitions would have occurred without the TARP funds, this institution expressed the view that the acquisitions were an excellent use of the TARP funds because the additional deposits acquired with the branches would (through leveraging) allow the bank to increase future lending many times over the expected acquisition cost.

#### **Reported Future Uses of TARP Funds**

Nearly 78 percent of recipients reported future plans for deployment of TARP funds. They most frequently cited lending and capital accumulation activities. Recipients that reported plans for future deployment of TARP funds typically expected that lending activity would increase; almost all of those institutions stated that they deployed or intend to deploy a portion of TARP funds to support lending. Banks also indicated that they were less likely to use TARP funds for investment in securities, debt repayments, and capital reserves in the future. Furthermore, more respondents reported that they were actually considering using TARP funds to acquire another bank than those who reported they already have done so.

Other banks reported that they had not yet allocated funds for lending and other activities because of the short time elapsed since the receipt of funds, the demand for credit, and the uncertain economic environment. In January 2009, 147 survey recipients received TARP funds, sometimes only weeks before receiving the survey request. Accordingly, many of these recipients had only a limited amount of time to deploy TARP funds fully. Some recipients provided responses with perspectives on the timing of the survey and the time passed since the receipt of funds, including a firm that made this request:

- “Because this transaction closed only three weeks ago, we would respectfully ask that in reviewing our response, you do so in light of the very limited period of time that has passed between January 30, 2009 and the date of this letter.”

Other institutions provided insight into their initial limited ability to deploy TARP funds due to the weakened demand for credit and the broader economy. One such bank stated that “our liquid assets created by the capital injection are being invested nightly with the Federal Reserve until such time as the economy and demand for loans within our markets returns and the capital can be effectively employed.”

### Overall Benefits

Beyond specific details on their use of funds, banks also provided insights into the overall benefit of the TARP funding, some of which were previously noted. Importantly, many recipients addressed these questions:

- What actions were they able to take that they could not have taken without receiving the TARP funds?
- Conversely, what actions were they able to avoid because of the infusion of TARP funds?

For example, approximately two-thirds of those who addressed this question reported that, without TARP funds, their lending levels would have been lower than levels they were able to achieve with TARP funds.<sup>10</sup> A more complete summary of the broad impact of receiving TARP funds—the actions that were possible to be taken, as well as the actions avoided—is provided in Appendix F.

The importance of each of the benefits in terms of actions that could be taken or avoided in return for receiving TARP funds is well summarized by the comments of one respondent:

“At the outset TARP capital was viewed as providing three core elements. First, it would enhance the liquidity position as a source of long-term committed funding. Second, it would strengthen the balance sheet by bolstering the capital position, thus giving all key stakeholders (regulators, investors, debt investors, customers, employees) confidence in [the bank’s] ability to weather the current ‘economic storm.’ The final element is achieved only through satisfying the first two, and that is the ability to continue executing our strategic business model through serving customers and growing our core lending business.”

<sup>10</sup> 106 respondents indicated at least one of the following categories reflected in Appendix F: Grow Lending, Enhance Lending Activity, Reduce Loan Terms, Reduce Lending, Freezing Lending, or Exiting the Banking Business.

## Conclusions and Recommendations

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Although most banks reported that they did not segregate or track TARP fund usage on a dollar-for-dollar basis, they were able to report on actual or planned activities that were supported by TARP funds as well as macro benefits associated with having the funds. These responses demonstrate that banks can provide useful information to improve transparency over how they use the TARP funds. The uses of funds identified in this report are as of a particular point in time and that use could vary somewhat over time depending on changing economic circumstances. Because of time constraints, many of the survey respondents had not yet allocated all of their TARP funds as of the March 2009 response date. Furthermore, more than 250 institutions have received TARP funds since the survey was issued, including a \$3.4 billion dollar investment in insurance company through the Capital Purchase Program.

Treasury has engaged in ongoing efforts to obtain lending data from each TARP recipient, but this tells only a small part of the story. It fails to recognize that TARP recipients do far more with their TARP funds than simply originating loans: they have also used these funds in a broader array of interrelated activities, as demonstrated in this audit, such as making investments, acquiring other financial institutions, and simply maintaining the capital as a cushion against future losses. SIGTARP has previously recommended that Treasury require all TARP recipients to report on their use of TARP funds, but, with limited exceptions, Treasury has not done so. Based on the survey responses, SIGTARP believes that this recommendation continues to be essential to meet Treasury's stated goal of bringing transparency to the TARP program and informing the American people and their representatives in Congress on what is being done with their investment.

To improve transparency over the use of funds, SIGTARP recommends that the Secretary of the Treasury require TARP recipients to submit periodic reports to the Department of Treasury on their uses of TARP funds, such as lending, investments, acquisitions and other activities, including a description of what actions they were able to take that they would not have taken without TARP funding.

SIGTARP also recommends that the Secretary of the Treasury require TARP recipients to retain all supporting documentation in conjunction with any reporting requirement that Treasury may impose.

### Management Comments and Audit Response

In written comments on a draft of this report, Treasury's Assistant Secretary for Financial Stability did not express concurrence with the report's recommendation but raised questions regarding the information provided; this response was consistent with the Department's previous opposition to this recommendation as noted in SIGTARP's Quarterly reports to the Congress. For a copy of Treasury comments on a draft of this report, see Appendix H.

In commenting on this report, the Assistant Secretary recognized that the report illustrated the broad range of uses to which capital may be put, including building capital reserves and supporting lending and making investments. Yet, at the same time, the Secretary suggested caution in drawing conclusions from this data noting that “although it might be tempting to do so, it is not possible to say that investment of TARP dollars resulted in particular loans, investments or other activities by the recipient. “ He went on to use selectively a quote in the report that most TARP recipients did not segregate TARP funds and that, once received, the cash associated with the TARP funding became indistinguishable from any other cash sources. He further stated that “even if TARP investments could be traced to particular uses, those uses cannot be said to be attributable to the TARP investment if the same expenditures would have been made from other sources even in the absence of TARP funding.”

SIGTARP’s report clearly points out the diverse views of respondents regarding the fungibility of TARP funds received and the difficulty of saying precisely which dollar was used for which purpose. Nonetheless, SIGTARP’s report provides significant information on the use of funds and notes that, with limited exceptions, the information provided by the survey respondents on their use of funds did not vary significantly between those banks that reported they segregated TARP funds from other funding sources and those that did not segregate TARP funds. Both groups provided meaningful responses indicating their actual and planned use of funds. SIGTARP finds it compelling that it received a 100 percent response rate to its survey and 98 percent of the respondents were able to describe wide ranging uses of their funds, typical of the range of actions that banks would be expected to take in having received the funds at a time of financial crisis in the country where the need to stabilize financial institutions and foster lending was paramount. Moreover, they were able to speak broadly about the benefits of having received the funds—both actions they were able to take as a result of receiving the funds as well as actions avoided.

For Treasury to discount wholly SIGTARP’s results because a particular bank may not be able to say which dollar was used for a specific purpose substantially underestimates a bank’s capacity — on a practical level — to know how its resources are being utilized. Take the example of an American family with a checking account. Because all of the family income goes into the same account, the family cannot say with any precision which paycheck paid for which particular bill. That does not mean, however, that the family cannot give meaningful information about what it did with the sizeable bonus that the wife received at the end of the year. Such infusions of money can be budgeted; such infusions can be used to do things that would not have been possible without such infusion. Banks are no different, and indeed should be in a better position to plan, and to track, how it will use a sizeable capital infusion. Stated another way, if a bank is receiving an infusion of tens of millions, if not billions, of TARP dollars, that bank is very likely to budget how it will be put to work and can likely give at least a general indication of what the bank was able to do that it would not have but for that sizeable infusion. Treasury’s decision to reject this information just because the bank may not be able to trace the exact dollars ignores this common sense view.

It also ignores the data that was collected in this audit. Many of the banks’ responses revealed uses to which the banks put the TARP funds that can be readily tested. If a bank reports that it was able to repay a specific loan with TARP funds that it would not have been able to repay but

for TARP funds, that is a use that can be tested. If a bank reports that it took the TARP funds and purchased agency MBS, that, too can be verified. If a bank states that it put the TARP funds into its account at the Federal Reserve to save for future potential losses that too can be checked. In sum, the fact that there may be some limitations on the precision of the data that could be collected by requiring use of funds reporting does not mean that such reporting could not generate meaningful information, including meaningful information that will not be captured by Treasury's lending snapshots.

## Appendix A—Scope and Methodology

SIGTARP performed this audit under the authority of Public Law 110-343, as amended, which also incorporates the duties and responsibilities of inspectors general under the Inspector General Act of 1978, as amended. This audit reports on the use of TARP funds by 360 institutions that participated in TARP’s Capital Purchase Program. Our specific objective was to determine how TARP recipients have used the funds received.

