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Testimony

Before the Subcommittee on Domestic  
Policy, Committee on Oversight and  
Government Reform, House of  
Representatives

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# TROUBLED ASSET RELIEF PROGRAM

## Status of Efforts to Address Transparency and Accountability Issues

Statement of Richard J. Hillman, Managing Director  
Financial Markets and Community Investment



**GAO**

Accountability \* Integrity \* Reliability

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Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss our work on the Troubled Asset Relief Program (TARP), under which the Department of the Treasury (Treasury) has the authority to purchase and insure up to \$700 billion in troubled assets held by financial institutions through its Office of Financial Stability (OFS).<sup>1</sup> As you know, Treasury was granted this authority in response to the financial crisis that has threatened the stability of the U.S. banking system and the solvency of numerous financial institutions. The Emergency Economic Stabilization Act (the act) that authorized TARP on October 3, 2008, requires GAO to report at least every 60 days on findings resulting from our oversight of the actions taken under TARP.<sup>2</sup> We are also responsible for auditing OFS's annual financial statements and for producing special reports on any issues that emerge from our oversight. To carry out these oversight responsibilities, we have assembled interdisciplinary teams with a wide range of technical skills, including financial market and public policy analysts, accountants, lawyers, and economists who represent combined resources from across GAO. In addition, we are building on our in-house technical expertise with targeted new hires, re-employed annuitants with related expertise, and outside experts. The act also created additional oversight entities—the Congressional Oversight Panel (COP) and the Special Inspector General for TARP (SIGTARP)—that also have reporting responsibilities. We are coordinating our work with COP and SIGTARP and are meeting with officials from both entities to share information and coordinate our oversight efforts. These meetings help to ensure that we are collaborating as appropriate and not duplicating efforts.

My statement today is based primarily on our January 30, 2009 report, the second under the act's mandate, which covers the actions taken as part of

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<sup>1</sup>GAO, *Troubled Asset Relief Program: Status of Efforts to Address Transparency and Accountability Issues*, [GAO-09-296](#) (Washington D.C.: Jan. 30, 2009) and *Troubled Asset Relief Program: Additional Actions Needed to Better Ensure Integrity, Accountability, and Transparency*, [GAO-09-161](#) (Washington, D.C.: Dec. 2, 2008).

<sup>2</sup>Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat. 3765. The act requires the U.S. Comptroller General to report at least every 60 days, as appropriate, on findings resulting from oversight of TARP's performance in meeting the act's purposes; the financial condition and internal controls of TARP, its representatives, and agents; the characteristics of asset purchases and the disposition of acquired assets, including any related commitments entered into; TARP's efficiency in using the funds appropriated for its operations; its compliance with applicable laws and regulations; and its efforts to prevent, identify, and minimize conflicts of interest among those involved in its operations.

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TARP through January 23, 2009, and follows up on the nine recommendations we made in our December 2, 2008 report.<sup>3</sup> This statement also provides additional information on some recent developments related to TARP, including Treasury's new financial stability plan. Our oversight work under the act is ongoing, and our next report is due to be issued by March 31, 2009, as required. This statement focuses on (1) the nature and purpose of activities that have been initiated under TARP; and (2) Treasury's efforts to establish a management structure for TARP, including a system of internal controls over the use of TARP funds. To do this work, we reviewed documents related to TARP, including contracts, agreements, guidance, and rules. We also met with OFS, contractors, federal agencies, and officials from all eight of the first large institutions to receive disbursements. We plan to continue to monitor the issues highlighted in the report, as well as future and ongoing capital purchases, other more recent transactions undertaken as part of TARP (for example, guarantees on assets of Citigroup and Bank of America), and the status of other aspects of TARP. We conducted this performance audit between December 2008 and March 2009 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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## Summary

Treasury has announced a number of new programs to try to stabilize financial markets, but most of its activities during this period have continued to fall under its Capital Purchase Program (CPP). As of March 5, 2009, Treasury had disbursed approximately \$300 billion in TARP funds, about \$197 billion of it for CPP. Treasury has recently announced the Financial Stability Plan, which outlines a set of measures to address the financial crisis and restore confidence in the U.S. financial and housing markets, and a Homeowner Affordability and Stability Plan to mitigate foreclosures and preserve homeownership. Treasury also has taken important steps since our first report to implement all nine of our recommendations. However, due in part to the short time that has elapsed since our first report, we continued to identify a number of areas that warrant Treasury's ongoing attention. We recommended in our latest

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<sup>3</sup>Information is current as of January 23, 2009, unless otherwise noted in the statement.

