United States Government Accountability Office

GAO

Report to Congressional Committees

June 2009

TROUBLED ASSET RELIEF PROGRAM

June 2009 Status of Efforts to Address Transparency and Accountability Issues

GAO-09-658

June 2009

TROUBLED ASSET RELIEF PROGRAM

June 2009 Status of Efforts to Address Transparency and Accountability Issues

GAO Accountability·Integrity·Reliability

Highlights

Highlights of GAO-09-658, a report to congressional committees

Why GAO Did This Study

GAO's fifth report on the Troubled Asset Relief Program (TARP) follows up on prior recommendations. It also reviews (1) activities that had been initiated or completed under TARP as of June 12, 2009; (2) the Department of the Treasury's Office of Financial Stability's (OFS) hiring efforts and use of contractors; and (3) TARP performance indicators. To do this, GAO reviewed signed agreements and other relevant documentation and met with officials from OFS, contractors, and financial regulators.

What GAO Recommends

GAO makes 5 recommendations, including that Treasury improve disclosure of the warrant repurchase process, fully implement a communication strategy that ensures that all key congressional stakeholders are kept up to date about TARP, and in consultation with the primary federal regulators, ensure consideration of generally consistent criteria to evaluate repurchase requests. GAO also recommends that the Federal Reserve consider providing certain aggregate information related to the stress tests to the public and OFS in particular.

Treasury described the steps it has taken since our March report. The Federal Reserve said that GAO's recommendation was operationally difficult and the information reported would be potentially misleading. GAO continues to see value in reporting aggregate trend information.

View GAO-09-658 or key components.
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What GAO Found

As of June 12, 2009, Treasury had disbursed $330 billion of the roughly $700 billion in TARP funds (see table below). Most of the funds ($200 billion) went to purchase preferred shares and subordinated debentures of 623 financial institutions under the Capital Purchase Program (CPP), which continues to be OFS's primary vehicle for stabilizing financial markets. At the same time that Treasury continues to purchase preferred shares in institutions, others have paid about $1.9 billion to repurchase shares and Treasury announced that it expects to receive approximately $68 billion from CPP repurchases later in June 2009. Unlike the capital purchase process, Treasury, in conjunction with primary federal regulators, has yet to share criteria used to evaluate repurchase requests. Treasury also has provided only limited information about the actual warrant repurchase process resulting in questions about whether it is getting the best price for taxpayers.

Status of TARP Funds as of June 12, 2009

Dollars in billions

Program	Treasury's current projected use of funds[a]	Disbursed
Capital Purchase Program	$218.0	$199.5
Targeted Investment Program	40.0	40.0
Capital Assistance Program	TBD[b]	TBD
Systemically Significant Failing Institutions	70.0	41.2
Asset Guarantee Program	12.5	0.0
Automotive Industry Financing Program	82.6	49.2
Making Home Affordable	50.0	0.0
Consumer and Business Lending Initiative[c]	70.0	0.1
Public Private Investment Program	100.0	0.0
Totals	**$643.1**	**$330.0**

Source: Treasury OFS, unaudited.

[a]Amounts represent Treasury's most recent projected funding level. Portions of Treasury's projected use of funds are not yet legal obligations.
[b]Treasury has announced the Capital Assistance Program but has not yet projected its funding level.
[c]The Consumer and Business Lending Initiative now includes the Term Asset-Backed Securities Loan Facility and the Small Business and Community Lending Initiative.

Treasury continued to operationalize its more recent programs, including the Capital Assistance Program (CAP). As part of this program, the Federal Reserve led the stress tests of the largest 19 U.S. bank holding companies, which revealed that about half needed to raise additional capital to keep them strongly capitalized and lending even if economic conditions worsen. Whether any of the institutions will have to participate in CAP has yet to be determined. While the Federal Reserve disclosed the stress test results, it has no plans to disclose information about the 19 institutions going forward. What information, if any, is disclosed will be left to the discretion of the affected institutions raising a number of concerns including potentially inconsistent or only selected information being disclosed. Moreover, the Federal Reserve had not developed a mechanism to share information with OFS about the ongoing condition of the 19 bank holding companies that continue to participate in TARP programs.

According to Treasury, its Financial Stability Plan has provided a basis for its communication strategy. Treasury plans to more regularly communicate with congressional committees of jurisdiction about TARP. However, until this strategy is fully implemented, all congressional stakeholders will not be receiving information in a consistent or timely manner. A key component of the communication strategy is the new www.financialstability.gov Web site. While a goal of the new site is to provide the public with a more user friendly format, Treasury has not yet measured the public's satisfaction with the site.

OFS has made progress in establishing its management infrastructure. Continued attention to hiring remains important because some offices within OFS, including the Office of the Chief Risk and Compliance Officer, continue to have a number of vacancies that will need to be filled as TARP programs are fully implemented. Treasury has also continued to build a network of contractors and financial agents to support TARP administration and operations. These contracts and agreements are key tools OFS has used to help develop and administer its TARP programs. Treasury has provided information to the public on procurement contracts and financial agency agreements, but has not included a breakdown of cost data by each entity. As a result, Treasury is missing an opportunity to provide additional transparency about TARP operations.

GAO again notes the difficulty of measuring the effect of TARP's activities. As shown in the table below, some indicators suggest general improvements in various markets since our March 2009 report, although the cost of credit has risen in some cases. Specifically, the Baa corporate bond rate and LIBOR have declined but mortgage and Aaa bond rates have risen. However, perceptions of risk in credit markets (as measured by premiums over Treasury securities) have decreased in interbank, mortgage, and corporate bond markets, while total mortgage originations have increased. Empirical analysis of the interbank market, which showed signs of significant stress in 2008, suggests that the CPP and programs outside of the TARP announced in October of 2008 resulted in a statistically significant improvement in risk spreads even when other important factors were considered. In addition, although Federal Reserve survey data suggest that lending standards remained tight, collectively the largest CPP recipients extended roughly $260 billion on average each month in new loans to consumers and businesses in the first quarter of 2009, according to the Treasury's loan survey. However, attributing any of these changes directly to TARP continues to be problematic because of the range of actions that have been and are being taken to address the current crisis. While these indicators may be suggestive of TARP's ongoing impact, no single indicator or set of indicators can provide a definitive determination of the program's impact.

Select Credit Market Indicators

Credit market rates and spreads

Indicator	Description	Basis point change since GAO March 2009 report	Basis point change since October 13, 2008
LIBOR	3-month London interbank offered rate, LIBOR (an average of interest rates offered dollar-denominated loans)	Down 38	Down 388
TED Spread	Spread between 3-month LIBOR and 3-month Treasury yield	Down 57	Down 407
Aaa bond rate	Rate on highest quality corporate bonds	Up 22	Down 62
Aaa bond spread	Spread between Aaa bond rate and 10-year Treasury yield	Down 101	Down 61
Baa bond rate	Rate on corporate bonds subject to moderate credit risk	Down 84	Down 108
Baa bond spread	Spread between Baa bond rate and 10-year Treasury yield	Down 207	Down 107
Mortgage rates	30-year conforming loans rate	Up 61	Down 87
Mortgage spread	Spread between 30-year conforming loans rate and 10-year Treasury yield	Down 53	Down 74

Quarterly mortgage volume and defaults

Indicator	Description	Change from December 31, 2008 to March 31, 2009 (latest available data)
Mortgage originations	New mortgage loans	Up $185 billion to $445 billion
Foreclosure rate	Percentage of homes in foreclosure	Up 55 basis points to 3.85 percent

Source: GAO analysis of data from Global Insight, Thomson Datastream, and *Inside Mortgage Finance*.

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Abbreviations

ABS	asset-backed security
AGP	Asset Guarantee Program
AIFP	Automotive Industry Financing Program
AIG	American International Group Inc.
ALLL	allowance for loan and lease losses
ARRA	American Recovery and Reinvestment Act of 2009
CAP	Capital Assistance Program
CDFI	Community Development Financial Institution Funds
CMBS	commercial mortgage-backed security
CPP	Capital Purchase Program
FDIC	Federal Deposit Insurance Corporation
FMV	fair market value
GM	General Motors Corporation
GMAC	GMAC LLC
HAC	Heteroskedasticity and Autocorrelation-Consistent
HAMP	Home Affordable Modification Program
LIBOR	London Interbank Offered Rate
OCC	Office of the Comptroller of the Currency
OFS	Office of Financial Stability
OGE	Office of Government Ethics
OMB	Office of Management and Budget
OTS	Office of Thrift Supervision
PBGC	Pension Benefit Guaranty Corporation
PPIP	Public Private Investment Program
SBA	Small Business Administration
SCAP	Supervisory Capital Assessment Program
SSFI	Systemically Significant Failing Institutions Program
TALF	Term Asset-Backed Securities Loan Facility
TARP	Troubled Asset Relief Program
TIP	Targeted Investment Program
VEBA	voluntary employee beneficiary associations

United States Government Accountability Office
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Congressional Committees

On October 3, 2008, the Emergency Economic Stabilization Act of 2008 (the act) was signed into law. The act established the Office of Financial Stability (OFS) within the Department of the Treasury (Treasury) and authorized the Troubled Asset Relief Program (TARP).[1] Among other things, the act, as amended, provides Treasury with broad, flexible authorities to buy or guarantee billions in troubled assets, which include mortgages and mortgage-related instruments, and any other financial instrument whose purchase Treasury determines is needed to stabilize the financial markets.[2]

The act also created oversight mechanisms to oversee the implementation and operations of TARP. These include a requirement that the U.S. Comptroller General report at least every 60 days on (1) findings resulting from oversight of TARP's performance in meeting the purposes of the act; (2) the financial condition and internal controls of TARP, its representatives, and agents; (3) the characteristics of both asset purchases and the disposition of assets acquired, including any related commitments that are entered into; (4) TARP's efficiency in using the funds appropriated for the program's operation; (5) TARP's compliance with applicable laws and regulations; efforts to prevent, identify, and minimize conflicts of interest of those involved in TARP's operations; and (6) the efficacy of contracting procedures.[3] In order to eliminate unnecessary duplication of effort, we have continued to coordinate our work with entities created under the act who also were assigned oversight responsibilities for TARP, including the Congressional Oversight Panel, the Financial Stability Oversight Board (FinSOB), and the Special Inspector General for TARP (SIGTARP).

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[1]Pub. L. No. 110-343, 122 Stat. 3765 (2008), codified at 12 U.S.C. §§ 5201 et seq.

[2]The act originally authorized Treasury to buy or guarantee up to $700 billion in troubled assets. The Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22, Div. A, amended the act and reduced the maximum allowable amount of outstanding troubled assets under the act by almost $1.3 billion, from $700 billion to $698.741 billion. Section 102 of the act, 12 U.S.C. § 5212, authorizes Treasury to guarantee troubled assets originated or issued prior to March 14, 2008, including mortgage-backed securities.

[3]Section 116 of the act, 12 U.S.C. § 5226.

This report follows up on the status of recommendations from our previous reports and addresses (1) the nature and purpose of activities that have been initiated or completed under TARP from March 27, through June 12, 2009, unless otherwise noted; (2) OFS's progress in hiring staff and use of contractors; and (3) outcomes measured by indicators of TARP's performance.[4]

Scope and Methodology

To determine the nature and purpose of TARP activities from March 27, 2009, through June 12, 2009, unless noted otherwise, and the status of actions taken in response to our recommendations from our March 2009 report, we reviewed documents from OFS that described the amounts, types, and terms of Treasury's purchases of senior preferred stocks, subordinated debt, and warrants under the Capital Purchase Program (CPP). We also reviewed documentation and interviewed officials from OFS who were responsible for approving financial institutions to participate in CPP and overseeing the repurchase process for CPP preferred stock and warrants.[5] Additionally, we contacted officials from the four federal banking regulators—the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Federal Reserve), and the Office of Thrift Supervision (OTS)—to obtain information on their process for reviewing CPP applications, the status of pending applications, their process for reviewing preferred stock and warrant repurchase requests, and their examination process for reviewing recipients' lending activities and compliance with TARP requirements.

To update the status of the Targeted Investment Program (TIP), the Systemically Significant Failing Institutions Program (SSFI), and the Automotive Industry Financing Program (AIFP), we reviewed relevant documents and interviewed OFS officials about these programs. We also

[4]See GAO, *Troubled Asset Relief Program: Additional Actions Needed to Better Ensure Integrity, Accountability, and Transparency*, GAO-09-161 (Washington, D.C.: Dec. 2, 2008); *Troubled Asset Relief Program: Status of Efforts to Address Transparency and Accountability Issues*, GAO-09-296 (Washington, D.C.: Jan. 30, 2009); *Troubled Asset Relief Program: March 2009 Status of Efforts to Address Transparency and Accountability Issues*, GAO-09-504 (Washington, D.C.: Mar. 31, 2009); and *Auto Industry: Summary of Government Efforts and Automakers' Restructuring to Date*, GAO-09-553 (Washington, D.C.: Apr. 23, 2009). See appendix II for status of all prior recommendations.

[5]A warrant is an option to buy shares of common stock or preferred stock at a predetermined price on or before a specified date.

met with Federal Reserve officials to discuss the stress test methodology and results for the 19 largest U.S. bank holding companies and reviewed related documents relevant to the Capital Assistance Program (CAP).

To provide an update on the Federal Reserve's Term Asset-Backed Securities Loan Facility (TALF) and its efforts related to small business securitizations—and in consideration of GAO's statutory limitations on auditing certain functions of the Federal Reserve—we reviewed publicly available information on the Web sites of the Federal Reserve and the Federal Reserve Bank of New York that had been made available since our March 2009 report. We also interviewed officials in OFS for updates to TALF.[6] For updates to Public Private Investment Program (PPIP) and small business efforts related to its Consumer and Business Lending Initiative, we reviewed agency documentation and interviewed Treasury and FDIC officials. For updates on the Small Business Administration (SBA) efforts related to improving credit and securitization markets for small businesses, we relied on previously issued GAO work.[7]

To determine Treasury's progress in developing an overall communications strategy for TARP, we assessed Treasury's activities based on GAO reports on effective communications.[8] We also accessed www.financialstability.gov—Treasury's new Web site for communication

[6]The Federal Banking Agency Audit Act limits GAO's authority to audit certain Federal Reserve activities. Specifically, GAO audits of the Federal Reserve generally may not include monetary policy matters, including discount window operations and open market operations. This prohibition limits GAO's ability to audit the Federal Reserve Board's actions taken with respect to TALF. The Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22, enacted on May 20, 2009, amended the Federal Banking Agency Audit Act to provide GAO authority to audit Federal Reserve Board actions taken under section 13(3) of the Federal Reserve Act with respect to a single and specific partnership or corporation. Among other things, this amendment provides GAO with authority to audit Federal Reserve actions taken with respect to three entities also assisted under TARP—Citigroup, Inc., American International Group, Inc., and Bank of America Corporation—but does not provide GAO with authority to audit Federal Reserve monetary policy actions taken with respect to TALF.

[7]See GAO, *Small Business Administration's Implementation of Administrative Provisions in the American Recovery and Reinvestment Act of 2009*, GAO-09-507R (Washington, D.C.: Apr. 16, 2009).

[8]See GAO, *Financial Literacy and Education Commission: Progress Made in Fostering Partnerships, but National Strategy Remains Largely Descriptive Rather Than Strategic*, GAO-09-638T (Washington, D.C.: April 29, 2009) and *Securities Investor Protection: Update on Matters Related to the Securities Investor Protection Corporation*, GAO-03-811 (Washington, D.C.: July 11, 2003).

of TARP-related strategies—through June 4, 2009. Further, we interviewed officials from OFS and Treasury's Office of Public Affairs to determine what steps Treasury had taken to coordinate communications with the public and Congress.

To determine the status of OFS's efforts to hire staff to administer TARP duties, we reviewed OFS's organizational chart, documents on staff composition and workforce planning, Treasury's most recent budget proposal submission to the Office of Management and Budget (OMB), and OFS vacancy announcements posted on www.financialstability.gov and www.USAjobs.gov from March 31, 2009, to June 8, 2009. We also reviewed our prior work on human capital flexibilities and strategic workforce planning to assess OFS's performance in these areas. In addition, we met with a variety of Treasury and OFS officials to discuss the staffing levels of OFS offices including vacancies, their processes for recruiting employees with the skill sets and competencies needed to administer TARP, steps taken to find permanent replacements to fill key leadership positions, and the extent of pay comparability challenges. We also met with officials from the Office of Personnel Management to discuss their coordination with Treasury in establishing hiring flexibilities and other tools to staff OFS.