We conducted this audit from February to June 2009 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient and appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. Within the limitations noted below, we believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We contracted with Concentrance Consulting Group, Inc. (Concentrance) to help us review and analyze the responses we received. We interacted and worked with the Concentrance team at least weekly from April through June 2009 to help develop the analysis and produce the report.

We developed a narrative survey letter that provided for open-ended responses to elicit in-depth information. We chose this approach because the institutions are so wide in diversity in terms of asset size, institution type, and institution-specific economic factors. Regarding the use of funds, we asked each recipient to provide a narrative response that outlined:

- whether they segregated TARP funds from other institutional funds
- their actual use of TARP funds to date
- their expected future use of unspent TARP funds

We also asked recipients to consider their anticipated use of TARP funds when they applied for such funds, as well as any actions they have taken that they could not have taken without the infusion of TARP funds. Furthermore, we encouraged recipients to make reference to any statements to the media, shareholders, or others concerning their intended or actual use of TARP funds, as well as any internal email, budgets, or memoranda describing anticipated use of funds. Additionally, we asked recipients to segregate and preserve all documents referencing the use or anticipated use of TARP funds—such as any internal email, budgets, or memoranda regarding anticipated or actual use of TARP funds—and to provide copies of pertinent supporting documentation (financial or otherwise) to support their response. We also asked each institution to sign a statement attesting to the accuracy of the data. To determine the extent to which firms segregated and tracked TARP funds, we analyzed the survey responses to determine the extent to which the respondents reported that they segregated the TARP funds from other bank capital and established a process for tracking specific uses of funds.

To determine how recipients reported their use or plans to use TARP funds, we identified a number of common response categories and analyzed the various actions associated with the use

of TARP funds, including general activities (such as general lending) and associated subcategories (such as residential lending and small business lending). Similarly, we identified investment categories, such as agency MBS, agency debt, and corporate debt. We took a number of steps to ensure the consistency of our analysis. We developed a checklist for analysts to review each survey response. If an analyst had questions related to a survey response, another analyst reviewed the response; then they discussed these cases collectively until they reached consensus agreement in interpreting the response relative to other responses. In addition, a quality control team that was not involved in the analytical process reviewed all of the data entries.

### **Limitations on Data**

SIGTARP's review and analysis was confined to the survey responses and supporting documentation, as provided, reported, and certified by the TARP recipients. These data are not sufficient for statistical inferences. They should be interpreted only as directional insights, not as definitive characterizations of the TARP recipients' use of funds. The survey did not encompass or inquire about funds received from other government or non-government sources and the extent to which such funding influenced the use of TARP funding.

## Appendix B—How Banks Use Capital

Capital is an essential component of a bank's financial capacity to sustain itself, grow, and serve its customers.<sup>11</sup> Regulators and market participants recognize the critical role that capital plays in supporting confidence in the health of banks and of the financial system.<sup>12</sup> Capital generally provides at least three broad benefits:

- enabling the banks to absorb current and future losses while further protecting the interests of the bank's creditors
- strengthening the bank's capacity and willingness to lend
- providing added liquidity by injecting cash into the firm, thereby making funds available to address a variety of corporate funding needs, such as repayment of maturing debt

Federal banking regulators<sup>13</sup> have established minimum capital adequacy ratios to ensure that banks can absorb a reasonable level of losses before becoming insolvent.<sup>14</sup> Therefore, maintaining acceptable capital ratios protects depositors and other senior creditors while enhancing the stability and efficiency of the U.S. financial system, especially during recessionary times.

Federal banking regulators have traditionally focused upon "Tier 1" capital. Tier 1 capital includes common stock, disclosed retained earnings, and qualifying perpetual preferred stock. Additionally, Treasury and the banking regulators determined that qualifying U.S.-controlled banks, savings associations, and certain savings and loan holding companies that issued senior preferred stock to the Treasury under the CPP could include such capital instruments in meeting their Tier 1 capital requirements.<sup>15</sup> Banks must consider a number of key factors in prudently allocating Tier 1 capital. When considering deploying excess capital above the minimum regulatory capital adequacy levels, a bank must balance two critical factors:

1. Prior to issuing any dividend distributions or stock repurchases, the bank needs to maintain a capital cushion that can absorb unanticipated losses and protect against the risk of insolvency.
2. The bank needs to leverage the excess capital to provide more lending and investing, potentially generating more income.

With respect to lending and investing, capital can have a multiplier effect; one dollar in capital can generate multiple dollars in loans and investments. It can seed lending and investments by combining with and leveraging other sources of funds, such as relatively inexpensive bank

<sup>11</sup> A bank's capital is also referred to as equity.

<sup>12</sup> Treasury, White Paper, "The Capital Assistance Program and Its Role in the Financial Stability Plan"

<sup>13</sup> The federal banking regulators are the Office of the Comptroller of the Currency, the Office of Thrift Supervision, the Federal Reserve Board, and the Federal Deposit Insurance Corporation.

<sup>14</sup> Capital adequacy ratios are a quantification of the amount of a bank's capital presented as a percentage of its risk-weighted credit exposures and are key measures of a bank's financial strength.

<sup>15</sup> Treasury Announces TARP Capital Purchase Program Description, October 14, 2008- HP-1207.

deposits. One added dollar of Tier 1 capital might generate the potential for the bank to then issue an additional \$10 in loans. That is because based on regulatory rules, a healthy bank that receives \$1 million in TARP funds can then borrow up to \$10 million to make new loans to consumers or businesses and still be deemed to be adequately capitalized, as long as the regulator finds that overall capital is sufficient and that the bank is able to absorb losses such as loan defaults. The bank could also leverage capital by using new capital to buy deposits from other banks further increasing their ability to issue new loans.

The CPP funds were a primary source of new Tier 1 capital available to financial institutions when credit losses were rapidly eroding the existing capital of many firms and the ability to raise private capital was severely constrained. Given the nationwide decline in real estate values, many banks faced losing the stream of income they had enjoyed from homeowner payments on mortgages. Moreover, as they foreclosed on properties, they found that resale value of the properties was often dramatically lower than the amount of the loan. Similarly, the market for the mortgage-related securities had also declined, and many of the securities the banks held could no longer be sold in the open market for more than a fraction of what the bank had paid for them.<sup>16</sup>

The injection of new funding can strengthen the capital base of the recipient banks and provide for added liquidity. Generally, a bank has sufficient liquidity if it can easily meet its needs for funds by having readily available cash, loans, and securities that can be easily sold, or if it has the ability to otherwise raise or borrow funds. Prior to the current recession, banks generally were able to raise cash easily by borrowing and selling a wide array of assets without government support. Banks used short-term and long-term secured (collateralized) loans and unsecured debt funding, as well as securitization,<sup>17</sup> to generate and maintain liquidity, and thus had more funds available for lending.

Securitization entails packaging loans into asset-backed securities, and the sale of these securities provided a source of funds to banks. In the past, the ability to sell these loans as securities freed up capital and funds for more lending. The failure of securitized assets, which include consumer and business loans, has played a prominent role in the current credit crisis. The weakness in the securitized asset market substantially can be traced back to the individual subprime borrowers whose loans had been securitized. As the subprime borrowers began to miss their monthly loan payments, the value of the securities backed by the borrowers' loans began to lose value. Throughout 2008, investors were losing confidence in these securities and therefore stopped buying them. Many banks were dependent on the cash they received from selling their loans to securities issuers or investors; when this market essentially disappeared, they were unable to generate enough money to continue making new loans.<sup>18</sup>

Consequently, the onset of the current credit contraction was also accompanied by a general weakening of balance sheets of U.S. banks. A balance sheet provides a summary of a firm's financial position reflecting its assets, liabilities, and equity at a specific date. A number of key factors contributed to balance sheet weaknesses, including

<sup>16</sup> SIGTARP, "Quarterly Report to Congress," 4/21/2009.

<sup>17</sup> The process by which new securities are created by combining or bundling other financial assets together, including loans, and selling the resulting financial instrument, usually in pieces, to investors.

<sup>18</sup> SIGTARP, "Quarterly Report to Congress," 4/21/2009.

- the erosion of capital levels because of losses
- the inability of banks to sell many of the securities they held in the open market for more than a fraction of what they had paid<sup>19</sup>

Accordingly, these securities remained on the balance sheets as investments, thereby tying up precious capital and liquidity.