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report that Treasury continue to take action to further improve TARP's transparency and accountability and more clearly articulate and communicate a strategic vision for TARP. Specifically, we recommended that Treasury:

- expand the scope of the monthly CPP surveys for the 20 largest banks to include collecting at least some information from all institutions participating in the program;
- ensure that future CPP agreements include a mechanism that will better enable Treasury to track the use of the capital infusions and seek to obtain similar information from existing CPP participants;
- establish a process to ensure compliance with all CPP requirements, including those associated with limitations on dividends and stock repurchase restrictions;
- communicate a clearly articulated vision for TARP that incorporates actions to preserve homeownership and describes how all individual programs are intended to work in concert to achieve that vision; and once this vision is clearly articulated, document the skills and competencies needed within the department to carry it out;
- develop a comprehensive system of internal controls over TARP, including policies, procedures, and guidance for program activities that are robust enough to ensure that the program's objectives and requirements are met;
- continue to expeditiously hire personnel needed to carry out and oversee TARP;
- expedite efforts to ensure that sufficient personnel are assigned and properly trained to oversee the performance of all contractors, especially for contracts priced on a time-and-materials basis, and move toward fixed-price arrangements whenever possible as requirements are better defined over time;
- develop and implement a well-defined and disciplined risk-assessment process, which is essential to monitoring the status of programs and identifying any risks that previously announced programs will not be adequately funded; and
- review and renegotiate existing conflict-of-interest mitigation plans, as necessary, to enhance specificity and conformity with the new interim conflict-of-interest regulation and take continued steps to manage and

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monitor conflicts of interest and enforce mitigation plans.

Consistent with our recommendations, the recently announced Financial Stability Plan outlines some steps that Treasury is taking to improve the transparency and accountability of new programs going forward. But Treasury still faces several challenges. First, our initial report emphasized the lack of monitoring and reporting for CPP investments and recommended stronger measures for ensuring that participating institutions used the funds to meet the program's purpose and comply with CPP requirements on, for example, executive compensation and dividend payments. In response to our recommendation, Treasury completed its initial survey of the 20 largest institutions to monitor lending and other activities and announced plans to analyze quarterly monitoring data (call reports) for all reporting institutions.<sup>4</sup> While the monthly survey is a step toward greater transparency and accountability for the largest institutions, we continue to believe that additional action is needed to better ensure that all participating institutions are accountable for their use of TARP funds. Second, Treasury has continued to develop a system to ensure compliance with CPP requirements, including executive compensation, dividend payments, and repurchase of stocks, but it has not yet finalized its plans for detecting noncompliance and taking enforcement actions. Third, we noted that Treasury had made limited progress in articulating and communicating an overall strategic vision for TARP and continued to respond to institution- and industry-specific needs. This lack of clarity has complicated Treasury's ability to effectively communicate to Congress, the financial markets, and the public. As Treasury provides more details on its new Financial Stability Plan, its strategic approach to addressing the financial crisis may become clearer.

Treasury has made progress in establishing a management structure for TARP, including adopting a framework for developing and implementing its system of internal control for TARP activities that is consistent with our recommendation. However, as of our January report, OFS had yet to implement a disciplined risk-assessment process. Treasury has taken steps to help ensure a smooth transition to a new administration by keeping positions filled and using an expedited hiring process. However, it continues to face difficulty providing competitive salaries to attract skilled

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<sup>4</sup>Call reports are quarterly reports that collect basic financial data of commercial banks in the form of a balance sheet and income statement (formally known as *Report of Condition and Income*).