To assess OFS's process for vetting employees' potential conflicts of interest, we reviewed information from Treasury's databases used to track submission and reviews of Treasury employees' confidential and public financial disclosure reports. Specifically, we reviewed information in the databases for 64 OFS employees hired as of April 23, 2009. Of these, 56 were permanent employees required to submit confidential financial disclosure reports and 8 were senior-level officials required to submit public disclosure reports.[9] In order to determine the reliability of the information provided in the databases, we interviewed Treasury officials and performed basic tests on the data. We determined that the information provided for these 64 employees was sufficiently reliable for our purposes. We also reviewed standard operating procedures that Treasury developed to manage the submissions and reviews of its employees' financial

[9]Although Treasury had entered information in the tracking database for 15 senior-level officials required to complete public financial disclosure reports, information for 7 of these individuals did not reflect the dates that the forms were submitted to and reviewed by Treasury in response to their appointment to OFS. This occurred because these individuals had already submitted forms during the past fiscal year to their former federal employers and so the dates entered reflect their original submission and review dates in their formerly held positions during 2008.

disclosure reports and new internal operating procedures developed specifically for reviewing OFS employees' confidential financial disclosure reports. In coordination with GAO experts on federal ethics laws and regulations, we reviewed information provided by 15 senior-level OFS officials in public financial disclosure reports and identified any potential conflicts meriting additional discussion with Treasury ethics counsel. In addition, we met with Treasury and OFS officials to discuss their reviews of financial disclosure reports and the training provided to OFS staff on the laws and regulations pertaining to ethical conduct in the federal workplace, including those related to conflicts of interest. We met with officials from the Office of Government Ethics (OGE) to discuss pertinent ethics regulations that applied to Treasury and reviewed their guidance on ethical standards of conduct for employees.[10] We also reviewed reports published by Treasury's Office of the Inspector General describing conflicts of interest incidents and their resolution.

To assess OFS's use of contractors and financial agents to support TARP administration and operations for the period of March 14 through June 1, 2009, we reviewed information from Treasury for (1) new financial agency agreements, contracts, blanket purchase agreements, and interagency agreements; and (2) task orders, modifications, and amendments involving ongoing contracts and agreements. We analyzed this information, in part, to identify small or minority- and women-owned prime contractors and subcontractors providing TARP services and supplies. To report OFS expenses for contracts and agreements, we obtained information from the OFS Chief Financial Officer. To identify the extent to which federal banking regulators use contractors to support their TARP activities, we obtained information from FDIC, Federal Reserve, OCC, and OTS. To assess the status of OFS progress in developing a final TARP conflicts-of-interest rule and responding to our prior recommendations to (1) complete reviews of vendor conflicts-of-interest mitigation plans to conform with the interim rule and to (2) issue guidance requiring key communications and decisions be documented, we interviewed officials from Treasury and reviewed applicable documents.

To assess the status of internal controls related to TARP activities and the status of TARP's consideration of accounting and reporting topics, we

[10]The Office of Government Ethics is an executive branch agency that exercises leadership in the executive branch to prevent conflicts of interest on the part of government employees and to resolve conflicts of interest that do occur.

reviewed documents provided by OFS and conducted interviews and made inquiries with officials from OFS, including the Chief Financial Officer, Deputy Chief Financial Officer, Deputy Chief Risk Officer, Cash Management Officer, Director of Internal Controls, and their representatives. To evaluate selected internal control activities related to the CPP, AIFP, and SSFI programs, we designed tests using OFS's process flows, narratives, risk matrices, and high-level operational procedures. As part of our ongoing work, we completed the following additional activities:

- For CPP, we tested certain internal control activities related to dividend payments received through June 12, 2009, from institutions included in our previous sample of 45 unique preferred stock purchase transactions for the four months ended January 31, 2009. To make that selection, we used a monetary unit sampling (probability proportionate to size) methodology. We also tested dividends received through June 12, 2009, for TIP, Asset Guarantee Program (AGP), and AIFP.

- For SSFI, we tested selected control activities, including approvals, reviews, and closing documentation, for the American International Group Inc. (AIG) restructuring. The documentation that we reviewed included an exchange agreement and purchase agreement executed on April 17, 2009.

- For AIFP, we tested controls over the (1) authorization and execution of the initial General Motors Corporation (GM) and Chrysler LLC (Chrysler) agreements (executed on December 31, 2008, and January 2, 2009, respectively), (2) funding process, (3) receipt of promissory notes and securities, (4) disbursements made by Treasury under the agreements, and (5) receipts of interest and principal. In addition, we verified that the loan amounts disbursed to and interest received from GM and Chrysler were consistent with the terms of the agreements.

Finally, in our initial report under the mandate, we identified a preliminary set of indicators on the state of credit and financial markets that might be suggestive of the performance and effectiveness of TARP.[11] We consulted Treasury officials and other experts and analyzed available data sources and the academic literature. We selected a set of preliminary indicators that offered perspectives on different facets of credit and financial markets, including perceptions of risk, cost of credit, and flows of credit to

[11]GAO-09-161.

businesses and consumers.[12] We assessed the reliability of the data upon which the indicators were based and found that, despite certain limitations, they were sufficiently reliable for our purposes. To update the indicators in this report, we primarily used data from Thomson Datastream—a financial statistics database. As these data are widely used, we conducted only a limited review of the data but ensured that the trends we found were consistent with other research. We also relied on data from *Inside Mortgage Finance*, Treasury, the Federal Reserve, the Chicago Board Options Exchange, and *Global Insight*. We have relied on data from these sources for past reports and determined that, considered together, these auxiliary data were sufficiently reliable for the purpose of presenting and analyzing trends in financial markets. The data from Treasury's survey of lending to the top 21 CPP recipients (as of March 31, 2009) are based on internal reporting from participating institutions, and the definitions of loan categories may vary across banks. Because the data are unique, we are not able to benchmark the origination levels against historical lending or seasonal patterns at these institutions. Based on discussions with Treasury and our review of the data, we found that the data were sufficiently reliable for the purpose of documenting trends in lending. The survey data will prove valuable for more thorough analyses of lending activity in future reports. We also conducted an econometric analysis to assess the impact of CPP on the TED spread. Although we used a standard and widely used methodology, the model results should be interpreted with caution because we did not attempt to capture all potential factors that might explain movements in the TED spread. Moreover, in spite of the empirical evidence, we cannot link improvements in the TED spread exclusively to CPP (see app. III for more detail).

We conducted this performance audit from April 2009 through June 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.

[12]No indicator on its own provides a definitive perspective on the state of markets; collectively, the indicators should provide a broad sense of stability and liquidity in the financial system and could be suggestive of the program's impact. However, it is difficult to draw conclusions about causality because a variety of actions that have been taken to address the economic downturn.

Background

Since its creation, OFS has implemented numerous programs and initiatives to carry out TARP. According to Treasury, the purpose of each program is as follows:

- **CPP** was created in October 2008 to stabilize the financial system by providing capital to viable banks through the purchase of preferred shares and subordinated debentures. In return for its investment, the Treasury will receive dividend payments and warrants.
- **TIP** was created in January 2009 to foster market stability and thereby strengthen the economy by making case-by-case investments in institutions that Treasury deems are critical to the functioning of the financial system.
- **AGP** was created in November 2008 to provide government assurances for assets held by financial institutions that are viewed as critical to the functioning of the nation's financial system.
- **SSFI** was created in November 2008 to provide stability in financial markets and avoid disruptions to the markets from the failure of a systemically significant institution. Treasury determines participation in this program on a case-by-case basis.
- **AIFP** was created in December 2008 to prevent a significant disruption of the American automotive industry. Treasury has determined that such a disruption would pose a systemic risk to financial market stability and have a negative effect on the U.S. economy. The program requires participating institutions to implement plans that will achieve long-term viability.
- **Auto Supplier Support Program** was created in March 2009 to help stabilize the auto supply base, which designs and builds the components for cars and trucks.
- **Making Home Affordable Program** was created in March 2009 to offer assistance to as many as 7 to 9 million homeowners. The program aims to prevent the destructive impact of the housing crisis on families and communities. According to Treasury, it will not provide money to speculators, but will target support to the working homeowners who have made every possible effort to stay current on their mortgage payments.[13]

[13]The Making Home Affordable program will be the focus of a future GAO report.

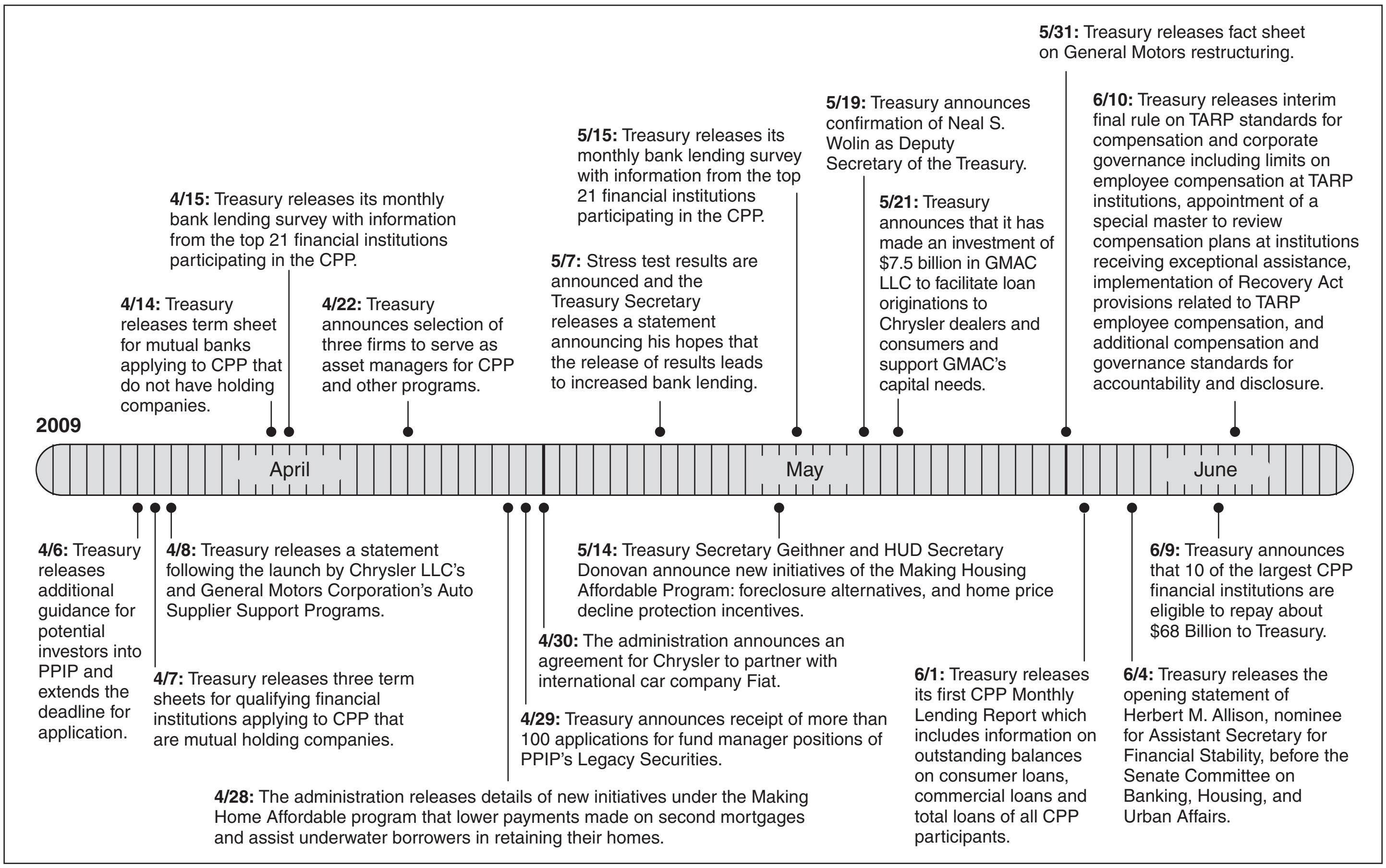
- **Consumer and Business Lending Initiative** created in March 2009 is an initiative under the Financial Stability Plan that includes the Federal Reserve-run TALF. This initiative is intended to support consumer and business credit markets by providing financing to private investors to issue new securitizations to help unfreeze and lower interest rates for auto, student, and small business loans; credit cards; commercial mortgages; and other consumer and business credit. Subsequently, it subsumed the Small Business and Community Lending Initiative, which was also created in March 2009 to increase credit available to local businesses by reducing fees and increasing guarantees for SBA loans and having Treasury purchase securities backed by SBA loans.

- **CAP** was created in February 2009 to restore confidence throughout the financial system that the nation's largest banking institutions have sufficient capital to cushion themselves against larger-than-expected future losses, and to support lending to creditworthy borrowers.

- **PPIP** was established in March 2009 to address the challenge of "legacy assets" as part of Treasury's efforts to repair balance sheets throughout the financial system and increase the availability of credit to households and businesses. In conjunction with the FDIC, Treasury established the Legacy Loans Programs component of PPIP.

Since our March 2009 report, a number of major TARP-related events have occurred (see fig. 1).

Figure 1: Timeline of Major TARP Events from March 24, 2009, through June 12, 2009



Source: GAO.

Treasury Has Established Its Core Programs under TARP but Continues to Finalize Some Details

As of June 12, 2009, Treasury projected that it had used $643.1 billion of its almost $700 billion limit for TARP. Highlights of the transactions and activities under the various programs include the following:

- CPP continues to be one of OFS's most active programs with OFS continuing to deploy funds and other participants beginning to repay investments.
- While OFS has hired asset mangers, it has yet to clearly identify what role the asset managers will have in monitoring compliance.

- The Federal Reserve announced the results of the stress test under CAP, for which Treasury extended the deadline for applications through November 9, 2009. As of June 8, 2009, no applications had been submitted.

- The Federal Reserve announced a number of modifications to TALF and has completed a number of fundings since March 2009.

- OFS and FDIC took additional steps to implement the PPIP's Legacy Loans Program, but postponed a previously planned pilot sale of assets by open banks.

- Treasury, in conjunction with the Federal Reserve and SBA, has also announced additional efforts to provide more accessible and affordable credit to small businesses.

- Citigroup, Inc. (Citigroup) expanded its request to convert preferred securities and trust preferred securities for common stock from $27.5 billion to $33 billion and finalized the exchange agreement on Jun 9, 2009, but the conversion had not been completed as of June 12, 2009.

- OFS finalized a $30 billion equity facility with AIG under SSFI and restructured AIG's existing preferred stock from cumulative to noncumulative shares but did not require additional concessions from AIG counterparties.

- OFS provided an additional $44 billion in assistance to Chrysler and GM under AIFP.

Finally, consistent with our recommendations, Treasury has continued to take steps to develop an integrated communication strategy for TARP, but we continue to identify areas that warrant ongoing attention and consideration.

Treasury Has Disbursed Almost Half the TARP Limit

As of June 12, 2009, Treasury had disbursed about $330 billion in TARP funds, approximately $200 billion of them for CPP (table 1).

Table 1: Status of TARP Funds as of June 12, 2009

Dollars in billions

Program	Treasury's current projected use of funds[a]	Apportioned	Disbursed	Asset purchase price[b]
Capital Purchase Program	$218.0	$218.0	$199.5	$199.5
Targeted Investment Program	40.0	40.0	40.0	40.0
Capital Assistance Program	TBD[c]	TBD	TBD	TBD
Systemically Significant Failing Institutions	70.0	70.0	41.2	69.8
Asset Guarantee Program	12.5	5.0	0.0	5.0
Automotive Industry Financing Program[d]	82.6	93.7	49.2	85.0
Making Home Affordable	50.0	32.5	0.0	18.3
Consumer and Business Lending Initiative[e]	70.0	20.0	0.1	20.0
Public Private Investment Program	100.0	0.0	0.0	0.0
Totals	**$643.1**	**$479.2**	**$330.0**	**$437.6**
Less repurchases				**$1.9**[f]
Total asset purchase price				**$435.7**

Source: Treasury OFS, unaudited.

[a]The amounts represent Treasury's most recent projected funding level. Portions of Treasury's projected use of funds are not yet legal obligations. Projected funds may differ from the original announced maximum program funding level. For example, Treasury originally announced a maximum funding level of $250 billion for CPP but now projects that it will not exceed $218 billion.

[b]The Asset Purchase Price reflects the aggregate amount Treasury agreed to pay to purchase outstanding troubled assets that are subject to the almost $700 billion purchase limit in section 115 of the Emergency Economic Stabilization Act. This amount includes the aggregate amount of outstanding guarantees made by Treasury, even though Treasury has not disbursed any cash to honor a guarantee. For example, AGP's asset purchase price includes the $5 billion Citigroup guarantee, even though no cash has been disbursed to Citigroup through this program. However, as required under section 102 of the act, it does not include a subtraction from the outstanding guarantee amount to reflect the balance in the Troubled Assets Insurance Financing Fund.

[c]Treasury has announced CAP but has not yet projected its funding level.

[d]Treasury's current projected use of funds is less than the apportionment and asset purchase price for AIFP because Treasury expects to disburse less money than originally anticipated.

[e]The Consumer and Business Lending Initiative now includes TALF and the Small Business and Community Lending Initiative.

[f]Repurchases represent the amounts received from CPP participant institutions that repurchased preferred shares from Treasury. Repurchases exclude any amounts relating to private institutions' repurchases of preferred shares obtained through the exercise of warrants and public institutions' repurchases of warrants.