Under normal market conditions, bank capital fuels lending, and strong earnings give the firm the opportunity to distribute dividends and repurchase shares. Dividend distribution and share repurchases return capital to shareholders. However, the current recessionary environment, future macroeconomic uncertainties, and continued credit losses made the distribution of capital to shareholders and allocation to lending activities more challenging. To conserve capital, banks may curtail dividends distribution to their common shareholders and stop repurchasing their common shares. Additionally, firms were likely to reduce lending and investments.

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<sup>19</sup> SIGTARP, "Quarterly Report to Congress," 4/21/2009.

## Appendix C—Survey Letter

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OFFICE OF THE SPECIAL INSPECTOR GENERAL  
 TROUBLED ASSET RELIEF PROGRAM  
 1500 Pennsylvania Ave., N.W., Suite 1064  
 Washington, D.C. 20220

February 5, 2009

(Addressee)

The Emergency Economic Stabilization Act of 2008 (“EESA”) that established the Troubled Asset Relief Program (TARP) also created the Office of the Special Inspector General Troubled Asset Relief Program (SIGTARP). SIGTARP is responsible for coordinating and conducting audits and investigations of any program established by the Secretary of the Treasury under the act. As part of an audit into TARP recipients’ use of funds and their compliance with EESA’s executive compensation requirements,

I am requesting that you provide my office, within 30 days of this request, the following information:

- (1) A narrative response specifically outlining (a) your anticipated use of TARP funds; (b) whether the TARP funds were segregated from other institutional funds; (c) your actual use of TARP funds to date; and (d) your expected use of unspent TARP funds. In your response, please take into consideration your anticipated use of TARP funds at the time that you applied for such funds, or any actions that you have taken that you would not have been able to take absent the infusion of TARP funds.
- (2) Your specific plans, and the status of implementation of those plans, for addressing executive compensation requirements associated with the funding. Information provided regarding executive compensation should also include any assessments made of loan risks and their relationship to executive compensation; how limitations on executive compensation will be implemented in line with Department of Treasury guidelines; and whether any such limitations may be offset by other changes to other, longer-term or deferred forms of executive compensation.

February 5, 2009

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In connection with this request:

- (1) We anticipate that responses might well be quantitative as well as qualitative in nature regarding the impact of having the funds, and we encourage you to make reference to such sources as statements to the media, shareholders, or others concerning your intended or actual use of TARP funds, as well as any internal email, budgets, or memoranda describing your anticipated use of funds. We ask that you segregate and preserve all documents referencing your use or anticipated use of TARP funds such as any internal email, budgets, or memoranda regarding your anticipated or actual use of TARP funds.
- (2) Your response should include copies of pertinent supporting documentation (financial or otherwise) to support your response.
- (3) Further, I request that, your response be signed by a duly authorized senior executive officer of your company, including a statement certifying the accuracy of all statements, representations, and supporting information provided, subject to the requirements and penalties set forth in Title 18, United States Code, Section 1001.
- (4) Responses should be provided electronically within 30 days to SIGTARP at [SIGTARP.response@do.treas.gov](mailto:SIGTARP.response@do.treas.gov) with an original signed certification and any other supporting documentation mailed to: Special Inspector General – TARP, 1500 Pennsylvania Avenue, NW; Suite 1064; Washington, D.C. 20220.

We think this initiative is vital to providing transparency of the TARP program, and to the ability of SIGTARP and others to assess the effectiveness of TARP programs over time. If you have any questions regarding this initiative, please feel free to contact Mr. Barry W. Holman, my Deputy Inspector General for Audit at [REDACTED]

Very truly yours,



Neil M. Barofsky  
Special Inspector General

OMB Control No. 1505-0212  
(Expires August 2009)

An agency is not authorized to conduct, and persons are not required to respond to, an information collection request unless it displays a valid control number. Response is mandatory for all selected participants in the TARP program.

## Appendix D—CPP Survey Recipients

Table 5 provides information on the 360 CPP recipients that responded to the survey.

**Table 5: CPP Recipient Respondents, Funds Received and Date**

| Institution Name                                      | Funding (millions) | TARP Agreement Date |
|---|--------------------|---------------------|
| 1st Constitution Bancorp                              | \$12.00            | 12/23/2008          |
| 1st FS Corporation/ Mountain 1st Bank & Trust         | \$16.00            | 11/14/2008          |
| Alliance Financial Corporation <sup>20</sup>          | \$27.00            | 12/19/2008          |
| American Express Company <sup>21</sup>                | \$3,389.00         | 1/9/2009            |
| American State Bancshares                             | \$6.00             | 1/9/2009            |
| Ameris Bancorp/ Ameris Bank                           | \$52.00            | 11/21/2008          |
| AmeriServ Financial, Inc                              | \$21.00            | 12/19/2008          |
| Associated Banc-Corp                                  | \$525.00           | 11/21/2008          |
| Bancorp Rhode Island, Inc./Bank Rhode Island          | \$30.00            | 12/19/2008          |
| BancTrust Financial Group, Inc./Bank Trust            | \$50.00            | 12/19/2008          |
| Bank of America <sup>22</sup>                         | \$25,000.00        | 10/28/2008          |
| Bank of Commerce                                      | \$3.00             | 1/16/2009           |
| Bank of Commerce Holdings                             | \$17.00            | 11/14/2008          |
| Bank of Marin Bancorp <sup>23</sup>                   | \$28.00            | 12/5/2008           |
| Bank of New York Mellon Corp <sup>24</sup>            | \$3,000.00         | 10/28/2008          |
| BNC Bancorp/Bank of North Carolina                    | \$31.00            | 12/5/2008           |
| Bank of the Ozarks, Inc.                              | \$75.00            | 12/12/2008          |
| Banner Corporation/Banner Bank                        | \$124.00           | 11/21/2008          |
| Bar Harbor Bankshares/Bar Harbor Bank & Trust         | \$19.00            | 1/16/2009           |
| BB&T Corp. <sup>25</sup>                              | \$3,134.00         | 11/14/2008          |
| BCSB Bancorp, Inc.                                    | \$11.00            | 12/23/2008          |
| Berkshire Hills Bancorp, Inc. <sup>26</sup>           | \$40.00            | 12/19/2008          |
| Blue Valley Ban Corp                                  | \$22.00            | 12/5/2008           |
| BNCCORP, Inc.   | \$20.00            | 1/16/2009           |
| Boston Private Financial Holdings Inc.                | \$154.00           | 11/21/2008          |
| Bridge Capital Holdings                               | \$24.00            | 12/23/2008          |
| Bridgeview Bancorp, Inc./ Bridgeview Bank Group       | \$38.00            | 12/19/2008          |
| Broadway Financial Corporation/ Broadway Federal Bank | \$9.00             | 11/14/2008          |
| C&F Financial Corporation                             | \$20.00            | 1/9/2009            |
| Cache Valley Banking Company                          | \$5.00             | 12/23/2008          |

<sup>20</sup> Repaid Treasury on May 13, 2009.

<sup>21</sup> Repaid Treasury on June 17, 2009.

<sup>22</sup> Bank of America received \$15 billion on October 28, 2008, and \$10 billion on January 9, 2009.

<sup>23</sup> Repaid Treasury on March 31, 2009.

<sup>24</sup> Repaid Treasury on June 17, 2009.

<sup>25</sup> Repaid Treasury on June 17, 2009.

<sup>26</sup> Repaid Treasury on May 27, 2009.

Note: Funding numbers provided reflect some rounding.