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employees. Also, given the TARP's evolving nature and the changes under the new administration, Treasury needs to identify OFS's long-term organizational needs. Additionally, consistent with our recommendation on contracting oversight, Treasury has enhanced such oversight by tracking costs, schedules, and performance and addressing the training requirements of personnel who oversee the contracts. However, as we previously recommended, Treasury needs to continue to identify and mitigate conflicts of interest in contracting.

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### Treasury Has Continued to Focus on CPP, but a Variety of Other Programs Have Been Created or Are Being Planned

Treasury has continued to focus on CPP, but a variety of other programs have been created or are in progress, as shown in table 1. As of March 5, 2009, Treasury had disbursed almost 80 percent of the \$250 billion it had allocated for CPP to purchase almost \$197 billion in preferred shares of 467 qualified financial institutions (table 1).<sup>5</sup> Treasury has begun to receive dividend payments relating to capital purchases under CPP and other programs. According to Treasury, as of February 17, 2009, it had received about \$2.4 billion.

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<sup>5</sup>Through December 31, 2008, TARP capital purchases and loans totaled \$247 billion. The Congressional Budget Office (CBO) estimated the subsidy cost for these transactions at \$64 billion, or 26 percent, using valuation procedures similar to those specified in the Federal Credit Reform Act and adjusted for market risk as specified in the Emergency Economic Stabilization Act. See Congressional Budget Office, *The Troubled Asset Relief Program: Report on Transactions Through December 31, 2008* (Jan. 2009). COP estimated the subsidy cost at \$78 billion, or 31 percent, using multiple valuation methods and an evaluation of similar private transactions. See Congressional Oversight Panel, *February Oversight Report: Valuing Treasury's Acquisitions* (Feb. 6, 2009). In connection with our audit of TARP's financial statements, we will be evaluating and testing the credit subsidy model that TARP uses to value capital purchases and loans for financial reporting purposes.

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**Table 1: Status of TARP Funds as of March 5, 2009 (dollars in billions)**

<b>Program</b>	<b>Disbursed</b>
Capital Purchase Program	\$ 196.8
Systemically Significant Failing Institutions	40.0
Targeted Investment Program	40.0
Automotive Industry Financing Program	23.7
Citigroup Asset Guarantee	0.0
Bank of America Asset Guarantee	0.0
Making Home Affordable Program	0.0
Term Asset-backed Securities Loan Facility – 1	0.0
Consumer & Business Lending Initiative	0.0
<b>Totals</b>	<b>\$ 300.5</b>

Source: Treasury OFS, unaudited.

Initially, Treasury approved \$125 billion in capital purchases for nine of the largest public financial institutions that federal banking regulators and Treasury considered to be systemically significant to the operation of the financial system.<sup>6</sup> At the time, these nine institutions held about 55 percent of U.S. banking assets. Subsequent purchases were made for qualified institutions of various sizes (in terms of total assets) and types. As we noted in our January report, most of the institutions that received CPP capital were publicly held institutions, although a limited number of privately held institutions and community development financial institutions (CDFI) also received funds.<sup>7</sup>

Treasury has taken a number of important steps toward better reporting on and monitoring of CPP. These steps are in keeping with our prior recommendations that Treasury bolster its ability to determine whether

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<sup>6</sup>While Treasury approved \$125 billion to the nine largest institutions, it initially disbursed funds to eight. The \$10 billion to Merrill Lynch was not disbursed until January 9, 2009, after its merger with Bank of America was completed.

<sup>7</sup>CDFIs are specialized financial institution working in market niches that are underserved by traditional financial institutions. CDFIs provide a range of financial products and services such as mortgage financing for low-income and first-time homebuyers and not-for-profit developers; flexible underwriting and risk capital for needed community facilities; and technical assistance, commercial loans and investments to small start-up or expanding businesses in low-income areas.