Officers and employees of Treasury may not obligate or expend appropriated funds in excess of the amount apportioned by OMB on behalf of the President. Treasury stated that as of June 12, 2009, OMB had apportioned about $479.2 billion of the funding levels announced for TARP. Given this information, it appears that Treasury has not exceeded the troubled asset purchase limit or obligated funds in excess of those OMB has apportioned. We are continuing to obtain additional information from Treasury and review the controls that Treasury has in place to help ensure compliance with the funding restrictions.

In addition, beginning in April 2009, the budgetary costs of TARP asset purchases, loans, and loan guarantees since the inception of the program represent the net present value of estimated cash flows to and from the government, excluding administrative costs.[14] OFS is continuing to develop and enhance its methodology and documentation surrounding its estimated cash flows. We will review TARP's estimated cash flows and resulting program costs as part of our ongoing work.

Treasury Has Received Approximately $6.2 Billion in Dividend Payments

From TARP's inception through June 12, 2009, Treasury had received approximately $6.2 billion in dividend payments on shares of preferred stock acquired through CPP, TIP, AIFP, and AGP (table 2). Treasury's agreements under these programs entitled it to receive dividend payments on varying terms and at varying rates.[15] The dividend payments to Treasury are contingent on each institution declaring dividends.

[14]This reporting is based on the Federal Credit Reform Act of 1990 and Section 123 of the act, which states that the discount rate used to determine the present value of cash flows be adjusted for market risk.

[15]For example, according to the CPP terms for publicly held institutions, participating institutions pay quarterly dividends at a rate of 5 percent per year for the first 5 years on the initial preferred shares acquired by Treasury. After the first 5 years, the preferred shares pay quarterly dividends at a rate of 9 percent per year. Any preferred shares acquired through Treasury's exercise of warrants pay quarterly dividends at a rate of 9 percent per year.

Table 2: TARP Dividend Payments Received as of June 12, 2009

Dollars in thousands

Program	Dividend payments received	Cumulative dividends not declared and not paid	Noncumulative dividends not declared and not paid
Capital Purchase Program	$4,822,420	$5,962	$802
Targeted Investment Program	1,128,889	-	-
Automotive Industry Financing Program[a]	159,611	-	-
Asset Guarantee Program	107,573	-	-
Systemically Significant Failing Institutions Program[b]	-	-	-[c]
Total	**$6,218,493**	**$5,962**	**$802**

Source: Treasury OFS, unaudited.

[a]GMAC LLC is the only institution participating in AIFP that issued preferred shares to Treasury and is scheduled to pay dividends per the terms of the security purchase agreement through June 12, 2009. The other AIFP participants issued debt instruments to Treasury that are not reflected on this table.

[b]AIG is the sole participant in the Systemically Significant Failing Institutions program. On April 17, 2009, AIG and Treasury restructured their November 25, 2008, agreement. Under the restructuring, Treasury exchanged $40 billion of cumulative Series D preferred shares for $41.6 billion of noncumulative Series E preferred shares. The amount of Series E preferred shares is equal to the original $40 billion, plus approximately $733 million in undeclared dividends as of February 1, 2009—the scheduled quarterly dividend payment date—$15 million in dividends compounded on the undeclared dividends, and an additional $855 million in dividends accrued from February 1, 2009, but not paid as of April 17, 2009.

[c]AIG's restructured agreement kept the quarterly dividend payment dates of every May 1, August 1, November 1, and February 1, established by the original November 25, 2008, agreement. However, the restructured agreement also specified that dividends were payable beginning with the first dividend payment date to occur at least 20 calendar days after the restructuring date. Accordingly, in compliance with these dividend payment terms, the dividend payment for the period from April 17, 2009, through May 1, 2009, which amounts to approximately $150.2 million, is to be included in the August 1, 2009, scheduled quarterly dividend payment.

From March 21, 2009, through June 12, 2009, 17 CPP participants had not declared or paid dividends of approximately $6.6 million. Specifically, 7 institutions did not declare and pay their cumulative dividends of approximately $6 million and 10 institutions did not declare and pay their noncumulative dividends of approximately $666,000.[16] OFS said it received notification from the 17 institutions that they did not intend to declare or pay their May 15, 2009, quarterly dividends. According to OFS officials, of the 17 institutions, 13 informed Treasury that state or federal banking regulations or policies restricted them from declaring dividends, 1 indicated concern about its profitability, and 3 did not provide an explanation as to why they did not declare dividends. According to the standard terms of CPP, after six nonpayments by a CPP institution—whether or not consecutive—Treasury and other holders of preferred securities equivalent to Treasury's can exercise their right to appoint two members to the board of directors for that institution at the institution's first annual meeting of stockholders subsequent to the sixth nonpayment.

Five of these participants were also among the original eight participants that did not declare or pay approximately $150,000 in noncumulative dividends as reported in our March 2009 report. Two of the eight paid their most recent dividend payments for the May 15, 2009, quarterly dividend payment date. The other participant subsequently declared and paid the approximately $14,000 in noncumulative dividends previously not paid and its most recent May 15, 2009, quarterly dividend.

Treasury Continues to Deploy Funds through CPP While Some Participants Repay Investments

Treasury has continued to use CPP as a primary vehicle under TARP as it attempts to stabilize financial markets. As of June 12, 2009, Treasury had disbursed about 92 percent of the $218 billion (revised from the original $250 billion) it had allocated for the purchase of almost $199.5 billion in preferred shares and subordinated debt from 623 qualified financial institutions (table 3).[17] These purchases ranged from about $301,000 to $25 billion per institution. As of June 12, 2009, about $712 million in preferred stock shares and subordinated debt from 91 financial institutions had been purchased since our March 2009 report.

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[16]If an institution does not declare a dividend for noncumulative preferred stock during the dividend period, the noncumulative preferred shareholders generally have no right to receive any dividend for the period, and the institution has no obligation to pay a dividend for the period, whether or not dividends are declared for any subsequent dividend period. Generally, if an institution does not declare a dividend for cumulative preferred stock during the dividend period the unpaid dividends accumulate and the institution must pay the cumulative accrued dividends before making dividend payments to other classes of shareholders.

[17]For purposes of CPP, financial institutions generally include qualifying U.S.-controlled banks, savings associations, and both bank and savings and loan holding companies.

Table 3: Capital Investments Made through the Capital Purchase Program as of June 12, 2009

Closing date of transaction	Amount of CPP capital investment	Cumulative percentage of allocated funds used for CPP capital investment	Number of qualified financial institutions receiving CPP capital
10/28/2008	$115,000,000,000	52.75	8
11/14/2008	33,561,409,000	68.15	21
11/21/2008	2,909,754,000	69.48	23
12/5/2008	3,835,635,000	71.24	35
12/12/2008	2,450,054,000	72.37	28
12/19/2008	2,791,950,000	73.65	49
12/23/2008	1,911,751,000	74.52	43
12/31/2008	15,078,947,000	81.44	7
1/9/2009	14,771,598,000	88.22	43
1/16/2009	1,479,938,000	88.89	39
1/23/2009	385,965,000	89.07	23
1/30/2009	1,151,218,000	89.60	42
2/6/2009	238,555,000	89.71	28
2/13/2009	429,069,000	89.91	29
2/20/2009	365,397,000	90.07	23
2/27/2009	394,906,000	90.26	28
3/6/2009	284,675,000	90.39	22
3/13/2009	1,455,160,000	91.05	19
3/20/2009	80,748,000	91.09	10
3/27/2009	192,958,000	91.18	14
4/3/2009	54,826,000	91.20	10
4/10/2009	22,790,000	91.21	5
4/17/2009	40,945,000	91.23	6
4/24/2009	121,846,000	91.29	12
5/1/2009	45,532,000	91.31	7
5/8/2009	42,019,000	91.33	7
5/15/2009	107,623,000	91.38	14
5/22/2009	108,333,000	91.43	12
5/29/2009	89,207,000	91.47	8
6/5/2009	40,269,000	91.49	3
6/12/2009	39,108,000	91.51	7
Total	**$199,482,185,000**	**91.51%**	**623**[a]

Sources: Treasury and GAO.

Note: Treasury adjusted its allocation to CPP from $250 billion to $218 billion in March 2009. According to Treasury officials, this downward adjustment reflects the estimated funding needs of the program based on participation to date and the money it expects to receive from participants that repay their CPP capital investment. The cumulative percentage of allocated fund numbers are now a percentage of the $218 billion.

[a]The total number of financial institutions was reduced by two because SunTrust Banks, Inc. (SunTrust) and Bank of America Corporation (Bank of America) each received two capital investment under CPP. SunTrust received a partial capital investment of $3.5 billion on November 12, 2008, and another of $1.35 billion on December 31, 2008, Bank of America received $15 billion on October 28, 2008, and, after merging with Merrill Lynch & Co., Inc., an additional $10 billion on January 9, 2009.

As of June 12, 2009, a variety of types of institutions had received CPP capital investments under TARP, including 278 publicly held institutions, 307 privately held institutions, 22 S-corporations, 16 community development financial institutions (CDFI), and no mutual institutions.[18] These purchases represented investments in state-chartered and national banks and U.S. bank holding companies located in 48 states, the District of Columbia, and Puerto Rico. For a detailed listing of financial institutions that received CPP funds as of May 29, 2009, see GAO-09-707SP.[19]

Treasury and the federal regulators continued to review applications for CPP. According to Treasury, it has received over 1,300 CPP applications from the regulators as of June 12, 2009, fewer than 100 were awaiting decision by the Investment Committee. For many applications in this category, Treasury is awaiting updated information from the regulators before taking the application to the Investment Committee for a vote. The bank regulators also reported that they were reviewing applications from more than 220 institutions that had not yet been forwarded to Treasury. Qualified financial institutions generally have 30 calendar days after Treasury notifies them of preliminary approval for CPP funding to submit

[18]An *S-corporation* makes a valid election to be taxed under subchapter S of chapter 1 of the Internal Revenue Code and thus does not pay any income taxes. Instead, the corporation's income or losses are divided among and passed through to its shareholders. A *mutual organization* is a company that is owned by its customers rather than by a separate group of stockholders. Many thrifts and insurance companies (for example, Boston Mutual and New York Life) are mutuals. A *CDFI* is a specialized financial institution that works 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.

[19]GAO, *Troubled Asset Relief Program: Capital Purchase Program Transactions for the Period October 28, 2008, through May 29, 2009, and Information on Financial Agency Agreement, Contract, Blanket Purchase Agreements, and Interagency Agreements Awarded as of June 1, 2009*, GAO-09-707SP (Washington, D.C.: June 17, 2009).

investment agreements and related documentation. OFS officials stated that about 400 financial institutions that received preliminary approval had withdrawn their CPP applications as of June 12, 2009. Many of these institutions withdrew their applications because of the uncertainty surrounding future program requirements.[20]

Some financial institutions have continued to raise concerns about the length of time it is taking the bank regulators and Treasury to process their CPP applications. Bank regulatory officials noted that many factors could affect the time it took to process a particular bank's CPP application. For example,

- the necessary term sheet for a particular ownership structure might not have been available when the bank filed its application and the application could not be processed,[21]
- the bank regulators' interagency CPP Council needed to review the application,
- regulators needed to perform on-site visitations or conduct new bank examinations if the existing examination was dated,
- regulators needed to consider enforcement actions, or
- regulators had to request additional information (e.g., related to credit quality) from the bank before processing its application.

Data provided by the bank regulators showed that, as of May 15, 2009, the average processing time for CPP applications—from the date the regulator received the institution's application to the date it was forwarded to Treasury—varied from 28 days to 57 days depending on the regulator

[20]We are continuing to examine the process for accepting and approving CPP applications. Specifically, we have begun reviewing CPP applications that had been funded from October 2008 through January 2009 to determine the extent to which the regulators and OFS were consistently applying established criteria and adequately documenting the regulators' recommendations and OFS's final decisions. We also plan to review subsequent applications, and in conjunction with SIGTARP, to evaluate the process across the banking regulators. We will report on this work separately.

[21]Treasury issued the term sheet for publicly held institutions on October 20, 2008; for privately held institutions on November 17, 2008; for S-corporations on January 14, 2009; and for mutual institutions on April 7 and 14, 2009.

(table 4).[22] OFS officials noted that some of the reasons for delays in the final processing of CPP applications once they had been received, were the need to obtain shareholder approval to issue preferred stock to Treasury, obtain executive compensation certification waivers, or schedule board of directors meetings. According to data provided by OFS, as of May 15, 2009, the average processing time from the receipt of CPP application package from the regulators to preliminary funding approval was about 12 days, and from preliminary funding approval to disbursement of funds was about 34 days. We are verifying this information as part of our ongoing review of the CPP process.

Table 4: Average Processing Days Reported by the Federal Reserve, OTS, OCC and Treasury of CPP Applications, as of May 15, 2009

Bank regulator	Average processing days from bank regulator CPP application receipt date to submission to Treasury	Average processing days from Treasury CPP application receipt date from bank regulators to Treasury disbursement of funds	Average total processing time[a]
Federal Reserve	28	42	**70**
Office of Thrift Supervision	45	37	**82**
Office of the Comptroller of the Currency	57	40	**97**

Sources: Federal Reserve, OCC, OTS, and OFS.

Notes: FDIC is not included because according to officials, it did not track such information and was unable to provide such data. These numbers are based on applications that were processed by the banking agencies and submitted to Treasury, regardless of whether the application was ultimately funded or withdrawn. Applications that were withdrawn prior to a recommendation being submitted to Treasury and applications still in process were not included in the averages.

Because these are averages and to the extent that the regulators and Treasury continue to approve applications that have been in the pipeline, the averages are likely to increase over time.

[a]Average total processing time is the sum of the prior two columns.

[22]According to FDIC, it does not keep track of processing times for individual applications and thus was unable to provide us with the average processing time for the more than 1,700 CPP applications it has received.

Treasury Extended the Deadline for Small Banks to Apply for CPP Funding and Increased the Funding Limit

The Treasury Secretary announced in a May 13, 2009, speech that Treasury had taken additional actions under CPP to ensure that small community banks and holding companies (qualifying financial institutions with total assets less than $500 million) would have the capital they needed to lend to creditworthy borrowers. Small banks now have until November 21, 2009, to apply to CPP under all term sheets. All current CPP participants that qualify as a small bank under these new program terms will be allowed to reapply and note on their applications that they are making a supplemental request for CPP funding. These applications will be evaluated via an expedited approval process that Treasury is currently working with the four primary federal banking regulators to establish.[23] New CPP participants will continue to have their applications processed under the original CPP applications process. Treasury also increased the maximum amount of CPP funding a small financial institution may receive from the current 3 percent of risk-weighted assets to 5 percent of risk-weighted assets.[24] The new deadline for small banks to apply to their regulator to form holding companies and apply for CPP funding is also November 21, 2009.

Treasury Finalized CPP Standard Term Sheets for Mutual Institutions

On April 7, and 14, 2009, Treasury issued standardized term sheets for four types of mutual institutions: mutual holding companies with publicly held subsidiary holding companies, mutual holding companies with privately held subsidiary holding companies, top-tier mutual holding companies without subsidiary holding companies, and mutual banks or savings associations not controlled by holding companies. The terms for the four types of mutual institutions are generally similar to those for the corresponding publicly held institutions, privately held institutions and S-corporations, with some exceptions. The application deadline for mutual holding companies was May 7, 2009; for mutual banks or savings associations not controlled by holding companies the deadline was May 14, 2009.

[23] This applies to all types of CPP participants: publicly held institutions, privately held institutions, S-corporations, and mutual institutions. The application deadlines for each of these types of CPP participants have passed.

[24] Risk-weighted asset are the total assets and off-balance sheet items held by an institution that are weighted for risk according to regulation by the Federal Reserve.

Like the terms for publicly held institutions, those for publicly held mutual subsidiary holding companies stipulate that

- the preferred shares pay dividends at a rate of 5 percent annually for the first 5 years and 9 percent annually thereafter;
- the shares are nonvoting, except with respect to protecting investors' rights;
- a warrant must be issued for common stock with an aggregate value equal to 15 percent of the Treasury's CPP investment;
- financial institutions may repurchase their shares at their face value;
- preferred stock will count as tier 1 regulatory capital;[25] and
- Treasury generally may transfer the preferred shares to a third party at any time.

In addition, the number of shares of common stock underlying the warrant held by Treasury will be reduced by 50 percent if the institution completes a qualified equity offering for 100 percent of the amount of the preferred stock during 2009.[26]

The terms for privately held subsidiary holding companies are generally similar, except for the warrant for preferred stock. For these companies, as for privately-held institutions, warrants for preferred stock may have an aggregate value equal to 5 percent of the Treasury's CPP investment. Treasury intends to immediately exercise such warrants for warrant preferred shares with a 9 percent dividend rate.