| Institution Name  | Funding (millions) | TARP Agreement Date |
|---|--------------------|---------------------|
| Cadence Financial Corporation                                   | \$44.00            | 1/9/2009            |
| Capital Bancorp, Inc.   | \$5.00             | 12/23/2008          |
| Capital Bank  | \$41.00            | 12/12/2008          |
| Capital One Financial Corporation <sup>27</sup>                 | \$3,555.00         | 11/14/2008          |
| Capital Pacific Bancorp   | \$4.00             | 12/23/2008          |
| Carolina Bank Holdings, Inc.                                    | \$16.00            | 1/9/2009            |
| Carver Bancorp, Inc.  | \$19.00            | 1/16/2009           |
| Cascade Financial Corporation                                   | \$39.00            | 11/21/2008          |
| Cathay General Bancorp/ Cathay Bank                             | \$258.00           | 12/5/2008           |
| Cecil Bancorp, Inc.   | \$12.00            | 12/23/2008          |
| Center Bancorp, Inc.  | \$10.00            | 1/9/2009            |
| Center Financial Corporation/Center Bank                        | \$55.00            | 12/12/2008          |
| Centerstate Banks of Florida Inc.                               | \$28.00            | 11/21/2008          |
| Centra Financial Holdings, Inc./Centra Bank, Inc. <sup>28</sup> | \$15.00            | 1/16/2009           |
| Central Bancorp, Inc./Central Co-operative Bank                 | \$10.00            | 12/5/2008           |
| Central Federal Corporation                                     | \$7.00             | 12/5/2008           |
| Central Jersey Bancorp  | \$11.00            | 12/23/2008          |
| Central Pacific Financial Corp.                                 | \$135.00           | 1/9/2009            |
| Centrue Financial Corporation                                   | \$33.00            | 1/9/2009            |
| CIT Group Inc.  | \$2,330.00         | 12/31/2008          |
| Citigroup Inc./Citibank National Association                    | \$25,000.00        | 10/28/2008          |
| Citizens & Northern Corporation                                 | \$26.00            | 1/16/2009           |
| Citizens Bancorp  | \$10.00            | 12/23/2008          |
| Citizens Community Bank   | \$3.00             | 12/23/2008          |
| Citizens First Corporation                                      | \$9.00             | 12/19/2008          |
| Citizens Republic Bancorp, Inc.                                 | \$300.00           | 12/12/2008          |
| Citizens South Bank   | \$21.00            | 12/12/2008          |
| City National Corporation                                       | \$400.00           | 11/21/2008          |
| Coastal Banking Company, Inc.                                   | \$10.00            | 12/5/2008           |
| CoBiz Financial Inc.  | \$64.00            | 12/19/2008          |
| Codorus Valley Bancorp, Inc.                                    | \$17.00            | 1/9/2009            |
| Colony Bankcorp, Inc./Colony Bank                               | \$28.00            | 1/9/2009            |
| Columbia Banking System Inc.                                    | \$77.00            | 11/21/2008          |
| Comerica Inc.   | \$2,250.00         | 11/14/2008          |
| Commerce National Bank  | \$5.00             | 1/9/2009            |
| Community 1st Bank  | \$3.00             | 1/16/2009           |
| Community Bank of the Bay                                       | \$2.00             | 1/16/2009           |
| Community Bankers Trust Corporation                             | \$18.00            | 12/19/2008          |
| Community Financial Corporation/Community Bank                  | \$12.64            | 12/19/2008          |
| Community Investors Bancorp, Inc.                               | \$3.00             | 12/23/2008          |
| Community Trust Financial Corporation                           | \$24.00            | 1/9/2009            |
| Community West Bancshares                                       | \$16.00            | 12/19/2008          |
| Congaree Bancshares, Inc.                                       | \$3.00             | 1/9/2009            |

<sup>27</sup> Repaid Treasury on June 17, 2009.

<sup>28</sup> Repaid Treasury on March 31, 2009.

| Institution Name  | Funding (millions) | TARP Agreement Date |
|---|--------------------|---------------------|
| Crescent Financial Corporation                                | \$25.00            | 1/9/2009            |
| Crossroads Bank (FFW Corporation)                             | \$7.29             | 12/19/2008          |
| CVB Financial Corp  | \$130.00           | 12/5/2008           |
| Dickinson Financial Corporation II                            | \$146.00           | 1/16/2009           |
| Eagle Bancorp, Inc.   | \$38.00            | 12/5/2008           |
| East West Bancorp   | \$307.00           | 12/5/2008           |
| Eastern Virginia Bankshares, Inc.                             | \$24.00            | 1/9/2009            |
| ECB Bancorp, Inc./East Carolina Bank                          | \$18.00            | 1/16/2009           |
| Emclair Financial Corp./The Farmers National Bank of Emmenton | \$8.00             | 12/23/2008          |
| Encore Bancshares Inc.  | \$34.00            | 12/5/2008           |
| Enterprise Financial Services Corp./ Enterprise Bank & Trust  | \$35.00            | 12/19/2008          |
| Exchange Bank   | \$43.00            | 12/19/2008          |
| F.N.B. Corporation  | \$100.00           | 1/9/2009            |
| Farmers Capital Bank Corporation                              | \$30.00            | 1/9/2009            |
| FCB Bancorp, Inc.   | \$9.00             | 12/19/2008          |
| Fidelity Bancorp, Inc.  | \$7.00             | 12/12/2008          |
| Fidelity Financial Corporation                                | \$36.00            | 12/19/2008          |
| Fidelity Southern Corporation                                 | \$48.00            | 12/19/2008          |
| Fifth Third Bancorp   | \$3,408.00         | 12/31/2008          |
| Financial Institutions, Inc.                                  | \$38.00            | 12/23/2008          |
| First Bancorp, North Carolina                                 | \$65.00            | 1/9/2009            |
| First BanCorp, Puerto Rico                                    | \$400.00           | 1/16/2009           |
| First Bankers Trustshares, Inc.                               | \$10.00            | 1/16/2009           |
| First Banks, Inc.   | \$295.00           | 12/31/2008          |
| First California Financial Group, Inc                         | \$25.00            | 12/19/2008          |
| First Community Bancshares Inc.                               | \$42.00            | 11/21/2008          |
| First Community Bank Corporation                              | \$11.00            | 12/23/2008          |
| First Community Corporation                                   | \$11.00            | 11/21/2008          |
| First Defiance Financial Corp.                                | \$37.00            | 12/5/2008           |
| First Financial Bancorp                                       | \$80.00            | 12/23/2008          |
| First Financial Holdings Inc.                                 | \$65.00            | 12/5/2008           |
| First Financial Service Corporation                           | \$20.00            | 1/9/2009            |
| First Horizon National Corporation                            | \$867.00           | 11/14/2008          |
| First Litchfield Financial Corporation                        | \$10.00            | 12/12/2008          |
| First Manitowoc Bancorp, Inc. <sup>29</sup>                   | \$12.00            | 1/16/2009           |
| First Midwest Bancorp, Inc.                                   | \$193.00           | 12/5/2008           |
| First Niagara Financial Group <sup>30</sup>                   | \$184.00           | 11/21/2008          |
| First PacTrust Bancorp, Inc.                                  | \$19.00            | 11/21/2008          |
| First Security Group, Inc.                                    | \$33.00            | 1/9/2009            |
| First Sound Bank  | \$7.00             | 12/23/2008          |
| Firstmerit Corporation <sup>31</sup>                          | \$125.00           | 1/9/2009            |

<sup>29</sup> Repaid Treasury on May 27, 2009.

<sup>30</sup> Repaid Treasury on May 27, 2009.

<sup>31</sup> Repaid Treasury on April 22, 2009.

| Institution Name   | Funding (millions) | TARP Agreement Date |
|--|--------------------|---------------------|
| Flushing Financial Corporation                                       | \$70.00            | 12/19/2008          |
| FPB Bancorp, Inc.  | \$6.00             | 12/5/2008           |
| Fulton Financial Corporation   | \$377.00           | 12/23/2008          |
| Goldman Sachs & Co. <sup>32</sup>                                    | \$10,000.00        | 10/28/2008          |
| GrandSouth Bancorporation  | \$9.00             | 1/9/2009            |
| Great Southern Bancorp/ Great Southern Bank                          | \$58.00            | 12/5/2008           |
| Green Bankshares, Inc.   | \$72.00            | 12/23/2008          |
| Hampton Roads Bankshares, Inc.                                       | \$80.00            | 12/31/2008          |
| Hawthorn Bancshares, Inc.  | \$30.00            | 12/19/2008          |
| Heartland Financial USA, Inc.  | \$82.00            | 12/19/2008          |
| Heritage Commerce Corp.  | \$40.00            | 11/21/2008          |
| Heritage Financial Corporation                                       | \$24.00            | 11/21/2008          |
| HF Financial Corp <sup>33</sup>                                      | \$25.00            | 11/21/2008          |
| HMN Financial, Inc.  | \$26.00            | 12/23/2008          |
| Home Bancshares, Inc.  | \$50.00            | 1/16/2009           |
| HopFed Bancorp   | \$18.00            | 12/12/2008          |
| Horizon Bancorp  | \$25.00            | 12/19/2008          |
| Huntington Bancshares  | \$1,398.00         | 11/14/2008          |
| Iberiabank Corporation <sup>34</sup>                                 | \$90.00            | 12/5/2008           |
| Idaho Bancorp  | \$7.00             | 1/16/2009           |
| Independence Bank  | \$1.00             | 1/9/2009            |
| Independent Bank Corp. <sup>35</sup>                                 | \$78.00            | 1/9/2009            |
| Independent Bank Corporation   | \$72.00            | 12/12/2008          |
| Indiana Community Bancorp  | \$22.00            | 12/12/2008          |
| Intermountain Community Bancorp/Panhandle State Bank                 | \$27.00            | 12/19/2008          |
| International Bancshares Corporation/ International Bank of Commerce | \$216.00           | 12/23/2008          |
| Interwest Bancshares Corporation                                     | \$25.00            | 12/23/2008          |
| JP Morgan Chase & Co. <sup>36</sup>                                  | \$25,000.00        | 10/28/2008          |
| KeyCorp/Keybank National Association                                 | \$2,500.00         | 11/14/2008          |
| LCNB Corp.   | \$13.00            | 1/9/2009            |
| Leader Bancorp, Inc./Leader Bank, National Association               | \$6.00             | 12/23/2008          |
| LNB Bancorp Inc.   | \$25.00            | 12/12/2008          |
| LSB Corporation  | \$15.00            | 12/12/2008          |
| M&T Bank Corporation   | \$600.00           | 12/23/2008          |
| Magna Bank   | \$14.00            | 12/23/2008          |
| MainSource Financial Group, Inc.                                     | \$57.00            | 1/16/2009           |
| Manhattan Bancorp  | \$2.00             | 12/5/2008           |
| Marquette National Corporation                                       | \$36.00            | 12/19/2008          |
| Marshall & Ilsley Corporation  | \$1,715.00         | 11/14/2008          |

<sup>32</sup> Repaid Treasury on June 17, 2009.