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institutions are using CPP proceeds in ways that are consistent with the act's purposes and establish mechanisms to monitor compliance with program requirements. However, Treasury needs to take further steps in this area. Treasury has done an initial survey of the largest institutions to monitor their lending and other activities and announced plans to analyze quarterly monitoring data (call reports) for all reporting institutions. While the monthly survey is a step toward greater transparency and accountability for the largest institutions, we continue to believe that additional actions are needed to better ensure that all participating institutions are held accountable for their use of the funds. Without more frequent information on all participants, Treasury will have little timely information about the changing financial condition of participating institutions, potentially limiting the ability of its newly created team of analysts to understand how the institutions are using CPP funds and whether the program is having the desired effect. In addition, without ensuring that future CPP agreements include a mechanism that enables Treasury to track the use of capital infusions and that existing CPP participants provide similar information, Treasury may have difficulty determining whether an institution has used the funds in a manner consistent with TARP's purposes. Therefore, we recommended that Treasury expand the scope of planned monthly CPP surveys to include collecting at least some information from all participating institutions. We also recommended that future CPP agreements include a mechanism that enables Treasury to track the use of capital infusions and that Treasury seek to obtain similar information from existing CPP participants. We will continue to monitor Treasury's oversight efforts as well as the consistency of the approval process in future work.

Treasury has also continued to take steps to increase its planned oversight of compliance with terms of the CPP agreements, including limitations on executive compensation, dividends, and stock repurchases. Among these steps, Treasury has named an Interim Chief Compliance Officer. However, Treasury has not finalized its plans for detecting noncompliance with CPP requirements or for taking enforcement actions. Without a more structured mechanism in place to ensure compliance and with a growing number of institutions participating in the program, ensuring compliance with these important aspects of the program will become increasingly challenging. In its recently announced Financial Stability Plan, Treasury called for banks receiving government funds in the future to be held responsible for appropriate use of those funds through (1) stronger restrictions on dividend payment and executive compensation, and (2) enhanced reporting to the public, including reporting on lending activity. In addition, Treasury is in the process of drafting new regulations to



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implement the executive compensation requirements in the American Recovery and Reinvestment Act of 2009, which amended the requirements in the Emergency Economic Stabilization Act related to executive compensation and corporate governance of TARP fund recipients.<sup>8</sup> Among these amendments is a requirement for the boards of directors of any TARP fund recipient to have in place a company-wide policy regarding excessive or luxury expenditures, as identified by Treasury. These may include excessive expenditures on entertainment or events, office and facility renovations, aviation or other transportation services, or other activities or events that are deemed unreasonable. We plan to monitor how Treasury defines excessive or luxury expenditures and how Treasury assures that TARP fund recipients adopt reasonable policies and practices to control against such expenditures. We will also continue to monitor both the system that Treasury develops to ensure compliance with the agreements and the implementation of additional oversight and accountability efforts under its new plan.

Treasury has also continued to make some progress in improving the transparency of TARP and a few weeks ago announced its plans for the remaining TARP funds. In our December 2008 report, we first raised questions about the effectiveness of Treasury's communication strategy for TARP with Congress, the financial markets, and the public. These questions were further heightened in the COP's January report, which raised similar questions about Treasury's strategy for TARP. In response to our recommendation about its communication strategy, Treasury noted numerous publicly available reports, testimonies, and speeches. However, even after reviewing these items collectively, we found that Treasury's strategic vision for TARP remained unclear. For example, Treasury initially outlined a strategy to purchase whole loans and mortgage-backed securities from financial institutions, but changed direction to make capital investments in qualifying financial institutions as the global community opted to move in this direction. However, once Treasury determined that capital infusions were preferable to purchasing whole mortgages and mortgage-backed securities, it did not clearly articulate how the various programs—including CPP, the Systemically Significant Failing Institutions Program (SSFI), and the Targeted Investment Program (TIP)—would work collectively to help stabilize financial markets. For instance, Treasury has used similar approaches—capital infusions—to stabilize healthy institutions under CPP as well as SSFI and TIP, albeit

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<sup>8</sup>Pub. L. No. 111-5, div. B, title VII, § 7001 (Feb. 17, 2009) (amending section 111 of EESA).