The terms for top-tier mutual holding companies without subsidiary holding companies and mutual banks or savings associations without holding companies are similar to those for S-corporations. Those terms are generally similar to those for publicly held institutions, with the exception that debt—senior notes—is issued instead of preferred stock. In addition,

[25]Tier 1 capital is the core measure of a bank's financial strength from a regulator's point of view. It is considered the most stable and readily available capital for supporting a bank's operations.

[26]A qualified equity offering is the sale and issuance of Tier 1 qualifying perpetual preferred stock, common stock, or a combination of such stock for cash.

the senior notes count as tier 1 capital when held at the holding company level and tier 2 capital when held by a mutual bank or savings association. The senior notes pay interest at a rate of 7.7 percent annually for 5 years and 13.8 percent thereafter, and warrants for additional debt must equal 5 percent of the Treasury's initial investment.[27] Treasury exercises the warrants at the time of the initial capital investment. Holding companies may defer interest on the senior notes for up to 20 quarters, but any unpaid interest will accumulate and compound at the then-applicable interest rate in effect. In addition, these companies cannot pay dividends on shares of equity, mutual capital certificates, other capital instruments, or trust preferred securities as long as any interest is deferred. Treasury has indicated that, while the term sheets for privately held mutual institutions allow institutions to reduce the warrants held by Treasury if they complete a qualified equity offering during 2009, this provision was included in the term sheets in error. In each case, Treasury intends to exercise the warrants immediately and there is no need for the reduction provision.

Financial Institutions Have Begun to Repurchase Their CPP Preferred Stock and Warrants from Treasury but the Process Lacks Adequate Transparency

As permitted by the act—as amended by American Recovery and Reinvestment Act of 2009 (ARRA)—and the CPP agreements, participants may repurchase or buy back their preferred stock and warrants issued to Treasury under CPP at any time, subject to consultation with the primary federal banking regulator.[28] However, the regulators have yet to disclose to Treasury or the public a generally consistent set of criteria that they are using to make decisions concerning repayment other than that they follow existing applicable supervisory procedures. According to Treasury officials, ARRA severely limits Treasury's authority to decide whether banks may purchase their stock.[29] After all the preferred shares are

[27]According to the term sheets, the higher rates of 7.7 percent and 13.8 percent will equate to after-tax effective rates (assuming a 35 percent tax rate) of 5 percent and 9 percent, respectively—the same rates applied to securities issued by other classes of institutions participating in CPP.

[28]Pub. L. No. 111-5, 123 Stat. 115 (2009). Section 7001 provides, in part, that "Subject to consultation with the appropriate Federal banking agency, if any,….Treasury *shall* permit a TARP recipient to repay any assistance previously provided under the TARP to such financial institution, without regard to whether the financial institution has replaced the funds from any other source or to any waiting period." (Emphasis added.) ARRA also required that Treasury liquidate the warrants when the assistance was repaid. This requirement was amended by the Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22, which removed the requirement that Treasury liquidate the warrants when the assistance is repaid.

[29]Treasury cites ARRA section 7001, which, as noted above, states that Treasury "shall" permit repayment.

repurchased, the financial institution may repurchase all or part of the warrants held by Treasury. Under the original terms of CPP, financial institutions were prohibited from repurchasing within the first 3 years unless they completed a qualified equity offering.[30] ARRA amended this requirement by allowing institutions to repurchase their shares with the approval of their primary federal regulator. See appendix IV for a description of the repurchase process.

While Treasury has some information about the preferred stock repurchase process on the www.financialstability.gov Web site, the federal financial regulators have yet to disclose the specific criteria for approving repurchases for certain TARP recipients.[31] In order to help ensure consistency, agencies are expected to develop adequate internal controls to ensure consistent decision making.[32] Unless the Treasury, in consultation with the primary federal regulators, take steps to ensure that the regulators have and apply generally consistent criteria and clearly articulate the basis they have used or plan to use to approve or deny repurchase requests, Treasury will face an increased risk that TARP participants may not be treated equitably.

As of June 12, 2009, 22 institutions had repurchased their preferred stock from Treasury for a total of about $1.9 billion (see table 5 for additional repurchase information). Also, as of June 12, 2009, 5 financial institutions had repurchased their warrants and 3 institutions had repurchased warrant preferred stock from Treasury at an aggregate cost of about

[30]Our use of the term repurchases in this report is general and does not differentiate between repurchases and redemptions of senior preferred stock. A redemption of senior preferred stock occurs when an institution completes a qualified equity offering per the standard terms of the preferred stock and subsequently exchanges cash for its senior preferred stock previously issued to Treasury. A repurchase occurs when the institution buys back its senior preferred shares without having completed a qualified equity offering, as permitted by ARRA or an other authority.

[31]The Federal Reserve has provided such criteria for the 19 bank holding companies that were subject to the stress test. We discuss these criteria later in the report.

[32]See GAO, *Standards for Internal Control in the Federal Government*, AIMD-00-21.3.1 (Washington, D.C.: Nov. 1, 1999).

$13.3 million.[33] In addition, 3 financial institutions had informed Treasury that they did not plan to repurchase their warrants. For those institutions that informed Treasury that they did not intend to repurchase their warrants, Treasury may attempt to sell the warrants in the financial markets. According to a Treasury official, as of June 12, 2009, Treasury has not yet liquidated any CPP warrants in the financial markets.[34]

Table 5: Capital Purchase Program Repurchases, as of June 12, 2009

Dollars in thousands

Institution Type	Repurchase amount for preferred stock initially issued to Treasury	Repurchase amount for preferred stock issued through exercise of warrants	Repurchase amount for warrants	Dividend payments received at the time of repurchase[a]	Total cash received
Private Institutions	$31,900	$1,595	N/A	$179	**$33,674**
Public Institutions	1,839,960	N/A	11,725	11,920	**1,863,605**
Total	**$1,871,860**	**$1,595**	**$11,725**	**$12,099**	**$1,897,279**

Source: Treasury OFS, unaudited.

[a]Dividend payments received at the time of repurchase are also included in CPP dividend payments received in Table 2 of this report.

On June 9, 2009, Treasury announced that 10 of the largest U.S. financial institutions participating in CPP had met the requirements for repayment established by their primary federal regulator and that, following consultation with the regulators, Treasury had notified the institutions that they were eligible to complete the repurchase process. Collectively, the Treasury-held preferred shares in these 10 institutions have a liquidation preference of approximately $68 billion. Upon completion of the preferred

[33]The five institutions are publicly held. Privately held institutions do not have warrants to repurchase from Treasury. Treasury received from the privately held institutions warrants to purchase a specified number of shares of preferred stock, called warrant preferred stock, that pay dividends at 9 percent annually. The exercise price for the warrant preferred stock is $0.01 per share unless the financial institution's charter requires otherwise. Unlike for publicly held institutions, Treasury exercised these warrants immediately for warrant preferred stock.

[34]CPP preferred stock repayments by financial institutions are deposited to the General Fund of the U.S. Treasury that is used to repay the debt that was issued to fund Treasury's original purchase. The proceeds received from the repurchases reduce the outstanding balance under the almost $700 billion TARP limit. Treasury then may issue new debt to purchase new financial instruments if it so chooses. However, CPP dividends and interest paid by recipients back to TARP and the proceeds from liquidation from warrants and any common or preferred stock Treasury obtains through the exercise of warrants are deposited into the General Fund of the Treasury and are not to be used to reduce the outstanding balance under the almost $700 billion TARP limit.

stock repurchase process, each institution will have the right to repurchase the warrants held by Treasury.

As mentioned previously, as of June 12, 2009, 5 institutions had repurchased their warrants from Treasury. We found that Treasury followed a consistent process in these instances; however, according to Treasury, there is no readily available market for the warrants that had been repurchased to date. The value of those warrants depends on the valuation process and the underlying assumptions. In one instance, Treasury received multiple offers from the institution to repurchase its warrants but rejected the first two offers. The final offer that Treasury accepted was slightly lower than Treasury's own determination of the market value of the institution's warrants but more than twice the initial offer and slightly more than its second. According to documents we reviewed, in accordance with its process for determining whether to accept an offer from the institution, Treasury considered 1) warrant price indications from certain market participants, 2) certain warrant pricing models, 3) a warrant price calculation from a third-party contractor, and 4) Treasury's own financial analysis of the institution. According to Treasury, the final warrant price was deemed to be reasonable given that the institution's stock price had declined during negotiations, reducing the warrant's value and that Treasury's market value determination for the warrant was based on a number of factors that involve judgment such as liquidity discounts. If Treasury and the issuing institutions cannot agree on a price, either can invoke an appraisal procedure whereby each chooses an independent appraiser to determine the estimated fair market value (FMV) and if the two cannot agree on a FMV, they will appoint a third appraiser.[35] If an institution decides not to repurchase its warrants under the negotiation and appraisal procedure, Treasury may sell the warrants

[35]Under the appraisal procedure, the three valuations are to be averaged unless the larger of the differences between the higher and middle valuations and the middle and lower valuations is more than 200 percent of the smaller of the differences. If the larger difference exceeds 200 percent of the smaller of the differences, the outlying valuation that triggers the exception is to be excluded and the FMV is to be determined by the average of the remaining two. For example, if the FMVs are $75 million, $50 million, and $40 million, the $75 million FMV would be excluded because the difference between $75 million and $50 million ($25 million) is more than 200 percent of the difference between $50 million and $40 million ($10 million).

through an auction process—another mechanism that Treasury could use to sell shares—when it deems appropriate.[36]

Treasury describes the warrant repurchase process broadly on the www.financialstability.gov Web site. Additional details about the process are contained in the individual securities purchase agreements that are also posted on the Web site. Further, the final warrant prices are disclosed on the Web site. However, Treasury has provided limited information about the valuation process it has used to date. Specifically, it has not disclosed the details—such as the institution's initial offer or how the final price compares to Treasury's valuation. For less liquid securities, prices can vary widely depending on the assumptions underlying the valuation models leading some market observers to question whether Treasury had received a fair market value for the warrants that have been repurchased to date. By not being more transparent about the valuation process and the negotiations that were undertaken to establish the accepted warrant price, Treasury increases the likelihood that questions will remain about whether Treasury has best served taxpayers' interests. Given the broad ranging risks inherent in TARP, Treasury must take steps to help ensure that its decisions are not only fair and equitable but also that they result in maximum value. Unless Treasury takes this type of broad-based approach, it may not ensure that taxpayers' interests are fully protected.[37]

In our March 2009 report, we recommended that Treasury update guidance available to the public on determining warrant exercise prices to be consistent with actual practices applied by OFS. Treasury has since updated its frequently asked questions on its Web site to clarify the process it follows for determining the prices. However, there continues to be inconsistent guidance available on the Web site for calculating the exercise prices. Treasury told us that because any new CPP applicants would most likely be nonpublic institutions, the existing guidance documents would not apply. Therefore, Treasury does not believe the

[36]Once Treasury rejects the initial offer from an institution to repurchase its warrant, the institution and Treasury have 10 days to negotiate a purchase price. If they are unable to agree on a price, either party has 30 days from the day Treasury rejected the offer to invoke the appraisal procedure specified in the Securities Purchase Agreement. If Treasury rejects an offer from an institution and neither party invokes the appraisal procedure, Treasury may sell the warrant to a third party through any means, including an auction.

[37]The Special Inspector General for TARP is planning to explore additional issues involving the warrant valuation process.

inconsistent guidance is a significant issue and therefore does not plan on further addressing the inconsistency.

OFS Continues to Collect Information on Participants' Lending Activity and Recently Hired Asset Managers to Help Ensure Compliance with Securities Purchase Agreements

OFS continues to take important steps toward better reporting on and monitoring of CPP. These steps are consistent with our prior recommendations that Treasury bolster its ability to determine whether all institutions' activities are generally consistent with the act's purposes. On May 15, 2009, Treasury published the fourth monthly bank lending and intermediation snapshot and survey.[38] In April 2009, Treasury started collecting basic information from the 21 largest CPP recipients on their lending to small businesses in the monthly lending surveys. According to Treasury, these data will be published in June 2009. These monthly surveys are a step toward greater transparency and accountability for institutions of all sizes. Survey results will allow Treasury's newly created team of analysts to understand the lending practices of CPP participants and will help in measuring the program's effectiveness in achieving its goal of stabilizing the financial system by enabling the institutions to continue lending during the financial crisis. We will continue to monitor Treasury's oversight efforts, including implementation of its new survey of all other CPP recipients.

In addition, on June 1, 2009, Treasury published the results of its first monthly survey of lending at all CPP institutions. These data include loans outstanding to consumers, commercial entities and total loans outstanding. This survey will continue on a monthly basis going forward. The survey and the results can be found at www.financialstability.gov.

Also, and consistent with our prior recommendations, Treasury has continued to take steps to increase its oversight of compliance with terms of the CPP agreements, including limitations on executive compensation, dividends, and stock repurchases. Participating institutions are required to comply with the terms of these agreements, and we recommended that Treasury develop a process to monitor and enforce them. According to Treasury, it relied on its custodian bank—Bank of New York Mellon—to collect relevant information from a variety of informal sources, such as Securities and Exchange Commission filings and press releases and information provided by CPP participants. According to Treasury, if OFS

[38]See Treasury, *Treasury Department Monthly Lending and Intermediation Snapshot Summary Analysis for March 2009*, http://www.treas.gov/press/releases/tg30.htm.

becomes aware of any instances of noncompliance with requirements, they are to refer the instances to its Chief Risk and Compliance Office, which would work with the CPP office, to determine if further action is needed. On April 22, 2009, Treasury hired three asset management firms that will play a role in this process.[39] According to Treasury officials, the asset managers' primary role will be to provide Treasury with market advice about its portfolio of investments in financial institutions and corporations participating in various TARP programs. The managers will also help OFS monitor compliance with limitations on compensation, dividend payments, and stock repurchases.[40] Treasury said that it is also exploring software solutions and other data resources to improve compliance monitoring. We plan to continue monitoring this area.

As we have noted previously, without a more structured mechanism in place, and with a growing number of institutions participating in TARP, ensuring compliance with these important requirements will become increasingly challenging. While the institutions are obligated to comply with the terms of the agreement, Treasury has not yet developed a process to help ensure compliance and to verify that any required certifications are accurate.

Treasury Issued New Interim Final Rules on Executive Compensation

On June 10, 2009, Treasury adopted an interim final rule to implement the executive compensation and corporate governance provisions of the act, as amended by ARRA, as well as to adopt certain additional standards deemed necessary by the Secretary to carry out the purposes of the act.[41] The interim final rule requires that recipients of TARP financial assistance meet standards for executive compensation and corporate governance. The requirements generally include

[39]These three asset managers were selected from more than 200 submissions from firms interested in the November 7, 2008, solicitation for asset managers. Treasury also selected a consulting firm to provide management services relating to AIFP.

[40]The portfolio of TARP investments generally includes senior preferred stock, senior subordinated debt, equity warrants, and other equity and debt obligations.

[41]TARP Standards for Compensation and Corporate Governance, 74.Fed. Reg. 28, 394 (June 15, 2009)(to be codified at 31 C.F.R. Part 30). Pursuant to section 101(c) of the act, the Secretary is authorized to issue regulations and other guidance that the Secretary deems necessary and appropriate to carry out the purposes of the act. The interim final rule became effective on June 15, 2009, and will be open for public comment for an additional 60 days.

- limits on compensation that exclude incentives for senior executive officers to take unnecessary and excessive risks that threaten the value of TARP recipients;[42]

- provision for the recovery of any bonus, retention award, or incentive compensation paid to a senior executive officer or the next 20 most highly compensated employees based on materially inaccurate statements of earnings, revenues, gains, or other criteria;

- prohibition on making any golden parachute payment to a senior executive officer or any of the next 5 most highly compensated employees;

- prohibition on the payment or accrual of bonus, retention awards, or incentive compensation to senior executive officers or certain highly compensated employees, subject to certain exceptions for payments made in the form of restricted stock; and

- prohibition on employee compensation plans that would encourage manipulation of earnings reported by TARP recipients to enhance employees' compensation.

The new rule also requires the (1) establishment of a compensation committee of independent directors to meet semiannually to review employee compensation plans and the risks posed by these plans to TARP recipients; (2) adoption of an excessive or luxury expenditures policy; (3) disclosure of perquisites offered to senior executive officers and certain highly compensated employees; (4) disclosure related to compensation consultant engagement; (5) prohibition on tax gross-ups (payments to cover taxes due on compensation) to senior executive officers and certain highly compensated employees; and (6) compliance with federal securities rules and regulations regarding the submission of a nonbinding resolution on senior executive officer compensation to shareholders.