<sup>33</sup> Repaid Treasury on June 3, 2009.

<sup>34</sup> Repaid Treasury on March 31, 2009.

<sup>35</sup> Repaid Treasury on April 22, 2009.

<sup>36</sup> Repaid Treasury on June 17, 2009.

| Institution Name                                      | Funding (millions) | TARP Agreement Date |
|---|--------------------|---------------------|
| MB Financial Inc.                                     | \$196.00           | 12/5/2008           |
| MetroCorp Bancshares, Inc.                            | \$45.00            | 1/16/2009           |
| Mid Penn Bancorp, Inc.                                | \$10.00            | 12/19/2008          |
| MidSouth Bancorp, Inc.                                | \$20.00            | 1/9/2009            |
| Midwest Banc Holdings, Inc.                           | \$85.00            | 12/5/2008           |
| Mission Community Bancorp/Mission Community Bank      | \$5.00             | 1/9/2009            |
| Mission Valley Bancorp/ Mission Valley Bank           | \$6.00             | 12/23/2008          |
| Monadnock Bancorp, Inc.                               | \$2.00             | 12/19/2008          |
| Monarch Financial Holdings, Inc.                      | \$15.00            | 12/19/2008          |
| Morgan Stanley <sup>37</sup>                          | \$10,000.00        | 10/28/2008          |
| Morrill Bancshares, Inc.                              | \$13.00            | 1/16/2009           |
| MutualFirst Financial, Inc.                           | \$32.00            | 12/23/2008          |
| Nara Bancorp, Inc.                                    | \$67.00            | 11/21/2008          |
| National Penn Bancshares, Inc.                        | \$150.00           | 12/12/2008          |
| NCAL Bancorp  | \$10.00            | 12/19/2008          |
| New Hampshire Thrift Bancshares, Inc.                 | \$10.00            | 1/16/2009           |
| New York Private Bank & Trust Corp. / Emigrant Bank   | \$267.00           | 1/9/2009            |
| NewBridge Bancorp/New Bridge Bank                     | \$52.00            | 12/12/2008          |
| Nicolet Bankshares, Inc./Nicolet National Bank        | \$15.00            | 12/23/2008          |
| North Central Bancshares, Inc.                        | \$10.00            | 1/9/2009            |
| Northeast Bancorp                                     | \$4.00             | 12/12/2008          |
| Northern Trust Corporation <sup>38</sup>              | \$1,576.00         | 11/14/2008          |
| Oak Valley Bancorp                                    | \$14.00            | 12/5/2008           |
| OceanFirst Financial Corporation                      | \$38.00            | 1/16/2009           |
| Old Line Bancshares, Inc.                             | \$7.00             | 12/5/2008           |
| Old National Bancorp <sup>39</sup>                    | \$100.00           | 12/12/2008          |
| Old Second Bancorp, Inc.                              | \$73.00            | 1/16/2009           |
| One United Bank                                       | \$12.00            | 12/19/2008          |
| Pacific Capital Bancorp                               | \$181.00           | 11/21/2008          |
| Pacific City Financial Corporation/ Pacific City Bank | \$16.00            | 12/19/2008          |
| Pacific Coast Bankers' Bancshares                     | \$12.00            | 12/23/2008          |
| Pacific Coast National Bancorp                        | \$4.00             | 1/16/2009           |
| Pacific Commerce Bank                                 | \$4.00             | 12/23/2008          |
| Pacific International Bancorp                         | \$7.00             | 12/12/2008          |
| Park National Corporation                             | \$100.00           | 12/23/2008          |
| Parkvale Financial Corporation                        | \$32.00            | 12/23/2008          |
| Patapsco Bancorp, Inc.                                | \$6.00             | 12/19/2008          |
| Patriot Bancshares, Inc./ Patriot Bank                | \$26.00            | 12/19/2008          |
| Peapack-Gladstone Financial Corporation               | \$29.00            | 1/9/2009            |
| Peoples Bancorp of North Carolina, Inc.               | \$25.00            | 12/23/2008          |
| Pinnacle Financial Partners, Inc.                     | \$95.00            | 12/12/2008          |
| Plains Capital Corporation                            | \$88.00            | 12/19/2008          |

<sup>37</sup> Repaid Treasury on June 17, 2009.

<sup>38</sup> Repaid Treasury on June 17, 2009.

<sup>39</sup> Repaid Treasury on March 31, 2009.

| Institution Name  | Funding (millions) | TARP Agreement Date |
|---|--------------------|---------------------|
| PNC Financial Services Group Inc.                                   | \$7,579.00         | 12/31/2008          |
| Popular, Inc.   | \$935.00           | 12/5/2008           |
| Porter Bancorp, Inc.(PBI) Louisville, KY                            | \$35.00            | 11/21/2008          |
| Provident Bancshares Corp.  | \$152.00           | 11/14/2008          |
| Puget Sound Bank  | \$5.00             | 1/16/2009           |
| Pulaski Financial Corp  | \$33.00            | 1/16/2009           |
| Queensborough Company, The  | \$12.00            | 1/9/2009            |
| Redwood Capital Bancorp   | \$4.00             | 1/16/2009           |
| Redwood Financial, Inc.   | \$3.00             | 1/9/2009            |
| Regions Financial Corp./ Regions Bank                               | \$3,500.00         | 11/14/2008          |
| Rising Sun Bancorp  | \$6.00             | 1/9/2009            |
| S&T Bancorp   | \$109.00           | 1/16/2009           |
| Saigon National Bank  | \$2.00             | 12/23/2008          |
| Sandy Spring Bancorp, Inc.  | \$83.00            | 12/5/2008           |
| Santa Lucia Bancorp   | \$4.00             | 12/19/2008          |
| SCBT Financial Corporation <sup>40</sup>                            | \$65.00            | 1/16/2009           |
| Seacoast Banking Corporation of Florida/Seacoast National Bank      | \$50.00            | 12/19/2008          |
| Seacoast Commerce Bank  | \$2.00             | 12/23/2008          |
| Security Business Bancorp/Security Business Bank of San Diego       | \$6.00             | 1/9/2009            |
| Security California Bancorp/ Security Bank of California            | \$7.00             | 1/9/2009            |
| Security Federal Corporation  | \$18.00            | 12/19/2008          |
| Severn Bancorp, Inc.  | \$23.00            | 11/21/2008          |
| Shore Bancshares, Inc. <sup>41</sup>                                | \$25.00            | 1/9/2009            |
| Signature Bank <sup>42</sup>  | \$120.00           | 12/12/2008          |
| Somerset Hills Bancorp <sup>43</sup>                                | \$7.00             | 1/16/2009           |
| Sound Banking Company   | \$3.00             | 1/9/2009            |
| South Financial Group, Inc./ Carolina First Bank                    | \$347.00           | 12/5/2008           |
| Southern Bancorp, Inc.  | \$11.00            | 1/16/2009           |
| Southern Community Financial Corp./ Southern Community Bank & Trust | \$43.00            | 12/5/2008           |
| Southern Missouri Bancorp, Inc./ Southern Missouri Bank & Trust Co. | \$10.00            | 12/5/2008           |
| Southwest Bancorp, Inc.   | \$70.00            | 12/5/2008           |
| State Bancorp, Inc./State Bank of Long Island                       | \$37.00            | 12/5/2008           |
| State Bank & Trust/State Bankshares, Inc.                           | \$50.00            | 1/16/2009           |
| State Street <sup>44</sup>  | \$2,000.00         | 10/28/2008          |
| StellarOne Corporation  | \$30.00            | 12/19/2008          |
| Sterling Bancorp  | \$42.00            | 12/23/2008          |
| Sterling Bancshares, Inc./Sterling Bank <sup>45</sup>               | \$125.00           | 12/12/2008          |

<sup>40</sup> Repaid Treasury on May 20, 2009.