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with more stringent requirements. Moreover, with the exception of institutions selected for TIP being viewed as able to raise private capital, both SSFI and TIP share similar selection criteria. Treasury also created the Auto Industry Financing Program in December 2008 to prevent a disruption of the domestic automotive industry that would pose systemic risk to the nation's economy and provided loans to two auto companies and two financing companies that, among other business lines, provide consumer automotive loans. Further, the same institution may be eligible for multiple programs. At least two institutions (Citigroup and Bank of America) currently participate in more than one program, adding to the confusion about Treasury's strategy and vision for implementing TARP. Other actions also have raised additional questions about Treasury's strategy. For example, Treasury announced the first institution under TIP weeks before the program was established. Similarly, the Asset Guarantee Program was established after Treasury announced that it would guarantee assets under such a program, but many of the details of the program have yet to be worked out.

Since our January report, Treasury has taken three key actions related to our recommendation about the need for a clearly articulated vision for the program. First, on February 10, Treasury announced the Financial Stability Plan, which outlined a set of measures to address the financial crisis and restore confidence in U.S. financial and housing markets. The plan appears to be an approach designed to resolve the credit crisis by restarting the flow of credit to consumers and businesses, strengthening financial institutions, and providing aid to homeowners and small businesses. Next, on February 25, Treasury provided the standardized terms and conditions for eligible financial institutions participating in the Capital Assistance Program (CAP). Under CAP, an eligible institution that is found by its primary banking regulator to need additional capital to continue lending and absorb losses in a severe economic downturn will be eligible to participate in CAP.<sup>9</sup> Such institutions will be eligible to receive a capital investment from Treasury in the form of preferred securities that can be converted into common equity to help absorb losses and serve as a bridge to receiving private capital. A key element of Treasury's Financial Stability Plan, CAP is designed to ensure that, in severe economic conditions, the largest U.S. bank holding companies have sufficient capital to support

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<sup>9</sup>According to Treasury and the federal banking regulators, eligibility will be consistent with the criteria and deliberative process that has been established for identifying qualified financial institutions in the existing CPP.

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lending to creditworthy homeowners and businesses. As part of this effort, the federal banking regulators—the Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, and Office of Thrift Supervision—announced that they will begin conducting a one-time forward-looking capital assessment (or stress test) of the balance sheets of the 19 largest bank holding companies with assets exceeding \$100 billion. These institutions are required to participate in the coordinated supervisory capital assessment and may obtain additional capital from CAP if necessary.<sup>10</sup> Regulators noted that the capital assessment process for all eligible institutions was expected to be completed by April 30, 2009.

In addition, on March 4, 2009, Treasury unveiled its Making Home Affordable program, which is based in part on the use of TARP funds. Among other things, the plan is designed to do the following:

- It will use \$75 billion to modify the loans of up to 3-4 million homeowners to avoid potential foreclosure. The goal of modifying the mortgages of these homeowners is to reduce the amount owed per month to sustainable levels (a mortgage debt-to-income ratio of 31 percent). Treasury will share the cost of restructuring the mortgages with the other stakeholders (e.g., financial institutions holding whole loans or investors if loans have been securitized). Treasury announced a series of financial incentives for the loan servicers, mortgage holders/investors, and borrowers that are intended to “pay for success,” encourage borrowers to continue paying on time under the modified loan, and encourage servicers and mortgage holders/investors to modify at-risk loans before the borrower falls behind on a payment.
- It includes an initiative to help up to 4-5 million homeowners to refinance loans that are owned or guaranteed by Freddie Mac and Fannie Mae at current market rates. According to Treasury, these homeowners would not otherwise be able to refinance their loans at the conforming loan rates because the declining value of their homes has left them with little or no equity. Refinancing at current mortgage rates could help homeowners save thousands of dollars in their annual mortgage payments.

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<sup>10</sup>Eligible institutions with less than \$100 billion in risk-weighted assets are also eligible to participate in CAP. Risk-weighted assets are the total of all assets held by the bank that are weighted for credit risk according to a formula established in regulation by the Federal Reserve.