The new interim regulations also require the establishment of the Office of the Special Master for TARP Executive Compensation (Special Master) to address the application of the rules to TARP recipients and their employees. Among the duties and responsibilities of the Special Master,

[42]The senior executive officers are generally the principal executive officer, the principal financial officer, and the three most highly compensated executive officers (other than the principal executive officer and the principal financial officer).

with respect to TARP recipients of exceptional assistance, is to review and approve compensation payments and compensation structures applicable to the senior executive officers and certain highly compensated employees, and to review and approve compensation structures applicable to certain additional highly compensated employees. Companies receiving exceptional assistance include those receiving assistance under the SSFI, TIP, and AIFP and currently include AIG, Bank of America, Citigroup, Chrysler, Chrysler Financial, GM, and GMAC. TARP recipients not receiving exceptional assistance may apply to the Special Master for an advisory opinion with respect to compensation payments and structures. The Special Master will also have responsibility for administering the review of bonuses, retention awards, and other compensation paid to employees of TARP recipients before February 17, 2009, and the negotiation of appropriate reimbursements to the federal government. Finally, the interim final rule also establishes compliance reporting and record-keeping requirements regarding the rule's executive compensation and corporate governance standards.

While No Funds Have Been Disbursed under CAP, the Regulators Announced the Results of the Stress Tests of the 19 Largest U.S. Bank Holding Companies

While no funds had been disbursed under CAP as of June 12, 2009, regulators have announced the results of stress tests that were a key component of the program. Moreover, Treasury announced that institutions interested in CAP funding are required to submit CAP applications to their primary banking regulators by November 9, 2009. According to Treasury, no CAP applications have been received. In a process similar to the one used for CPP, the regulators are to submit recommendations to Treasury regarding an applicant's viability. A key component of the program is the Supervisory Capital Assessment Program (SCAP) or stress test of the 19 largest U.S. bank holding companies—those with risk-weighted assets of at least $100 billion—that together account for approximately two-thirds of the assets in the aggregate U.S banking industry. The federal banking regulators designed the assessment as a forward-looking exercise intended to help them gauge the extent of the additional capital buffer necessary to keep the institutions strongly capitalized and lending even if economic conditions are worse than had been expected between December 2008 and December 2010. On Thursday May 7, 2009, the Federal Reserve released the stress test results. Bank regulators found that 10 of the institutions needed to raise additional capital (via the private sector or CAP) to meet capital standards that would allow them to continue lending to creditworthy borrowers and absorb potential losses.

The stress tests involved two economic scenarios, one representing the baseline expectation and the other a more adverse outlook involving a deeper and more protracted downturn. According to the Federal Reserve, the more adverse outlook was not intended to be a worst-case scenario but rather a deliberately stringent test designed to account for highly uncertain financial and economic conditions by identifying the extent to which a bank holding company is vulnerable today to a weaker than expected economy in the future. The required capital buffer was sized based on the more adverse scenario. While the forecast for the three economic indicators—GDP growth, unemployment rates, and home price changes—were considered quite severe at the time they were formulated in February, subsequent data indicated that the probability of the more adverse scenario was likely higher than previously thought, particularly with respect to the unemployment rate. According to Federal Reserve officials, house prices are at least as important as the unemployment rate in determining estimated losses at banks over the next 2 years because many of the estimated losses are related to real estate values. The specified trend in house prices under the more adverse scenario still represents a very severe outcome. These are areas that we plan to continue to monitor.

Stress Tests Estimated Losses for 2009 and 2010 of $600 Billion and Projected Capital Requirements

Based on data as of December 31, 2008, the Federal Reserve estimated that total losses for the 19 companies during the 2009 to 2010 period would be approximately $600 billion, in addition to any losses prior to 2009 (table 6). As a result, the total losses for the top 19 U.S. bank holding companies since the beginning of the financial crisis in the second quarter of 2007 would be nearly $950 billion. The $600 billion represents a 7.7 percent loss of total risk-weighted assets for the 19 companies.

Table 6: Estimated Losses for the 19 U.S. Bank Holding Companies in SCAP, January 2009 through December 2010

Dollars in billions

Bank holding company	Total losses
Bank of America Corporation	**$136.6**
Citigroup, Inc.	**104.7**
JPMorgan Chase & Co.	**97.4**
Wells Fargo & Company	**86.1**
Morgan Stanley	**19.7**
PNC Financial Services Group, Inc.	**18.8**
The Goldman Sachs Group, Inc.	**17.8**
U.S. Bancorp	**15.7**
Capital One Financial Corporation	**13.4**

Dollars in billions

Bank holding company	Total losses
SunTrust Banks, Inc.	**11.8**
American Express Company	**11.2**
MetLife, Inc.	**9.6**
GMAC LLC	**9.2**
Regions Financial Corporation	**9.2**
FifthThird Bancorp	**9.1**
BB&T Corporation	**8.7**
State Street Corporation	**8.2**
KeyCorp	**6.7**
The Bank of New York Mellon Corporation	**5.4**
Total	**$599.2**

Source: Federal Reserve Board.

The U.S. bank holding companies were asked to list available resources that they could use to absorb losses without impacting capital. Primary among these was the allowance for loan and lease losses as of year end of 2008 and preprovision net revenue, or the expected recurring income from ongoing business lines before any credit costs. The SCAP buffer for each bank holding company is defined as the incremental capital that must be provided to ensure that the bank would be able to meet two capital ratio tests at December 31, 2010, assuming losses under the more adverse scenario. First, tier 1 common capital to risk-weighted assets must be at least 4 percent, and second, tier 1 capital to risk-weighted assets must be at least 6 percent at December 31, 2010. While some market observers have been critical of the process by which regulators shared preliminary results with the bank holding companies and made subsequent adjustments based on feedback from the bank holding companies, Federal Reserve officials noted that such discussions are a normal part of the examination process. Further, Federal Reserve officials explained that the adjustments to the capital shortfall or "SCAP Buffer" largely reflected addressing data errors, double counts, and other technical issues, rather than to present any substantive arguments made by the U.S. bank holding companies. We will be evaluating this process and will report on our results in a future report.

While the data used was as of December 31, 2008, some banks reported significant earnings and capital increases in the first quarter of 2009 from asset sales, announced common equity issuances, and in one case the announced, but not yet completed, conversion of preferred shares to common shares. The regulators incorporated these changes into their analysis. The results showed that 10 of the 19 institutions needed to raise a total of almost $75 billion in equity capital (table 7). As required, the institutions submitted capital plans to the Federal Reserve on June 8, 2009, on how they plan to raise the needed capital and will have a total of 6 months in which to raise the capital from private markets (common equity offerings, assets sales, and the conversion of other forms of capital into common equity) or additional government assistance through CAP. As of June 12, 2009, eight of the 19 U.S. bank holding companies have announced or raised a total of $59.2 billion toward the required $75 billion.

Table 7: Capital Raising Requirements SCAP Bank Holding Companies, as of June 12, 2009

Dollars in billions

U.S. Bank holding companies	SCAP buffer required under more adverse scenario	Capital action taken as of stress test and first quarter profit (loss)	Required new common equity under SCAP	New capital raised as of June 12, 2009	Capital actions announced as of June 12, 2009	Required capital yet to be raised
Bank of America Corporation	$46.5	$12.7	$33.9	$32.9	-	$1.0
Wells Fargo & Company	17.3	3.6	13.7	8.6	-	5.1
GMAC LLC	6.7	(4.8)	11.5	3.5	-	8.0
Citigroup, Inc.	92.6	87.1	5.5	-	5.5	-
Regions Financial Corporation	2.9	0.4	2.5	1.9	-	0.7
SunTrust Banks, Inc.	3.4	1.3	2.2	2.1	-	0.1
KeyCorp	2.5	0.6	1.8	1.3	-	0.5
Morgan Stanley	8.3	6.5	1.8	10.2	-	-
FifthThird Bancorp	2.6	1.5	1.1	1.0	1.1	-
PNC Financial Services Group, Inc.	2.3	1.7	0.6	0.6	-	-
Total	**$185.0**	**$110.6**	**$74.6**	**$62.0**	**$6.6**	**$15.4**

Source: Federal Reserve Board and company press releases.

[a]While GMAC has sold $7.5 billion in mandatorily converted preferred membership interests to Treasury, this amount was bifurcated with $3.5 billion being applied to the SCAP buffer requirement and the remaining $4 billion reserved for GMAC's agreement with Chrysler LLC to finance dealers and auto sales.

Note: Not all numbers total due to rounding.

Treasury and the Federal Reserve Released Stress Tests Results but Do Not Plan Further Disclosures

Both Treasury and Federal Reserve officials emphasized the unprecedented nature of the detailed bank-level disclosure of both losses and revenue forecasts in the stress tests. However, Federal Reserve officials told us that they had no plans to provide periodic updates of actual performance of the U.S. bank holding companies in the stress tests relative to loss or revenue estimates under the more adverse scenario. Federal Reserve officials said they view this information as part of the supervisory process. While the Federal Reserve shared preliminary results of the stress test with senior Treasury officials, it neither shared the results of the stress tests with CPP officials prior to the public release nor does it plan to provide any additional routine information going forward. However, federal Reserve officials said that supervisory information can be provided to Treasury on a confidential basis when Treasury has a significant program need for the information. Moreover, whether and to what extent the bank holding companies will disclose additional information is unclear. These decisions raise a number of potential concerns. First, to the extent that information is disclosed by the institutions, it may be disclosed selectively and may not be consistent across institutions and could lead to increased market uncertainty. Second, because the stress tests were conducted as part of CAP, not making the results available to OFS officials for ongoing participants could adversely impact Treasury's ability to monitor the program. Finally, such information would be useful in the measurement of the effectiveness of SCAP and CAP. Without it, the public will not have reliable information that can be used to gauge the accuracy of the stress test projections on a more detailed basis than what has been disclosed in the SCAP papers.[43]

The Federal Reserve Announced Criteria for Large Banks to Repay Capital Investments

With respect to the 19 U.S. bank holding companies that participated in SCAP, on June 1, 2009, the Federal Reserve released the criteria it plans to use to evaluate applications to repurchase Treasury's capital investments. The items published are similar to those already in use to evaluate

[43]See Board of Governors of the Federal Reserve System, "The Supervisory Capital Assessment Program: Design and Implementation," April 24, 2009, and "The Supervisory Capital Assessment Program: Overview of Results," May 7, 2009.

repurchase requests that had been received from smaller bank holding companies,[44] and include the following considerations

- the bank holding company's ability to continue to act as an intermediary and spur lending to creditworthy households and businesses,
- whether the bank holding company's post-repurchase capital position is consistent with the Federal Reserve's supervisory expectations,
- whether the bank holding company will maintain its financial and management support for its subsidiary banks subsequent to repurchase, and
- whether the bank holding company and subsidiaries are in a position to meet all of their funding and counterparty obligations without government capital or utilization of the FDIC's Temporary Liquidity Guarantee Program.

Finally, the Federal Reserve stated that the U.S. bank holding companies that participated in the SCAP process seeking to repurchase CPP would be subject to the following additional criteria:

- A demonstrated ability to raise long-term debt without any FDIC guarantee or equity in the public equity market.
- Progress towards a robust longer-term capital assessment and management process geared toward achieving and maintaining a prudent level and composition of capital commensurate with their business activities and firm-wide risk profile.

The Federal Reserve in consultation with the U.S. banking holding companies' primary bank regulator and FDIC informed Treasury on June 9, 2009, that it had no objection to the repurchase of preferred shares by 9 of the SCAP bank holding companies. Also on June 9, 2009, Treasury announced that these 9 U.S. bank holding companies, and one other large

[44]For U.S. bank holding companies other than the SCAP 19, the Federal Reserve's criteria include consideration of the ability of the company to maintain appropriate capital levels, even assuming worsening economic conditions; whether the holding company will be able to serve as a source of financial and managerial strength to subsidiary banks; and the level of capital and composition of capital, earnings, asset quality, and liquidity, among other factors.

institution, met the requirements for repayment and would be eligible to repay $68 billion to Treasury.

The Federal Reserve Announced Modifications to the Term Asset-Backed Securities Loan Facility

In May 2009, the Federal Reserve announced some modifications to TALF, a program administered by the Federal Reserve but part of the President's broader strategy to restart lending. As we have previously reported, the Federal Reserve originally designed TALF to make nonrecourse loans to fund purchases of asset-backed securities (ABS) that are secured by eligible consumer and small business loans.[45] The modifications to TALF include the addition of two asset classes, an extension of certain TALF loan terms, and additions to the credit rating agencies approved for rating TALF-eligible collateral.

The additional asset classes accepted for collateral are commercial mortgage-backed securities (CMBS) and securities backed by insurance premium finance loans. CMBS are securities backed by mortgages for commercial real estate, such as office buildings or shopping centers. The Federal Reserve noted that it had extended the range of eligible collateral to include CMBS to help prevent defaults on viable commercial properties, encourage further lending for commercial properties, and encourage the sale of distressed properties. CMBS issued on or after January 1, 2009, and "legacy" CMBS issued prior to January 1, 2009, will be accepted. The Federal Reserve Bank of New York has specified a number of requirements that must be met before it will accept this collateral—for example, CMBS must have the highest long-term investment grade credit rating available from certain credit rating agencies. [46] The Federal Reserve will include nonlegacy CMBS in its June subscriptions for TALF loans and legacy CMBS in its July subscriptions.[47] The Federal Reserve also announced that it would accept securities backed by insurance premium

[45]Nonrecourse loans are provided against collateral, and if they go into default the Federal Reserve assumes control of the pledged assets. However, if a participant in TALF is found ineligible or misrepresents the eligibility of its collateral, the loan will not be considered nonrecourse and must be repaid.

[46]For additional information on CMBS collateral requirements, see the Web site of the Federal Reserve Bank of New York at http://www.newyorkfed.org/markets/talf_faq.html.

[47]TALF subscriptions for CMBS will occur on a different schedule than for other ABS with nonlegacy CMBS collateral being first accepted on June 16, 2009, and as announced thereafter.

finance loans.[48] These securities will be included to encourage the flow of credit to small businesses, one of the goals of TALF under the Consumer and Business Lending Initiative.

Furthermore, the Federal Reserve extended the available terms for certain TALF loans from 3 years to 5 years to finance purchases of CMBS and ABS backed by student loans and SBA-guaranteed loans. The Federal Reserve will limit financing to $100 billion for loans with 5-year maturities. The volume of loans requested for TALF collateral increased significantly in May and June 2009, compared with the previous 2 months (table 8). Additionally, loans requested in March and April 2009 were provided only on collateral for auto and credit card securitizations, whereas May 2009 subscriptions extended to student loan, small business, and equipment securitizations for the first time. June 2009 subscriptions included the first loans requested for securities based on insurance premium finance loans and servicing advances. The total amount of loans requested on TALF-eligible collateral since the program's first activity is $28.5 billion.

Table 8: Amount of TALF Loans Requested from March through June 2009 by Loan Type

Dollars in millions

Type of loan	March	April	May	June	Total by loan type
Auto	$1,902	$811	$2,185	$3,307	**$8,205**
Credit card	2,805	897	5,525	6,223	**15,450**
Equipment	0	0	456	591	**1,047**
Floorplan	0	0	0	0	**0**
Insurance premium finance	-	-	-	529	**529**
Servicing advances	0	0	0	495	**495**
Small business	0	0	87	82	**169**
Student loan	0	0	2,348	228	**2,576**
Total	**$4,707**	**$1,708**	**$10,600**	**$11,453**	**$28,467**

Source: GAO analysis of information available on the Federal Reserve Bank of New York Web site.

Note: Not all numbers will total due to rounding.

[48] Insurance premium finance loans are originated to borrowers for the payment of insurance premiums.

On May 19, 2009, the Federal Reserve expanded the number of credit rating agencies approved for rating TALF-eligible collateral from three to five. All collateral accepted under TALF, with the exception of ABS backed by SBA-guaranteed small business loans and related debt instruments, must receive the highest investment-grade rating from at least two TALF-eligible rating agencies. Fitch Ratings, Moody's Investors Service, and Standard & Poor's are eligible rating agencies for all ABS. DBRS, Inc. and Realpoint LLC are two additional TALF-eligible rating agencies for CMBS collateral.

Treasury and FDIC Are Taking Steps to Implement the Public-Private Investment Program, but Progress Has Been Slow

As we previously reported, PPIP consists of the Legacy Loans Program and the Legacy Securities Program. Treasury and FDIC have been finalizing the terms of the Legacy Loans program. On March 26, 2009, FDIC announced that it was seeking public comments on a number of elements of the program. FDIC officials at the time stated that the implementation date for the program would depend on the nature of the comments received and the time required to consider them for the design of the program. FDIC officials with whom we spoke said that the implementation date of the program remained unclear because of changes to accounting rules, potential participants' concerns about having to write-down assets, and TARP-related restrictions. More recently, on June 3, 2009, FDIC announced that a previously planned pilot sale of assets by open banks will be postponed. In making that announcement, the Chairman stated that banks have been able to raise capital without selling bad assets but that FDIC will continue to work on the Legacy Loans Program and will be prepared to offer it in the future. Further, FDIC announced that it intended to test the Legacy Loans Program funding mechanism in a receivership assets sale with bids to begin in July. For the Legacy Securities Program, Treasury is currently reviewing fund manager applications. Treasury extended the application deadline for these fund managers from April 10, 2009, to April 24, 2009, in part to give small businesses and businesses owned by veterans, minorities, and women the ability to partner with larger fund managers in the program. Treasury initially announced that it anticipated prequalifying about 5 fund managers from about 100 applications; however, it later clarified that more than five fund managers may be prequalified depending on the number of applications deemed to be qualified. A public announcement of the selections will be made in June 2009. Treasury officials estimated that it could take the fund managers as long as 12 weeks to raise capital for the funds and it is difficult to determine how soon Treasury would be contributing matching capital and financing to the funds.