<sup>41</sup> Repaid Treasury on April 15, 2009.

<sup>42</sup> Repaid Treasury on March 31, 2009.

<sup>43</sup> Repaid Treasury on May 20, 2009.

<sup>44</sup> Repaid Treasury on June 17, 2009.

| Institution Name  | Funding (millions) | TARP Agreement Date |
|---|--------------------|---------------------|
| Sterling Financial Corporation/Sterling Savings Bank                | \$303.00           | 12/5/2008           |
| Summit State Bank   | \$9.00             | 12/19/2008          |
| Sun Bancorp, Inc. <sup>46</sup>                                     | \$89.00            | 1/9/2009            |
| SunTrust Banks, Inc.  | \$4,850.00         | 12/31/2008          |
| Superior Bancorp Inc.   | \$69.00            | 12/5/2008           |
| Surrey Bancorp/Surrey Bank & Trust                                  | \$2.00             | 1/9/2009            |
| Susquehanna Bancshares, Inc.  | \$300.00           | 12/12/2008          |
| SVB Financial Group   | \$235.00           | 12/12/2008          |
| Synovus Financial Corp./ Columbus Bank & Trust Co.                  | \$968.00           | 12/19/2008          |
| Syringa Bancorp   | \$8.00             | 1/16/2009           |
| Taylor Capital Group  | \$105.00           | 11/21/2008          |
| TCB Holding Company, Texas Community Bank                           | \$12.00            | 1/16/2009           |
| TCF Financial Corporation <sup>47</sup>                             | \$361.00           | 11/14/2008          |
| TCNB Financial Corp/The Citizens National Bank of Southwestern Ohio | \$2.00             | 12/23/2008          |
| Tennessee Commerce Bancorp, Inc./ Tennessee Commerce Bank           | \$30.00            | 12/19/2008          |
| Tennessee Valley Financial Holdings, Inc.                           | \$3.00             | 12/23/2008          |
| Texas Capital Bancshares, Inc. <sup>48</sup>                        | \$75.00            | 1/16/2009           |
| Texas National Bancorporation                                       | \$4.00             | 1/9/2009            |
| The Bancorp, Inc./The Bancorp Bank                                  | \$45.00            | 12/12/2008          |
| The Baraboo Bancorporation  | \$21.00            | 1/16/2009           |
| The Connecticut Bank and Trust Company                              | \$5.00             | 12/19/2008          |
| The Elmira Savings Bank, FSB  | \$9.00             | 12/19/2008          |
| The First Bancorp, Inc.   | \$25.00            | 1/9/2009            |
| The Little Bank, Incorporated                                       | \$8.00             | 12/23/2008          |
| TIB Financial Corp/TIB Bank   | \$37.00            | 12/5/2008           |
| Tidelands Bancshares, Inc.  | \$14.00            | 12/19/2008          |
| Timberland Bancorp, Inc.  | \$17.00            | 12/23/2008          |
| TowneBank   | \$76.00            | 12/12/2008          |
| Treaty Oak Bankcorp, Inc.   | \$3.27             | 1/16/2009           |
| Tri-County Financial Corporation                                    | \$16.00            | 12/19/2008          |
| Trustmark Corporation   | \$215.00           | 11/21/2008          |
| U.S. Bancorp <sup>49</sup>  | \$6,599.00         | 11/14/2008          |
| UCBH Holdings, Inc.   | \$299.00           | 11/14/2008          |
| Umpqua Holdings Corp.   | \$214.00           | 11/14/2008          |
| Union Bankshares Corporation  | \$59.00            | 12/19/2008          |
| United Bancorp, Inc.  | \$21.00            | 1/16/2009           |
| United Bancorporation of Alabama, Inc.                              | \$10.00            | 12/23/2008          |
| United Community Banks, Inc.  | \$180.00           | 12/5/2008           |

<sup>45</sup> Repaid Treasury on May 5, 2009.

<sup>46</sup> Repaid Treasury on April 8, 2009.

<sup>47</sup> Repaid Treasury on April 22, 2009.

<sup>48</sup> Repaid Treasury on May 13, 2009.

<sup>49</sup> Repaid Treasury on June 17, 2009.

| Institution Name   | Funding (millions) | TARP Agreement Date |
|--|--------------------|---------------------|
| United Financial Banking Companies, Inc.   | \$6.00             | 1/16/2009           |
| Unity Bancorp, Inc./Unity Bank   | \$21.00            | 12/5/2008           |
| Uwharrie Capital Corp./Bank of Stanly  | \$10.00            | 12/23/2008          |
| Valley Community Bank  | \$6.00             | 1/9/2009            |
| Valley Financial Corporation   | \$16.00            | 12/12/2008          |
| Valley National Bancorp <sup>50</sup>  | \$300.00           | 11/14/2008          |
| Virginia Commerce Bancorp  | \$71.00            | 12/12/2008          |
| VIST Financial Corp./VIST Bank   | \$25.00            | 12/19/2008          |
| Wainwright Bank & Trust Company  | \$22.00            | 12/19/2008          |
| Washington Banking Company/ Whidbey Island Bank                                      | \$26.00            | 1/16/2009           |
| Washington Federal Inc./ Washington Federal Savings & Loan Association <sup>51</sup> | \$200.00           | 11/14/2008          |
| Webster Financial Corporation  | \$400.00           | 11/21/2008          |
| Wells Fargo Bank   | \$25,000.00        | 10/28/2008          |
| Wesbanco Bank Inc.   | \$75.00            | 12/5/2008           |
| West Bancorporation, Inc.  | \$36.00            | 12/31/2008          |
| Western Alliance Bancorporation/Bank of Nevada                                       | \$140.00           | 11/21/2008          |
| Western Community Bancshares, Inc.   | \$7.00             | 12/23/2008          |
| Western Illinois Bancshares Inc.   | \$7.00             | 12/23/2008          |
| Whitney Holding Corporation  | \$300.00           | 12/19/2008          |
| Wilmington Trust Corporation   | \$330.00           | 12/12/2008          |
| Wilshire Bancorp, Inc.   | \$62.00            | 12/12/2008          |
| Wintrust Financial Corporation   | \$250.00           | 12/19/2008          |
| Yadkin Valley Financial Corporation  | \$36.00            | 1/16/2009           |
| Zions Bancorporation   | \$1,400.00         | 11/14/2008          |
| 1st Source Corporation   | \$111.00           | 1/23/2009           |
| AB&T Financial Corporation/Alliance Bank & Trust Company                             | \$4.00             | 1/23/2009           |
| Adbanc, Inc.   | \$12.70            | 1/29/2009           |
| Alarion Financial Services, Inc.   | \$7.00             | 1/23/2009           |
| AMB Financial Corporation  | \$3.67             | 1/30/2009           |
| Anchor Bancorp Wisconsin, Inc.   | \$110.00           | 1/30/2009           |
| Annapolis Bancorp, Inc.  | \$81.50            | 1/30/2009           |
| Bankers' Bank of the West Bancorp, Inc.  | \$12.64            | 1/30/2009           |
| BankFirst Capital Corporation  | \$16.00            | 1/23/2009           |
| Beach Business Bank  | \$6.00             | 1/30/2009           |
| California Oaks State Bank   | \$3.30             | 1/23/2009           |
| Calvert Financial Corporation  | \$1.00             | 1/23/2009           |
| Calwest Bancorp/South County Bank  | \$5.00             | 1/23/2009           |
| Central Bancshares, Inc.   | \$5.80             | 1/30/2009           |
| Central Valley Community Bancorp   | \$7.00             | 1/30/2009           |
| Central Virginia Bankshares, Inc.  | \$11.39            | 1/30/2009           |
| Commonwealth Business Bank   | \$8.00             | 1/23/2009           |
| Community Partners Bancorp   | \$9.00             | 1/30/2009           |

<sup>50</sup> Repaid Treasury on June 3, 2009.