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- It increases Treasury’s funding commitment to Fannie Mae and Freddie Mac to ensure the strength and security of the mortgage market and to help maintain mortgage affordability. The \$200 billion funding commitment is based on authority granted to Treasury under the Housing and Economic Recovery Act of 2008.<sup>11</sup>

We will continue to monitor the development and implementation of Treasury’s plan, including how its actions address the challenges we have previously identified.<sup>12</sup>

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### Efforts to Establish a Management Structure for TARP, including a System of Internal Control, Are Ongoing

Treasury has made progress in establishing its management infrastructure for TARP. However, its development of a system of internal control is still evolving, hiring for OFS is still ongoing, and Treasury is working to improve its oversight of contractors.

- OFS has adopted a framework for developing and implementing its system of internal control for TARP activities. OFS plans to use this framework to develop specific policies, drive communications on expectations, and measure compliance with internal control standards and policies. However, OFS has yet to develop comprehensive written policies and procedures governing TARP activities or implement a disciplined risk-assessment process.
- In the hiring area, Treasury took steps to help maintain continuity of leadership within OFS during and after the transition to the new administration. Specifically, Treasury ensured that interim chief positions would be filled to ensure a smooth transition and used direct-hire authority and various other appointments to bring a number of career staff on board quickly. OFS has increased its overall staff since our December 2008 report from 48 to 90 employees as of January 26, which includes an increase of permanent staff from 5 to 38. Treasury officials recently told us that the number of permanent staff had increased to 60. While progress has been made since our last report, the number of temporary and contract staff who will be needed to serve long-term organizational needs remains unknown. Because TARP has added many new programs since it was first established in October and program activities are changing under

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<sup>11</sup>Pub. L. No. 110-289, 122 Stat. 2654 (2008).

<sup>12</sup>See GAO, *Troubled Asset Relief Program: Status of Efforts to Address Defaults and Foreclosures in Home Mortgages*, [GAO-09-231T](#) (Washington, D.C.: Dec. 4, 2008) for a discussion of challenges facing loan modification programs.

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the new administration, we recognize that Treasury may find it difficult to determine OFS's long-term organizational needs at this time. However, such considerations will be vital to retaining institutional knowledge in the organization.

- Treasury's use of existing contract flexibilities has enabled it to enter into agreements and award contracts quickly in support of TARP. However, Treasury's use of time-and-materials contracts, although authorized when flexibility is needed, can increase the risk that government dollars will be wasted unless adequate mechanisms are in place to oversee contractor performance. Although Treasury has improved its oversight of contractors, the department itself has identified both certification of its Contracting Officer Technical Representatives and its use of time-and-materials pricing as high-risk issues that still need attention. In addition, while Treasury has taken the important step of recently issuing an interim regulation outlining the process for reviewing and addressing conflicts of interest among new contractors and financial agents, it is still reviewing existing contracts or agreements to ensure conformity with the new regulation. We believe this step is a necessary component of a comprehensive and complete system to ensure that all conflicts are fully identified and appropriately addressed.

In each of these areas, we made additional recommendations. Specifically, we recommended that Treasury, in addition to developing a comprehensive system of internal controls, develop and implement a well-defined and disciplined risk-assessment process, because such a process is essential to monitoring the status of TARP programs and identifying any risks that announced programs will not be adequately funded. We also recommended that Treasury continue to expeditiously hire personnel needed to carry out and oversee TARP. For contracting oversight, we recommended that Treasury expedite efforts to ensure that sufficient personnel are assigned and properly trained to oversee the performance of all contractors, especially for contracts priced on a time-and-materials basis, and move toward fixed-price arrangements whenever possible as program requirements are better defined over time. We also recommended that Treasury review and renegotiate existing conflict-of-interest mitigation plans, as necessary, to enhance specificity and conformity with the new interim conflicts of interest regulation and that it take continued steps to manage and monitor conflicts-of-interest and enforce mitigation plans. We will continue to monitor OFS's implementation of the internal control framework and hiring and contracting practices, both of which are vital to TARP's effectiveness.

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Mr. Chairman and Members of the Subcommittee, I appreciate the opportunity to discuss these critically important issues and would be happy to answer any questions that you may have.

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## Contact

For further information on this testimony, please contact Richard J. Hillman on (202) 512-8678 or [hillmanr@gao.gov](mailto:hillmanr@gao.gov).

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