The Administration Has Announced Small Business Lending Efforts That Are in Various Stages of Implementation

As we previously reported, Treasury, Federal Reserve, and SBA have plans in place to contribute to the administration's efforts to improve the accessibility and affordability of credit to small businesses. Treasury announced on March 16, 2009, that it would set aside $15 billion of TARP funds to directly purchase securities based on 7(a) and 504 small business loans guaranteed by SBA.[49] TALF, managed by the Federal Reserve Bank of New York, is also a part of the efforts to increase access to credit for small businesses. Under TALF, securities consisting of SBA-guaranteed 7(a) and 504 small business loans are provided as collateral to the Federal Reserve, and in return TALF provides loans, with the goal of encouraging securitizations for SBA-guaranteed debt.[50] For its part, SBA has been directed under ARRA to implement administrative provisions to help facilitate small business lending and enhance liquidity in the secondary markets. These administrative provisions include (1) temporarily requiring SBA to reduce or eliminate certain fees on 7(a) and 504 loans; (2) temporarily increasing the maximum 7(a) guarantee from 85 percent to 90 percent; and (3) implementing provisions designed specifically to facilitate secondary markets, such as extending existing guarantees in the 504 program and making loans to systemically important broker-dealers that operate in the 7(a) secondary market.

These initiatives are in various stages of implementation. Treasury has not yet purchased securities related to the Small Business and Community Lending Initiative, though it had stated that it expected to purchase 7(a)-related securities by the end of March 2009 and 504-related securities by the end of May 2009. A Treasury official said that Treasury has faced challenges implementing the program because of sellers' concerns about warrants and executive compensation, as stipulated under the act, as amended by ARRA. Treasury is reaching out to these sellers and

[49]This $15 billion is referred to as "Unlocking Credit for Small Business" and falls under the "Small Business and Community Lending Initiative" of Treasury's Financial Stability Plan. Separately, SBA has two principal loan guarantee programs, the 7(a) and 504 programs, which aim to facilitate the accessibility and affordability of financing to small businesses. Under the 7(a) program, SBA generally provides lenders guarantees on up to 85 percent of the value of loans to qualifying small businesses in exchange for fees to help offset the costs of the program. Under the 504 program, which generally applies to small business real estate and other fixed assets, SBA also provides certified development companies with a guarantee on up to 40 percent of the financing of the projects' costs in exchange for fees, while the small business borrowers and other lenders provide the remaining 60 percent of the financing with no guarantee. For additional information, GAO-09-507R.

[50]TALF efforts fall under the "Consumer and Business Lending Initiative" of Treasury's Financial Stability Plan.

anticipates completing term sheets in June 2009. Federal Reserve efforts related to small businesses have also started. As shown in table 8, in May 2009, TALF received collateral for and offered loans based on 7(a) and 504-related small business securities for the first time. Loans requested since May related to these small business securities total about $169 million. SBA, as we reported to congressional committees, issued policy notices to temporarily reduce or eliminate certain fees for 7(a) and 504 loans and temporarily increase the maximum 7(a) guarantee, effective as of March 16, 2009. SBA formalized its implementation of these provisions in Federal Register notices on June 8, 2009. However, the SBA has not yet implemented provisions intended to enhance secondary markets.[51]

Citigroup Finalized Its Previously Announced Securities Exchange Agreement on June 9, 2009

On May 7, 2009, Citigroup announced that it would expand its planned exchange of preferred securities and trust preferred securities for common stock from $27.5 billon to $33 billion. The stress test found that Citigroup would need an additional $5.5 billion in tier 1 common capital, for a total of $58.1 billion, to ensure adequate capital for the more adverse economic scenario. On June 9, 2009, Treasury and Citigroup finalized their exchange agreement and Treasury agreed to convert up to $25 billion of its Treasury CPP senior preferred shares for interim securities and warrants and its remaining preferred securities for trust preferred securities so that the institution could strengthen its capital structure by increasing tangible common equity. As part of the agreement, Citigroup agreed to offer to convert both privately placed and publicly issued preferred stock held by other preferred shareholders. To increase the exchange by $5.5 billion, Citigroup decided to offer to exchange more publicly held preferred stock and trust preferred securities for common stock. Treasury and Citigroup finalized the exchange agreement on June 9, 2009. According to OFS officials, the conversion of the government preferred shares to common stock will not be finalized until the exchange of $33 billion of preferred securities and trust preferred securities has been completed. In addition, Citigroup has taken a number of other actions designed to improve Citigroup's capital and financial position including the sale of Nikko Cordial Securities and a joint venture with Morgan Stanley relating to its brokerage subsidiary, Smith Barney. See appendix V for additional information about the condition of Citigroup.

[51]For additional details on the type and status of changes from SBA, see GAO-09-507R.

Citigroup issued its first 2009 quarterly TARP progress report on May 12, 2009.[52] Citigroup reported that it had authorized initiatives to deploy $44.75 billion in TARP capital. According to the report, $8.25 billion of new funding initiatives were approved during the first quarter of 2009 to expand the flow of credit to consumers, businesses, and communities. For example, Citigroup lent $1 billion to qualified borrowers to help homeowners refinance their primary residence. According to Treasury officials, Citigroup issued this report voluntarily and Treasury had not verified the information it contained.

Treasury Completed Transactions with AIG under the Systemically Significant Failing Institutions Program

Treasury completed the previously announced restructuring of its support for AIG by exchanging $40 billion of cumulative Series D preferred shares for $41.6 billion of noncumulative Series E preferred shares. The amount of Series E preferred shares is equal to the original $40 billion plus approximately $733 million in dividends undeclared on February 1, 2009; $15 million in dividends compounded on the undeclared dividends; and an additional $855 million in dividends accrued from February 1, 2009, but not paid as of April 17, 2009. Our tests of selected control activities found that Treasury had applied adequate financial reporting controls over the restructuring transaction.

AIG's restructured agreement kept the quarterly dividend payment dates of every May 1, August 1, November 1, and February 1 that were established in the original November 25, 2008, agreement. However, the restructured agreement also specified that dividends are not payable within 20 calendar days of the restructuring date and that the dividends for a period of fewer than 20 days would be payable in the subsequent dividend period. Accordingly, in compliance with these dividend payment terms, the dividends for the period from April 17 through May 1, 2009, which amounted to approximately $150.2 million, are to be included in the August 1, 2009, scheduled dividend payment.

Treasury also finalized its approximately $30 billion Series F preferred stock capital facility with AIG on April 17, 2009.[53] In our March report, we

[52]"What Citi Is Doing to Expand the Flow of Credit, Support Homeowners and Help the U.S. Economy," TARP Progress Report for First Quarter, May 12, 2009.

[53]The $30 billion preferred stock capital facility previously announced was reduced by $165 million representing retention payments AIG Financial products made to its employees in March 2009.

recommended that Treasury require that AIG seek concessions from stakeholders—such as management, employees, and counterparties—including seeking to renegotiate existing contracts, as appropriate, as it finalized this agreement. While Treasury extended negotiations several weeks, the negotiations did not result in material changes to the final agreement. According to Treasury, AIG had been consulting with Treasury on any substantial compensation payments until interim final executive compensation rules were issued on June 10, 2009.

Government Investment and Involvement in the Auto Industry Grows as Chrysler and GM Continue to Take Steps toward Restructuring

Since we last reported on the Automotive Industry Financing Progarm (AIFP),[54] Treasury has provided additional funding to the auto industry, including amounts to assist GM and Chrysler, which have filed voluntary petitions for reorganization under Chapter 11 of the U.S. Bankruptcy Code, bringing Treasury's total commitments under this program to approximately $82.6 billion.[55] Treasury committed to providing additional funding to support the companies both during and after their respective reorganizations, in the amounts of $8.5 billion for Chrysler and $30.1 billion for GM. In exchange for providing this funding, Treasury is to be repaid over a period of years for a portion of the amounts provided and will receive equity ownership in Chrysler and GM. Table 9 shows the amounts Treasury has provided or committed to providing under AIFP and its plans for being repaid for or otherwise recovering this funding.

[54] GAO reported separately on the federal assistance to the auto industry. See GAO, GAO-09-553.

[55] On April 30, 2009, Chrysler and its subsidiaries filed voluntary petitions under Chapter 11 of the U. S. Bankruptcy Code, and on June 1, 2009, GM and its subsidiaries filed voluntary petitions under Chapter 11 of the bankruptcy code. Both companies filed with the U.S. Bankruptcy Court, Southern District of New York.

Table 9: U.S. Treasury Assistance to the Auto Industry

Dollars in billions

Description of funding	Amount	Treasury's plans for recovery
Loans to Chrysler prior to bankruptcy filing	$4.0	$500 million—the portion secured by a senior lien on Mopar[a]—will be assumed under the restructured Chrysler's loan agreement (see row below).
Assistance to the restructured Chrysler after bankruptcy filing	8.5	$7.1 billion will be repaid as a term loan, including $5.1 billion to be repaid within 8 years and $2 billion to be repaid within 2.5 years. The loan is secured with a senior lien on all of the restructured Chrysler's assets. Treasury also received a 9.85 percent equity share in the new company. Treasury also set aside $350 million of the $8.5 billion for a loss-sharing provision and is not expected to be initially drawn.
Assistance to GM prior to bankruptcy filing	19.4	Treasury will receive $6.7 billion debt to be repaid as a term loan, $2.1 billion in preferred stock, and 61 percent equity in the new company.
Estimated assistance to the restructured GM after bankruptcy filing	30.1	
Supplier Support Program		Amounts provided to Chrysler and GM are due to be repaid in April 2010.
Chrysler	1.5	
GM	3.5	
Warranty Commitment Program		Treasury expects that Chrysler and GM will be able to continue to support their warranties and will not need the funds provided under these programs. The funds will be returned to Treasury.
Chrysler	0.3	
GM	0.4	
Assistance to auto finance companies Chrysler Financial and GMAC	14.9	Plans for recovery vary based on assistance provided.
Total assistance to Chrysler and GM	**$82.6**	

Source: GAO analysis of Treasury information.

[a]Mopar is Chrysler's parts business.

In the case of Chrysler, on April 30, 2009, the White House announced that Treasury would provide more than $8 billion in additional funding to help finance Chrysler's operations through bankruptcy and that Chrysler would attempt to arrange an alliance with the Italian automaker Fiat as part of its restructuring. On June 1, 2009, a bankruptcy judge approved Chrysler's restructuring proposal, including the alliance with Fiat, the sale of its assets to the new Chrysler, and the additional funding from Treasury.[56]

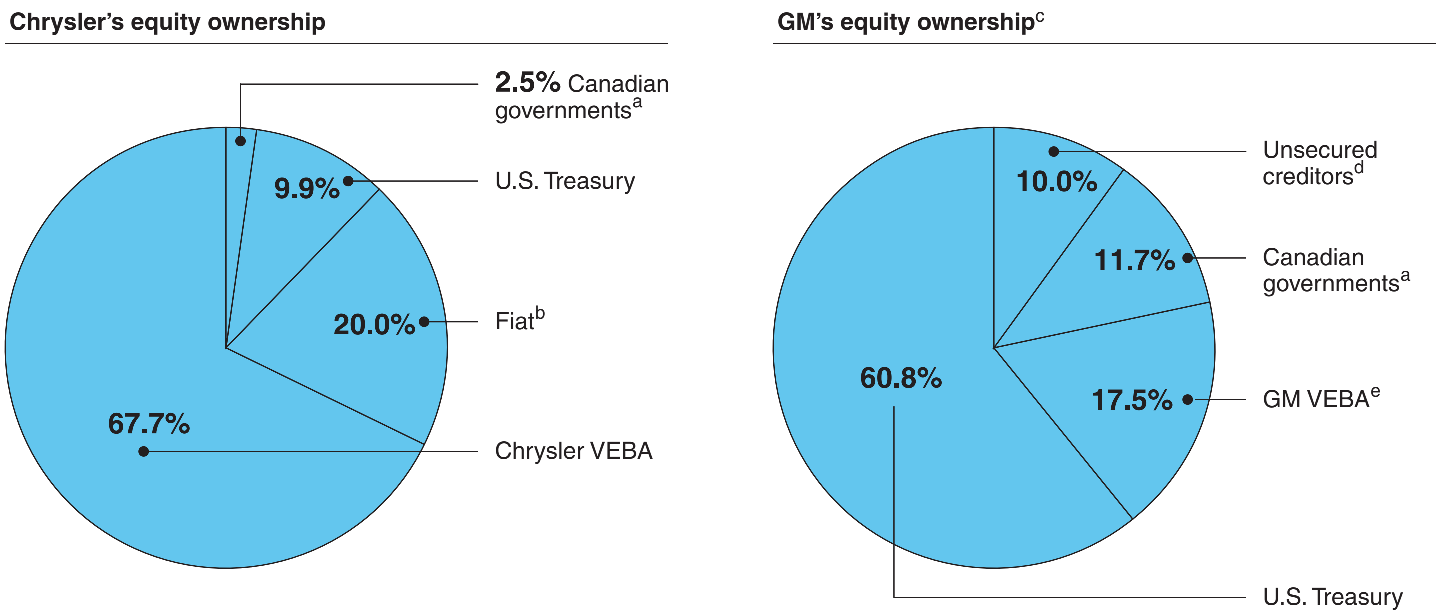
On June 9, 2009, the asset sale was finalized, and Treasury executed a loan agreement with the restructured Chrysler under which the company will be required to repay Treasury $7.1 billion, secured by a senior lien on all of the new Chrysler's assets. This new loan includes $500 million of the prebankruptcy loan that was secured by a senior lien on Mopar—Chrysler's parts business. Although Chrysler signed a loan agreement with Treasury for the entire $4.0 billion of the prebankruptcy loan, Treasury officials said that the U.S. government will likely recover little of this amount because other debt holders have seniority for being repaid. However, in further consideration of the funding to the restructuring of Chrysler, Treasury is initially receiving a 10 percent equity stake in the new company.

In the case of GM, on June 1, 2009, Treasury announced that it would make $30.1 billion of financing available to support an expedited bankruptcy proceeding and to transition the new GM through its restructuring plan. If GM's restructuring proposal is approved by the bankruptcy court—in exchange for the $30.1 billion in bankruptcy funding, as well as the $19.4 billion in prebankruptcy funding—the U.S. government would receive about $6.7 billion of debt, $2.1 billion in preferred stock, and approximately 61 percent of the equity in the new GM. At the present time, Treasury said it does not plan to provide additional assistance to GM beyond this commitment.

As part of the companies' reorganization, they have also reached agreements with other stakeholders to resolve outstanding obligations, including by offering these stakeholders equity shares in the companies. The agreements with each stakeholder group are discussed in more detail in the following paragraphs, and the companies' equity ownership following restructuring is shown in figure 2.

[56]An appeal had been filed with the U.S. Court of Appeals for the Second Circuit contesting the bankruptcy court's approval of the proposed asset sale under § 363 of the bankruptcy code. On June 5, 2009, the Court of Appeals affirmed the bankruptcy court's decision but stayed the asset sale until June 8, 2009. On June 6, 2009, some of Chrysler's creditors requested the U.S. Supreme Court to review and issue an emergency stay of the asset sale orders, and on June 8, 2009, Justice Ginsburg granted a temporary stay. On June 9, 2009, the Supreme Court removed the temporary stay and declined further review, allowing the asset sale to proceed.

Figure 2: Equity Ownership in Chrysler and GM after Restructuring



Source: GAO analysis of Department of Treasury information.

[a]The Canadian and Ontario governments will both receive equity in the new Chysler and GM.

[b]Fiat will have the right to earn up to 15 percent in additional equity in three tranches of 5 percent—each in exchange for meeting performance metrics, including introducing a vehicle produced at a Chrysler factory in the United States that performs at 40 miles per gallon; providing Chrysler with a distribution network in numerous foreign jurisdictions; and manufacturing state-of-the-art, next generation engines at a U.S Chrysler facility. Fiat will also hold an option to acquire up to an additional 16 percent fully diluted equity interest in the restructured Chrysler. Fiat may exercise this option once Treasury's loan has been repaid in full.

[c]GM's new equity ownership structure will be finalized pending the decision of the bankruptcy court. Ownership percentages assume warrants granted to unsecured creditors and the United Auto Workers' VEBA are exercised.

[d]Unsecured creditors would receive warrants to acquire an additional 15 percent of the new GM.

[e]The GM VEBA would receive warrants to acquire an additional 2.5 percent of the new GM.