<sup>51</sup> Repaid Treasury on May 27, 2009.

| Institution Name   | Funding (millions) | TARP Agreement Date |
|--|--------------------|---------------------|
| Country Bank Shares, Inc./Farmers&Merchants Bank             | \$7.53             | 1/30/2009           |
| Crosstown Holding Company/21st Century Bank                  | \$11.00            | 1/23/2009           |
| DNB Financial Corporation                                    | \$11.75            | 1/30/2009           |
| Equity Bancshares  | \$8.75             | 1/30/2009           |
| Farmer's and Merchants/F & M Bancshares, Inc.                | \$4.61             | 1/30/2009           |
| Farmers Bank   | \$9.00             | 1/23/2009           |
| First Citizens Banc Corp                                     | \$23.00            | 1/23/2009           |
| First Resource Bank  | \$2.60             | 1/30/2009           |
| First Southern Bancorp, Inc.                                 | \$10.90            | 1/30/2009           |
| First ULB Corp. <sup>52</sup>                                | \$5.00             | 1/23/2009           |
| First United Corporation                                     | \$30.00            | 1/30/2009           |
| Firstbank Corporation  | \$33.00            | 1/30/2009           |
| Flagstar Bancorp, Inc.                                       | \$266.66           | 1/30/2009           |
| FPB Financial Corp   | \$3.00             | 1/23/2009           |
| Fresno First Bank  | \$2.00             | 1/23/2009           |
| Goldwater Bank, NA   | \$2.57             | 1/30/2009           |
| Greer Bancshares Incorporated                                | \$9.99             | 1/30/2009           |
| Guaranty Federal Bancshares, Inc.                            | \$17.00            | 1/30/2009           |
| HillTop Community Bancorp, Inc.                              | \$4.00             | 1/30/2009           |
| Katahdin Bankshares Corp.                                    | \$10.45            | 1/30/2009           |
| Legacy Bancorp, Inc.   | \$5.50             | 1/30/2009           |
| Liberty Bancshares, Inc.                                     | \$58.00            | 1/23/2009           |
| Metro City Bank  | \$7.70             | 1/30/2009           |
| Middleburg Financial Corporation                             | \$22.00            | 1/30/2009           |
| Midland States Bancorp, Inc.                                 | \$10.00            | 1/23/2009           |
| Monument Bank  | \$4.73             | 1/30/2009           |
| Moscow Bancshares, Inc.                                      | \$6.00             | 1/23/2009           |
| Northway Financial, Inc.                                     | \$10.00            | 1/30/2009           |
| Oak Ridge Financial Services, Inc.                           | \$7.70             | 1/30/2009           |
| Ojai Community Bank  | \$2.08             | 1/30/2009           |
| Parke Bancorp, Inc.  | \$16.29            | 1/30/2009           |
| The Private Bank of The Peninsula/Peninsula Bank Holding Co. | \$6.00             | 1/30/2009           |
| Peoples Bancorp, Inc.  | \$39.00            | 1/30/2009           |
| Pierce County Bancorp  | \$7.00             | 1/23/2009           |
| Plumas Bancorp   | \$11.95            | 1/30/2009           |
| Princeton National Bancorp, Inc.                             | \$25.00            | 1/23/2009           |
| Private Bancorp, Inc.  | \$243.82           | 1/30/2009           |
| Metropolitan National Bank/Rogers Bancshares                 | \$25.00            | 1/30/2009           |
| Seaside National Bank & Trust                                | \$6.00             | 1/23/2009           |
| Southern Illinois Bancorp, Inc.                              | \$5.00             | 1/23/2009           |
| Stewardship Financial Corporation                            | \$10.00            | 1/30/2009           |
| Stone Bridge Financial Corp                                  | \$11.00            | 1/23/2009           |
| The Freeport State Bank <sup>53</sup>                        | \$0.30             | 2/6/2009            |

<sup>52</sup> Repaid Treasury on April 22, 2009.

| Institution Name                               | Funding (millions) | TARP Agreement Date |
|--|--------------------|---------------------|
| UBT Bancshares, Inc.                           | \$8.95             | 1/30/2009           |
| Valley Business Bank (Valley Commerce Bancorp) | \$7.70             | 1/30/2009           |
| W. T. B. Financial Corp/Washington Trust Bank  | \$110.00           | 1/30/2009           |
| Washington First Bank                          | \$6.63             | 1/30/2009           |
| WSFS Financial Corporation                     | \$53.00            | 1/23/2009           |

<sup>53</sup> The Freeport State Bank was included in our survey, however, their closing date on the TARP funds was delayed until February 6, 2009.

## Appendix E—Reported Actual Uses by Month of Disbursement, Asset Size, and Amount of Funding

Table 6 shows the number of banks that reported actual uses of CPP funds for each major category of use, segmented by the month when funds were disbursed.

**Table 6: Actual Uses of CPP Funds by Disbursement Month**

| Month Funds Disbursed             | OCT | NOV | DEC | JAN <sup>54</sup> | TOTAL |
|-----------------------------------|-----|-----|-----|-------------------|-------|
| <b>Number of Banks</b>            | 8   | 43  | 162 | 147               | 360   |
| <b>Banks Reporting Uses for:</b>  |     |     |     |                   |       |
| Lending                           | 8   | 38  | 145 | 109               | 300   |
| Investment                        | 5   | 20  | 54  | 31                | 110   |
| Debt Repayment                    | 0   | 8   | 21  | 23                | 52    |
| Acquisition                       | 0   | 5   | 7   | 3                 | 15    |
| Capital Cushion or Other Reserves | 1   | 17  | 69  | 69                | 156   |

Source: SIGTARP analysis of survey responses.

Note: Some percentages may have been rounded beyond 0.5 percentage points in order to add up to 100 percent.

Table 7 shows the number of banks that reported actual uses of CPP funds for each major category of use, segmented by the asset size of the recipient.

**Table 7: Actual Uses of CPP Funds by Asset Size**

| Asset Size                        | >\$100B | \$100B - 10B | \$10B - \$1B | \$1B - 100M | <\$100M | TOTAL |
|-----------------------------------|---------|--------------|--------------|-------------|---------|-------|
| <b>Number of Banks</b>            | 14      | 37           | 131          | 110         | 68      | 360   |
| <b>Banks Reporting Uses for:</b>  |         |              |              |             |         |       |
| Lending                           | 14      | 32           | 113          | 87          | 54      | 300   |
| Investment                        | 10      | 17           | 40           | 31          | 12      | 110   |
| Debt Payoff                       | 0       | 5            | 26           | 10          | 11      | 52    |
| Acquisition                       | 3       | 2            | 8            | 1           | 1       | 15    |
| Capital Cushion or Other Reserves | 2       | 19           | 55           | 48          | 32      | 156   |

Source: SIGTARP analysis of survey responses.

Note: Some percentages may have been rounded more than 0.5 percentage points in order to add up to 100 percent.

<sup>54</sup> One bank that was included in our survey was delayed in closing on its TARP funds until February 6, 2009.

Table 8 shows the number of banks that reported actual uses of CPP funds for each major category of use, segmented by the amount of funds received.

**Table 8: Actual Uses of CPP Funds by Amount of Funds Received**

| Amount of TARP Funds Received     | >\$10B | \$1B - 10B | \$100M - 1B | <\$100M | TOTAL |
|-----------------------------------|--------|------------|-------------|---------|-------|
| <b>Number of Banks</b>            | 6      | 17         | 54          | 283     | 360   |
| <b>Banks Reporting Uses for:</b>  |        |            |             |         |       |
| Lending                           | 6      | 16         | 46          | 232     | 300   |
| Investment                        | 3      | 10         | 24          | 73      | 110   |
| Debt Repayment                    | 0      | 2          | 7           | 43      | 52    |
| Acquisition                       | 0      | 5          | 1           | 9       | 15    |
| Capital Cushion or Other Reserves | 1      | 5          | 25          | 125     | 156   |

Source: SIGTARP analysis of survey responses.

Note: Some percentages may have been rounded beyond 0.5 percentage points in order to add up to 100 percent.

## Appendix F—Broad Impact of Receiving TARP Funds

To illustrate the broad impact of receiving TARP funds, Table 9 shows the reported actions that recipients would not have been able to achieve without TARP funding, and actions that recipients were able to avoid due to TARP funding. The distribution of firms that addressed these actions (in regards to the date of funding, the amount of funding received, and asset size) was comparable to the distribution of all recipients.

**Table 9: Broad Impact of Receiving TARP Funds Summary**

| Activity  | Number of Institutions | Percentage of Institutions <sup>55</sup> |
|---|------------------------|--|
| <b>Without TARP funds institutions would not have been able to:</b> |                        |  |
| Grow Lending  | 34                     | 21                                       |
| Enhance Lending Activity  | 21                     | 13                                       |
| Improve Capital Position  | 16                     | 10                                       |
| Conduct Loan Modifications  | 8                      | 5  |
| Grow Deposits   | 6                      | 4  |
| Purchase Investments  | 6                      | 4  |
| Reduce Loan Terms   | 4                      | 2  |
| Pay Debt  | 3                      | 2  |
| Complete an Acquisition   | 3                      | 2  |
| <b>Because of TARP funds institutions were able to avoid:</b>       |                        |  |
| Reducing Lending  | 46                     | 28                                       |
| Reducing their Loan Portfolio                                       | 17                     | 10                                       |
| Shrinking their Balance Sheet                                       | 14                     | 9  |
| Freezing Lending  | 11                     | 7  |
| Falling Below Well Capitalized Level                                | 5                      | 3  |
| Job Reductions  | 2                      | 1  |
| Exiting the Banking Business  | 1                      | 1  |

Source: SIGTARP analysis of survey responses.