- **Auto workers and retirees:** The International Union, United Automobile, Aerospace and Agricultural Implement Workers of America reached agreements separately with Chrysler and GM on modifications to the existing labor contract, as specified by the terms of Treasury's prebankruptcy loans to the companies. The agreements will be applicable to the reorganized companies. Chrysler and GM also developed plans to meet their obligations for funding their retiree healthcare funds, also known as voluntary employee beneficiary associations (VEBA). In the case of Chrysler, the VEBA will be funded by a note of $4.6 billion and will receive 55 percent of the new company's fully-diluted equity. In the case of GM, the company will fund its VEBA trust with a $2.5 billion note, $6.5 billion in preferred stock, 17.5 percent of the equity in the new GM, and warrants to purchase an additional 2.5 percent of the company. Both GM and Chrysler VEBAs will have the right to select one independent director for their respective company's board, but will have no other governance rights. Regarding the companies' pension plans, as we have previously reported, the termination of either company's plans would result in a substantial liability to the federal Pension Benefit Guaranty Corporation (PBGC), which insures private-sector defined benefit pension plans. However, at this time, the companies do not intend to terminate their plans, which will be transferred to the new companies as part of the reorganization.

- **Canadian government**: The Canadian government will provide restructuring funding to and become a shareholder of both companies. In total, the Canadian government has provided $3 billion to Chrysler and will hold $1.9 billion in debt and a 2.5 percent equity stake in the reorganized company.[57] For GM, the Canadian government will fund $9.5 billion in exchange for $1.7 billion in debt and preferred stock and approximately a 12 percent equity stake in the new GM. As a shareholder the Canadian government will have the right to select members of Chrysler's and GM's boards of directors.[58]

- **Former shareholders and creditors**: In the case of Chrysler, Daimler AG and Cerberus Capital, which together held 100 percent of Chrysler's prebankruptcy equity and $4 billion of Chrysler's debt, will relinquish their equity stakes and waive their share of debt holdings.[59] Chrysler's largest secured creditors agreed to exchange their portion of the $6.9 billion secured claim for a proportional share of $2 billion in cash. In the case of GM, bondholders representing more than half of GM's $27.1 billion in unsecured bonds have agreed to exchange their portion of bonds for 10 percent equity and warrants for an additional 15 percent in the restructured company. About $6 billion in debt held by GM's secured bank

[57]Amounts are in U.S. dollars.

[58]In both cases, the shareholders are the governments of Canada and Ontario.

[59]Additionally, Daimler AG will pay $600 million to Chrysler's pension funds to settle its obligation to the PBGC and Cerberus will contribute a claim it had against Daimler to assist in the Daimler settlement with the PBGC.

lenders will be repaid from proceeds of the loan GM received from Treasury and the Canadian government after it filed for bankruptcy.

- **Fiat:** As part of the alliance, Fiat has contributed intellectual property and "know how" to the new Chrysler in exchange for a 20 percent equity share in the reorganized company. Fiat also has the right to select three directors for the reorganized company and the right to increase its ownership incrementally up to a total of 35 percent.

As a shareholder of the reorganized companies, as well as a lender, Treasury will continue to have a monitoring and oversight role. For instance, Treasury will have the right to appoint four independent directors to Chrysler's board and five directors to GM's board.[60] However, Treasury officials told us they do not plan to play a role in the management of the companies following the selection of these directors. In addition, the companies are to meet the following requirements:

- Establish internal controls to provide reasonable assurance that they are complying with the conditions of the loan agreements relating to executive compensation, expense policy reporting, asset divestiture, and compliance with the Employ American Workers Act, and report to Treasury each quarter on these controls.

- Collect and maintain records to account for their use of government funds and their compliance with the terms and conditions under the Auto Supplier Support Program and other federal support programs.

- Provide Treasury with periodic financial reports.

Treasury officials said that they plan to require Chrysler and GM to submit monthly reporting packages containing the above items and to meet with the companies quarterly. They said that Treasury's involvement in the companies will be on a commercial basis and that their interest is in ensuring the companies are in a position to repay the loans.

We have previously reported that in a market economy, the federal role in aiding industrial sectors should generally be of limited duration and have noted the importance of setting clear limits on the extent of government

[60]The number of directors Treasury has the right to appoint varies based on the amount of GMAC LLC equity that Treasury owns at a given time.

involvement.[61] Regarding assistance provided to the auto industry, Treasury should have a plan for ending its financial involvement with Chrysler and GM that indicates how it will both divest itself of its equity shares—and the attendant responsibilities for appointing directors to the companies' boards—and ensure that it is adequately repaid for the financial assistance it has provided. In developing and implementing such a plan, it should weigh the objective of expeditiously ending the government's financial involvement in the companies with the objective of recovering an acceptable amount of the funding provided to these companies. Treasury has taken steps in this direction, including establishing repayment terms for the loan provided to the new Chrysler as part of its reorganization and developing plans to sell its equity in the companies over a period of years in a manner calculated to maximize its value. We plan to monitor Treasury's efforts to develop and implement a plan for ending the government's financial involvement with the automakers and will report our findings in future reports as appropriate.

Treasury Provides Funding to GMAC LLC to Assist in Auto Financing to Chrysler Dealers and Customers and to Address Capital Needs Identified under SCAP

In April 2009, Chrysler filed for bankruptcy. On May 20, 2009, the bankruptcy court approved GMAC LLC (GMAC) as the preferred provider of new credit to Chrysler's dealers and customers.[62] Also in May 2009, the Federal Reserve through SCAP identified the need for GMAC to raise additional capital to be in compliance with SCAP results.

The federal government indicated that it would provide additional assistance to GMAC to support GMAC's ability to originate new loans to Chrysler dealers and consumers and help address GMAC's capital needs as identified under SCAP.[63] On May 21, 2009, Treasury purchased $7.5 billion of mandatorily convertible preferred membership interests from GMAC with an annual 9 percent dividend, payable quarterly. Treasury's $7.5 billion investment included $4 billion to support GMAC and address its capital needs as identified through SCAP, which identified a need of $9.1 billion of new capital. After 7 years, the interests must be converted to

[61] GAO-09-553, *Auto Industry: A Framework for Considering Federal Financial Assistance*, GAO-09-247T (Washington, D.C.: Dec. 5, 2008), and *Auto Industry: A Framework for Considering Federal Financial Assistance*, GAO-09-242T (Washington, D.C.: Dec. 4, 2008).

[62] GMAC specializes in automotive finance, real estate finance, insurance, commercial finance, and online banking. As of March 31, 2009, GMAC had $180 billion in total assets.

[63] On December 29, 2008, Treasury purchased $5 billion of senior preferred membership interests from GMAC.

GMAC common interests. Prior to that time, they may be converted at Treasury's option upon specified corporate events (including public offerings). The shares may also be converted at GMAC's option with the approval of the Federal Reserve, though any conversion at GMAC's option must not result in Treasury owning in excess of 49 percent of GMAC's common membership interests, except (1) with prior written consent of Treasury, (2) pursuant to GMAC's capital plan, as agreed upon by the Federal Reserve, or (3) pursuant to an order of the Federal Reserve compelling such a conversion. On June 8, 2009, GMAC submitted a detailed capital plan to the Federal Reserve describing specific actions it has taken and plans to take to increase capital to meet its total SCAP capital needs.

Under the agreement, GMAC also issued warrants to Treasury to purchase additional mandatorily convertible preferred membership interests in an amount equal to 5 percent of the preferred purchased membership interests. The warrant preferred shares provide an annual 9 percent dividend payable quarterly. According to Treasury, because the exercise price for the warrants is nominal and there were no downside risks to exercising the warrants immediately, Treasury exercised the warrants at closing and received an additional $375 million of mandatorily convertible preferred membership interests. Under the funding agreement, GMAC must comply with all executive compensation and corporate governance requirements of Section 111 of the act applicable to qualifying financial institutions under CPP.

Treasury noted that the May 21, 2009, $7.5 billion capital investment would not immediately result in it holding any common membership interests in GMAC at that time. However, on May 29, 2009, Treasury exercised its option to exchange the $884 million loan it made to GM in December 2008 to acquire about 35 percent of the common membership interests in GMAC.

Treasury Has Continued to Take Steps to Develop an Integrated Communication Strategy for TARP, but Additional Actions Could Help Ensure the Strategy Is Effective

In our March 2009 report, we noted that while Treasury had taken a number of steps to address the ongoing crisis, it had been hampered with questions about TARP decision making and activities, raising questions about the effectiveness of its existing communication strategy.[64] As a result, we recommended that Treasury continue to develop an integrated communication strategy that may include, among other things, building understanding and support through the program, integrating communications and operations, and increasing the impact of communication tools such as print and video. Moreover, we emphasized the need for the communication strategy to establish a means to engage in regular and routine communication with Congress. Since our March 2009 report, Treasury said that it established a working group to address communications both within OFS and to external stakeholders. Treasury has stated that the working group is responsible for monitoring, reporting on, and addressing all OFS communication efforts, and has been developing a communications plan to build support for the various programs it has established under the act. Treasury also noted that its Financial Stability Plan provided the basis for its improved communication strategy.

The current communication strategy for TARP utilizes and builds on existing resources, such as Treasury's Office of Public Affairs and Office of Legislative Affairs. Officials from Treasury's Office of Public Affairs and Office of Legislative Affairs told us that the Financial Stability Plan announced in February 2009 provided a base for the new administration launching its current communication strategy. To ensure that Treasury can communicate with the public and Congress in a timely manner, officials from Treasury's Office of Public Affairs and Office of Legislative Affairs are included in regular policy meetings with OFS officials and officials from other offices in Treasury. As major changes occur, Treasury's Office of Public Affairs—in conjunction with OFS, the Office of the Secretary, and the Office of Legislative Affairs—has established a routine approach to more fully communicate activities to the public. Specifically, the Office of Public Affairs has a process that involves timely issuance of press releases and white papers, holding media briefings, and conducting outreach to the academic and investor community. According to Treasury, policy officials from OFS and Domestic Finance are involved in this process. Moreover, the Office of Public Affairs told us that Treasury had

[64] GAO-09-504.

dedicated a media and public affairs employee that works on TARP and in coordination with other senior members of the Public Affairs office.

Staff from the Office of Legislative Affairs told us that they routinely communicate with congressional leadership and staff from key committees with jurisdiction over TARP activities, specifically noting the Senate Committee on Banking, Housing, and Urban Affairs and the House Committee on Financial Services. They also respond to a variety of questions and requests made to them by individual members' and congressional staff on an ongoing basis. In addition, Treasury noted that on April 15, 2009, the Secretary transmitted written letters to congressional committees to provide a broad update on TARP-related activities, and on May 15, 2009, OFS staff provided background briefings to Congressional staff on TARP programs and recent developments. OFS told us they plan to provide additional briefings to congressional staff on a monthly basis. They also said that they are in the process of hiring a communications officer to work with the Office of Public Affairs and the Office of Legislative Affairs, who have two staff members dedicated to TARP, among other duties, to implement a coordinated communications strategy. Though these efforts may improve communication with congressional stakeholders, Treasury has yet to implement an approach that ensures all relevant stakeholders are routinely reached. For example, the act creating TARP includes several other committees of jurisdiction besides Senate Banking, Housing, and Urban Affairs and House Financial Services—the House and Senate Committees on Appropriations, the House and Senate Committees on Budget, the Senate Committee on Finance, and the House Committee on Ways and Means. However, according to Treasury officials, while they have more recently begun to outreach to others, their efforts have primarily been targeted to House Financial Services and Senate Banking. Treasury's communication strategy, once finalized, should help ensure regular and proactive outreach to all of the committees of jurisdiction and Congress in general. Until the plans for regular outreach to Congress on TARP matters are implemented, Treasury risks that some congressional committees or staff may not be receiving consistent and timely information, increasing the likelihood of misunderstanding by Congress and according to Treasury officials, will continue to be inundated with ad hoc TARP-related inquires.

Since our March 2009 report, Treasury has made operational its new Web site, www.financialstability.gov, to report TARP-related matters and has taken steps to improve the site's effectiveness through the use of various communication tools. Treasury said that this effort is part of a refocused public communications initiative to enhance communications on how

TARP strategies will stabilize the financial system and restore credit markets. According to Treasury, there are several key differences between the new site and the older Web page used to communicate TARP strategies, which was a part of the Treasury's Web site. Specifically, Treasury officials told us that the new site is less technical than the former Web page and the intention was to provide details on TARP activities in a more user-friendly, simplified manner that is easier for the general public to understand. For example, the site features a "decoder" tool that translates frequently-used financial language and TARP program names, such as "asset-backed security," to reach a wider audience. In addition, the site has provided information on all of the investments Treasury has made and the contractual terms of and participants in those investment programs. Treasury also posts a detailed monthly lending and intermediation survey on the Web site. Moreover, Treasury has provided links to program-related content provided on other federal agencies' sites, such as frequently asked questions on the TALF posted by the Federal Reserve. Treasury has also tried to provide information to better address constituent interests. For example, the Web site has included an interactive map illustrating state-by-state bank and financial institution funding provided under TARP. According to Treasury, the site provided some information on warrant sales and repayments of principal investments made to various institutions under CPP. Consistent with our recommendation aimed at better disclosure of monies paid to Treasury, it now includes dividends and interest received in its periodic reports to Congress that are also posted to the Web site, and according to Treasury, it is in the process of creating a mechanism to report dividends received under the various TARP programs on the Web site.

Treasury also created a separate Web site—www.makinghomeaffordable.gov—in order to communicate about the homeownership preservation program established under TARP. Treasury said that it has coordinated closely with the White House, HUD, FHFA, Fannie Mae, and Freddie Mac in developing a means to communicate information on the Making Home Affordable program to stakeholders across the country. The Web site includes information targeted to homeowners on refinancing and loan modifications and, according to Treasury, as of May 29, 2009, the site has received more than 19.5 million hits.

In other work, we have noted that best practices useful for improving the quality of federal public Web sites include conducting usability testing of Web sites and developing performance measures or other means to gauge customer satisfaction, such as conducting surveys and convening focus groups.[65] Treasury is in the process of entering into an agreement with a vendor to conduct usability testing of the Web site. According to a Treasury official, small surveys of site visitors will be conducted and every six months the vendor will suggest changes to improve the Web site. While Treasury said that the new Web site was designed to make information less technical and accessible to a wider audience, until Treasury gauges whether the new www.financiastability.gov Web site provides more useful and easily found information to the general public than the old Web page, Treasury lacks a meaningful measure of the effectiveness of its communication strategy.

The lack of ready access to key information on some recent TARP developments on the new www.financialstability.gov Web site underscores the need to seek input from others in making continuous improvements in TARP-related communications. For example, users from the general public, unfamiliar with the TARP terminology, would have difficulty finding basic descriptive information on the stress test initiative announced February 2009 under the administration's Financial Stability Plan. Among other things, we found that the Web site lacked readily-found information on the components of the test and test results. Further, while Treasury officials said that the decoder tool intends to translate more technical program information, as of June 4, 2009, we found no information in the decoder tool or elsewhere on the Web site to let users know that the stress test is now formally referred to in Treasury press releases as SCAP.

Treasury Has Made Progress in Developing OFS's Management Infrastructure

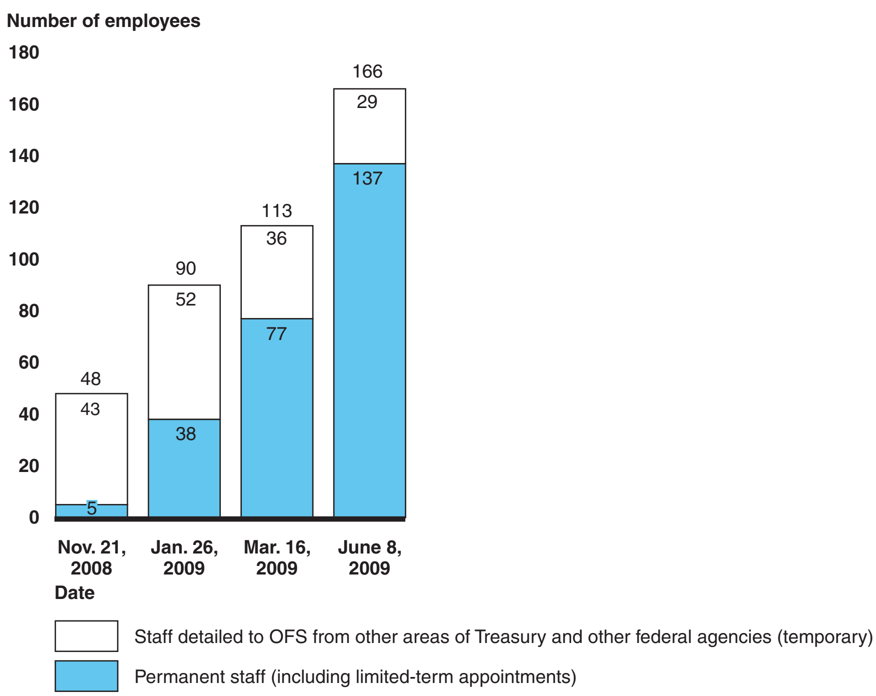
Since our March 2009 report, Treasury has continued to take steps to hire permanent OFS staff and detailees to fill short- and long-term organizational needs. First, Treasury has continued to seek qualified successors for various permanent leadership positions, including the Chief Investment and Chief Homeownership Preservation officers. Until permanent successors are identified, Treasury has appointed an Acting Chief Investment Officer and appointed an interim Chief Homeownership Preservation Officer to head these areas of OFS. In addition, Treasury has created a new senior position within OFS—a senior restructuring official—to oversee major investments that have been made under TARP. The administration has also nominated an individual to become the Assistant Secretary of Financial Stability. This appointment, which is

[65] GAO-09-638T.

subject to Senate confirmation, would fill the vacancy created by the departure of the Interim Assistant Secretary of Financial Stability, who had served in this capacity since TARP was created in October 2008.