Note: Numbers and percentages do not total since respondents reported multiple uses of funds.

<sup>55</sup> Percentages are based on 163 recipients that responded to this question.

## **Appendix G—Audit Team Members**

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This report was prepared and the review was conducted under the direction of Barry W. Holman, Audit Director, Office of the Special Inspector General for the Troubled Asset Relief Program. Other key SIGTARP staff included Michael Kennedy, James Shafer, Anne Blank, Trevor Rudolph, and Kamruz Zaman. The Concentrance staff members who supported SIGTARP in the audit and report development included Karmen Carr, Alex Kangelaris, Darius Grayson, Patricia Taylor, Christopher Laughlin, Matthew Herman, Yusuf Makhkamov, and Mandy Ho.

## Appendix H—Management Comments



ASSISTANT SECRETARY

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

July 15, 2009

Neil M. Barofsky, Esq.  
Special Inspector General  
for the Troubled Assets Relief Program  
United States Department of the Treasury  
1500 Pennsylvania Ave., N.W.  
Washington, D.C. 20220

Re: SIGTARP Use of Funds Report

Dear Mr. Barofsky:

Thank you for giving us the opportunity to review and comment on your draft report regarding the use of Troubled Assets Relief Program (TARP) funds by Capital Purchase Program (CPP) recipients. We share your desire to know whether expenditures of funds under the Emergency Economic Stabilization Act of 2008 (EESA) are helping to promote financial stability and liquidity, and ultimately helping consumers and businesses by enabling financial institutions to provide credit and other financial services. It is a responsibility of the Department of the Treasury (Treasury) to determine what types of reporting by TARP recipients are most useful in making that assessment.

In discussing use of TARP funds, it is important to distinguish between Treasury's capital-enhancement programs and its other programs. The CPP, Capital Assistance Program and the programs under which exceptional assistance has been provided to AIG, Citigroup and Bank of America are designed to provide capital to cushion against losses and allow financial institutions to continue operating in the ordinary course of business, including lending to consumers and businesses. In order to serve its purpose, capital must be available for general business purposes. By contrast, Treasury's home ownership preservation programs, Small Business Lending Initiative, Public-Private Investment Program, and Term Asset Backed Securities Loan Facility program impose specific restrictions on the use of TARP funds, and require controls and periodic reports to ensure that those restrictions are respected.

The responses of CPP participants described in your report illustrate the broad range of uses to which capital may be put, including building capital reserves, supporting lending and making investments. While those responses suggest the goals of EESA are being met, we think caution should be exercised in drawing conclusions from this data. Although it might be tempting to do so, it is not possible to say that investment of TARP dollars resulted in particular loans, investments or other activities by the recipient.

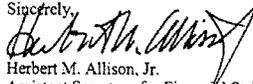
This is a function of basic accounting principles. Banks' double-entry bookkeeping systems do not trace the paths from creating liabilities (receiving capital) to investing in assets

(such as making loans). As the report notes at page 6, “the majority of recipients reported that they did not segregate TARP funds,” and “[m]ore than half of the banks that reported physical segregation of funds . . . stated that segregation was only a temporary measure pending future deployment of the funds.” Furthermore, “once received, the cash associated with the TARP funding became indistinguishable from any other cash sources . . .” In addition, money is fungible, and paying an expense from one source frees up cash to be used for other purposes. Even if TARP investments could be traced to particular uses, those uses cannot be said to be attributable to the TARP investment if the same expenditures would have been made from other sources even in the absence of TARP funding.

Treasury wants to see the investments it has made translate as quickly as possible into additional lending to creditworthy borrowers and increases in other services and benefits to consumers and businesses. We recognize that banks must rebuild their capital in light of the losses they have experienced and may yet experience. They must also maintain appropriate standards for lending and other activities. Treasury does not intend to tell banks how to run their businesses, but we will seek to collect and provide useful information that can help determine if we are making progress toward restoring financial stability. For example, Treasury believes that collecting and publishing data on aggregate lending levels addresses the issue that taxpayers are most concerned about. Accordingly, Treasury has been producing a Monthly Lending and Intermediation Survey and Snapshot, which contains quantitative information on three major categories of lending by the nation’s largest CPP banks. We are also producing an expanded CPP Lending Report, which reports on monthly average outstanding balances of consumer loans, commercial loans and total loans of all CPP recipients. Banks that seek capital under the Capital Assistance Program must submit a plan as to how they intend to use the assistance to strengthen lending capacity and must submit monthly reports on lending levels. The Treasury and Federal regulators also collect and publish other types of data on the condition of our financial institutions and the activity in particular financial markets that can contribute to assessing the health of our financial system.

We welcome any additional suggestions you have as to the types of data that Treasury should collect. Thank you again for giving us the opportunity to comment on your survey and please contact us if you have any questions.

Sincerely,



Herbert M. Allison, Jr.  
Assistant Secretary for Financial Stability

## SIGTARP Hotline

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If you are aware of fraud, waste, abuse, mismanagement or misrepresentations affiliated with the Troubled Asset Relief Program, please contact the SIGTARP Hotline.

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Washington, D.C. 20220

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REVIEW & OUTLOOK | JUNE 25, 2009

## Abolish the Inspector General

*Either the administration ought to abide by its own rules or get rid of the office.*

A core premise of the Obama campaign was that the Bush administration had corrupted government with political interference. Yet now it appears that this supposed manipulation was a problem because it was exercised by a *Republican* president.

To wit, the White House is trying to encroach on the powers of the government's Inspectors General, the ombudsmen charged with safeguarding taxpayer dollars. First there was the abrupt firing of Gerald Walpin, an IG who pursued one of President Obama's political supporters in California for misusing federal volunteerism subsidies. Then there is the matter of Neil Barofsky, a former federal prosecutor given the Sisyphean task of monitoring the \$700 billion Troubled Asset Relief Program.

According to a letter released last week by Iowa Republican Chuck Grassley, Treasury officers have told the TARP Special Inspector General that his office falls under the "direct supervision and direction" of Secretary Tim Geithner, which could compromise its independence. Already Mr. Barofsky has clashed with the administration "over certain Treasury documents that were being withheld from SIGTARP auditors on a specious claim of attorney-client privilege."

Eventually he seems to have received the records, which reportedly deal with the administration's role in approving the AIG bonuses. As for his legal authority, the matter has been referred to the Justice Department for an opinion. In a redacted April 7 memo released by Mr. Grassley, Mr. Barofsky defended his independence, arguing that under TARP he "statutorily has unfettered access to Treasury's privileged as well as non-privileged documents" and that Congress had a "clear intention" to "not subject us to the [Treasury] Secretary's ability to shut down an audit or investigation" (his emphasis).

Mr. Barofsky is almost certainly right, given that Democrats created the IG post when they still had President Bush to kick around. It was a great idea when a GOP Treasury was passing out TARP funds but now is a nuisance when scrutiny could embarrass their man in the Oval Office.

Recall too that the Bush years were clogged with media narratives about phantom political meddling. The dark genius of Karl Rove hovered over every policy decision. NASA scientist Jim Hansen and former Surgeon General Richard Carmona burnished their Beltway celebrity by claiming they were muzzled. Democrats waxed indignant about the supposed political purge of the U.S. Attorneys, the FDA on birth control and the EPA on everything.

However unserious these nanoscandals were, given their animating impulse Mr. Walpin's sacking and now the challenge to Mr. Barofsky's autonomy would be front-page news had Mr.

Bush pulled them off. But the administration has gotten away with waving off the Barofsky affair as trivial and smearing Mr. Walpin as an old coot.

Can we suggest an alternative? Abolish the IG position across the government. IGs were chartered by Democrats when Republicans kept winning the executive branch. While some of them sometimes produce valuable work, mostly they answer to Congress by teeing up pseudoscandals and serving as witnesses for the prosecution. Their probes do nothing to curb federal spending, so why waste the money?

Mr. Obama professed to love the Inspectors General as a Senator, and he cosponsored legislation that bolstered their autonomy and required the president to give Congress a month's notice and a reason before firing an IG. Either the administration ought to abide by its own rules or get rid of the office.

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