Second, Treasury has increased the number of permanent OFS staff. As of June 8, 2009, OFS had 166 total staff, with the number of permanent staff rising from 77 to 137 since our March 2009 report and the number of detailees decreasing to 29 (see fig. 3). In its latest budget request to OMB, Treasury anticipated that OFS would need 225 full-time employees to operate at full capacity in fiscal year 2010, an increase of 29 from its March 2009 estimate of 196. Having both detailees and long-term staff helps OFS meet its short- and long-term needs. Treasury continues to anticipate that permanent staff will support long-term responsibilities, while detailees will continue to play an important role by supporting the flexibility of OFS operations.

Figure 3: Number of Permanent Staff and Detailees, November 21, 2008, through June 8, 2009



Source: GAO analysis of Treasury data.

Currently, some offices are more fully staffed than others. OFS provided information on 2 types of vacancies—ones the agency is currently in the process of hiring for (current vacancies)—and ones that the agency anticipates based on the projected size of each office over time (anticipated vacancies). While the offices of the Chief Financial Officer and Chief Investment Officer have identified only a few current vacancies, the offices of the Chief Risk and Compliance Officer and Chief Homeownership Preservation Officer have identified several current vacancies (table 10). Current vacancies that Treasury has identified within OFS include senior positions for program compliance within the office of the Chief Risk and Compliance Officer and leadership positions for data analysis and communications and marketing within the office of the Chief Homeownership Preservation Officer. In some instances, OFS has filled important personnel gaps. For example, since our March 2009 report, OFS has filled two new staff positions for program and data management analysts to support its oversight of financial agents.[66]

Table 10: Number of Permanent Staff and Detailees, as of June 8, 2009

Functional area of OFS	Permanent staff	Detailees	Current vacancies	Anticipated vacancies
Chief Risk and Compliance Officer	18	2	16	8
Chief Homeownership Preservation Officer	6	3	16	3
Chief Operations Officer	19	9	8	2
Chief Investment Officer	43	14	8	14
Chief Financial Officer	18	1	7	0
Total	**104**	**29**	**55**	**27**

Source: OFS, Treasury.

Note: The table only shows staffing levels and vacancies for selected areas of OFS. Current vacancies are ones that OFS is currently in the process of bringing on board. Anticipated vacancies are ones that the agency believes it will have based on the projected size of each office over time.

Treasury has made progress in developing a more routine process for hiring OFS staff. During the transition from the previous administration, with new TARP responsibilities still emerging and OFS functional areas still developing, Treasury employed an informal approach to hiring staff in order to bring employees on board expeditiously and meet immediate mission needs. As TARP activities have solidified and become more stable,

[66]OFS also has plans to hire three additional analysts and an Acquisition Program Manager to support oversight of its financial agents.

Treasury and OFS staff have been better able to identify the skills and abilities OFS needs and develop a more structured process for hiring. Currently, Treasury routinely updates its Web site, www.financialstability.gov, to inform potential candidates of new OFS vacancies. These vacancy announcements are linked to job announcements posted on the USAJOBS Web site. Additionally, Treasury has developed more systematic approaches to reviewing applications and interviewing candidates. For example, Treasury recently updated its standard operating procedures for hiring staff to OFS. This includes a procedure describing how to bring on board federal employees to serve as detailees in OFS. While Treasury has developed more formal processes for assessing candidates seeking employment with OFS, the department still uses flexible hiring strategies in order to ensure that it is recruiting candidates with the right skill sets and abilities to meet OFS mission needs. For example, Treasury still utilizes the flexibilities provided under direct hire authority to select candidates for employment who do not submit formal applications via www.usajobs.gov. Nonetheless, Treasury officials said that they encourage all candidates expressing interest in OFS employment to apply via announcements posted on www.usajobs.gov whenever feasible. In addition, to retain critical skills learned on the job, Treasury has established a process to ensure knowledge transfer between outgoing and incoming OFS detailees.

Treasury continues to experience challenges in hiring qualified employees, however, in part due to pay disparities with federal financial regulatory agencies. In the past, Treasury told us that it had identified candidates with the right skills and abilities to fill various OFS positions, but these candidates often worked for financial regulators that could offer more competitive salaries than OFS. To mitigate the effects of pay differences, Treasury has employed some strategies that are available to all federal agencies. In particular, Treasury has utilized maximum payable rates and offered promotions to mid-level career employees.[67] According to Treasury, these incentives have been helpful in hiring some employees who had previously worked at financial regulatory agencies. Nonetheless, Treasury noted that while these tools have been useful in attracting lower- and mid-level career employees, they do not always address substantial

[67]The maximum payable rate rule allows an agency to set pay at a rate above that which would normally apply, based on the higher rate of pay the employee previously received in another federal job. The pay set, however, may not exceed the highest rate for the general schedule grade to which the employee would be entitled under normal pay-setting rules. See 5 C.F.R. Part 531.221.

differences between the compensation OFS can offer senior executives and the rates offered by financial regulators. In addition, while the department has the ability to use recruitment bonuses, use of this incentive has been limited to employees who are not currently government employees and therefore has not been used to recruit employees from financial regulatory agencies.[68] Moreover, while Treasury may use relocation bonuses, its use of these for recruiting employees from financial regulatory agencies has been limited because most candidates currently working for financial regulatory agencies would not have to relocate to accept a position in OFS.

Treasury Has Taken Various Steps to Manage Potential Conflicts of Interest among TARP Employees

As mentioned in our prior work, Treasury has told us that vetting OFS candidates' potential conflicts of interest has added time to the hiring process. In particular, there has been heightened concern about employees' financial interests creating potential conflicts because TARP decision-making activities often involve providing funds to various financial institutions and targeting assistance to certain types of investments (such as mortgage-backed securities) that new employees might hold.

Treasury officials told us they had taken a number of steps to manage potential conflicts of interest. First, Treasury officials have been obtaining information on candidates' potential conflicts earlier in the hiring process, through preliminary reviews of information provided on financial disclosure reports. OFS employees are subject to the same laws and regulations covering ethical codes of conduct as employees of other executive branch agencies. Accordingly, OFS employees are prohibited from participating personally and substantially in a particular matter that will affect their financial interests or those of (1) a spouse or minor child; (2) a general partner; (3) an organization for which they serve as an officer, director, trustee, general partner or employee; or (4) a person with whom they are negotiating for employment or have an arrangement concerning prospective employment.[69]

[68]Federal regulations currently limit use of recruitment bonuses to individuals hired from outside the federal government. See 5 C.F.R. Part 575 Subpart A.

[69]18 U.S.C. § 208(a); 5 C.F.R. §§ 2635.401-403; 5 C.F.R. pt. 2640. 101.Certain investments are exempt from this prohibition, including investments in securities that are valued at $15,000 or less and, regardless of their value, diversified interests in mutual funds and investment trusts.

In accordance with the Ethics in Government Act, Senate-confirmed appointees, members of the Senior Executive Service, and other senior-level executive branch employees must disclose assets and other interests that are attributable to them when beginning federal service and annually thereafter in a public financial disclosure report.[70] Other OFS employees whose duties involve the exercise of significant discretion are required by regulation to report their financial interests on a confidential financial disclosure report (see table 11). Employees required to file a financial disclosure report must do so within 30 days of appointment, unless granted an extension. Treasury said it had obtained and retained a copy of the financial disclosure reports filed by detailees with their home agencies.[71]

Table 11: Description of Financial Disclosure Reports Filed by OFS Employees

Report title	Type of official filing report	Information required
Public financial disclosure report[a]	Senate-confirmed appointees, members of the senior-executive service and other senior-level employees	List specified financial interests including outside income or gifts, assets, and liabilities and identify the value of and income generated by each interest by dollar ranges. Reports of transactions required on an annual basis.
Confidential financial disclosure report[b]	Other staff whose duties involved the exercise of significant discretion	List specified financial interests held; no requirement to specify values of assets or income amounts. No transaction reporting required.

Source: GAO.

[a]A blank version of this report may be accessed via Office of Government Ethics Web site. See http://www.usoge.gov/forms/sf278.aspx.

[b]A blank version of this report may be accessed via Office of Government Ethics Web site. See http://www.usoge.gov/forms/form_450.aspx.

Treasury has used databases to track reviews of Treasury employee financial disclosure reports. These databases provide sufficient evidence to demonstrate that, in general, OFS employees have filed financial disclosure reports within 30 days of their appointment. We found that in all but two cases, individuals required to complete these reports filed them

[70]5 U.S.C. App. § 101.

[71]We did not review information on OFS detailees' filing of confidential financial disclosure reports because they were already required to file these with their home agencies and were not new filers.

within 30 days of their appointment to OFS.[72] In one case, the employee was granted an extension to file and filed before the expiration of the extension period. In the other case, the employee appears to have submitted the report on time, but it was not officially marked as received by Treasury ethics counsel until 1 business day after the expiration of the 30-day time-to-file period.

Our analysis also supports Treasury's statement that it usually vets conflicts of interest earlier in the hiring process for OFS staff than for employees in other areas of Treasury. We found that, on average, permanent OFS employees required to submit confidential financial disclosure reports filed them about 21 days before their appointment. Moreover, we found that the majority of OFS employees coming from outside the federal government who were required to submit public financial disclosure reports filed the reports in advance of their appointment to OFS.

To address the unique aspects of TARP operations in its reviews of OFS employees' financial disclosure reports, Treasury established new internal operating procedures on February 17, 2009, concerning the submission and review of OFS employees' confidential financial disclosure reports. To facilitate a preliminary identification and communication of obvious potential conflicts, the new procedures set out as a goal to have OFS candidates submit for initial review confidential financial disclosure reports with Treasury ethics counsel before their formal appointment to OFS. Generally, Treasury has followed this new procedure. In our review, we found that of the 31 employees filing confidential financial disclosure reports who were appointed to OFS on or after February 17, 2009, Treasury ethics counsel received copies of such reports in advance of the candidate's appointment to OFS in all but three cases. The new procedures outlined plans for Treasury ethics counsel to better coordinate with OFS supervisors during their reviews of confidential financial

[72]In reviewing whether a report was filed on time, we determined that the date the report was marked as received by Treasury ethics counsel to be the date the report was "filed." We reviewed information in the database tracking information on 56 permanent employees filing confidential financial disclosure reports and 8 employees filing public financial disclosure reports. We were unable to determine the timeliness of a confidential financial disclosure report filing for 1 employee because certain key dates were missing and the date of appointment entered did not reflect the employee's appointment to OFS but instead to another area of Treasury.

disclosure reports submitted by OFS candidates.[73] Treasury officials said that the new coordination effort was helpful because OFS mission staff were often more familiar with the day-to-day roles and responsibilities of employees directly under their supervision. One of the tracking databases provides some evidence to support Treasury's assertion that it routinely coordinates reviews of employees' financial interests with OFS mission staff. Specifically, the database includes a field that tracks the dates of supervisory OFS staff reviews of confidential disclosure reports. In reviewing the database, we identified several instances in which OFS supervisors had reviewed confidential financial disclosure reports within a few days of the Treasury ethics counsel's initial review. We found that for 42 permanent employees, OFS supervisors reviewed confidential financial disclosure reports, on average, 5 days after Treasury's ethics counsel first received the reports. However, the supporting information is somewhat limited because the supervisory review field was incomplete for 14 of the 56 database pages we reviewed. Treasury's ethics counsel told us that this information was absent most often because of a lag in data entry. Specifically, Treasury said that dates might be entered into the database some time after the reviews were complete because supervisory mission staff might retain the reports for extended periods to, among other things, track potential conflicts identified in the reports and help ensure that employees recuse themselves from matters in which they had a financial interest.

Treasury provides various types of training to employees to help them understand conflicts of interest and ensure compliance with ethical standards of conduct. According to Treasury, this training is more rigorous for employees whose jobs have higher potential to involve financial or other conflicts. Treasury officials said that all employees receive group training at orientation and certain employees whose positions are of a more sensitive nature are provided one-on-one training with an ethics officer. The databases also support Treasury's statement that it provided both individual and group-based ethics training to OFS staff. Specifically, we found that as of April 23, 2009, all OFS staff who completed financial disclosure reports had received at least one ethics training session and almost half had received two or more types of ethics training sessions. While one database lacked some information on specific training dates, it

[73] According to a Treasury ethics official, the department did not establish any new procedures for vetting public disclosure reports since Treasury already extensively reviews these reports.

did provide some information on types of training provided to these individuals (such as one-on-one training with ethics officers, makeup training sessions, or group training conducted at orientation).

OFS uses a variety of other measures to manage potential conflicts of interest. Federal law permits Treasury to authorize a waiver permitting an employee to hold certain financial interests if Treasury determines that holding such interests does not substantially interfere with the integrity of the individual's performance.[74] According to Treasury, to date, two waivers have been issued to OFS employees. One of these waivers gave a new OFS employee 90 days to divest assets held in pooled investment funds that could have presented a conflict into nonconflicting assets. In the other case, after determining that a senior OFS official's deposits in a banking institution could present a conflict of interest to the extent that these deposits exceeded the FDIC-insured limit of $250,000, as a precautionary measure, Treasury issued a waiver to permit the individual to retain these deposit accounts. In both cases, Treasury determined that the investments involved were not likely to affect the integrity of the individual's federal service.

In addition, when reviewing financial disclosure reports, Treasury ethics counsel consulted with OFS employees on what activities they should recuse themselves from participating in during their employment with OFS because such activities could have potentially interfered with the independent and objective performance of their jobs. According to Treasury, during reviews of financial disclosure reports, OFS employees have agreed to divest themselves of certain financial assets to mitigate potential conflicts. Although Treasury does not routinely track divestments, Treasury provided some documentation demonstrating that multiple OFS employees divested assets that might have caused a conflict with their official duties.

Treasury has appropriately identified potential conflicts of interests among senior-level OFS officials and has taken appropriate steps to address such issues. We reviewed 15 public financial disclosure reports submitted by OFS officials as of April 23, 2009. Seven of the reports reviewed had already been submitted to the detailees' federal agencies during the past fiscal year, but Treasury's ethics counsel reviewed the reports again to assess potential conflicts in the context of the employee's OFS duties. In

[74] 18 U.S.C §208(b).

our review of the reports, we identified financial interests that could have conflicted with the independent and objective performance of some duties. During our consultation with Treasury's ethics counsel, however, we found that the same interests had already been identified, and we obtained information showing that the ethics counsel had taken the appropriate steps to address them. For example, in some cases, Treasury's ethics counsel instructed individuals to divest themselves of certain investments. In other cases, Treasury's ethics counsel directed individuals to recuse themselves from matters involving former employers or firms that compensated them for consulting services.

Treasury Has Continued to Engage Contractors and Financial Agents

Since our March 2009 report, Treasury has awarded 11 new contracts and entered into four new financial agency agreements, bringing to 40 the total number of TARP financial agency agreements,[75] contracts, and blanket purchase agreements as of June 1, 2009.[76] Of the 11 new contracts,

- 4 are in support of services related to the automotive industry,
- 2 are for legal services related to PPIP,
- 1 is for legal services related to small business loans and securities,
- 1 is to perform credit reform modeling analysis, and
- 3 are for OFS facilities services.

Of the 4 new financial agency agreements,

- 1 is for asset management services in support of the small business assistance program, and
- 3 are for asset management services in support of CPP.

[75]A financial agency agreement is a document that establishes and governs the relationship between Treasury and its financial agent. A financial agent is a financial institution that has authority to hold deposits of public money and perform related services. A financial agent has a principal-agent relationship with Treasury and owes a fiduciary duty of loyalty and fair dealing to the United States. See 31 C.F.R. pt. 202.

[76]In addition, Treasury is utilizing contractor support for internal controls, information technology, and financial advisory services through four interagency agreements.

Since March 2009, Treasury used expedited procedures to award seven contracts using other than full and open competition based on unusual and compelling urgency.[77] Treasury also used the General Services Administration's Federal Supply Schedule in three instances. [78] In most cases, Treasury solicited and received offers from multiple firms. While competition requirements do not apply to Treasury's authority to designate financial agents, Treasury issued a general solicitation for asset manager proposals in support of CPP and received more than 200 submissions, from which it made its current three selections. Treasury has yet to decide on the extent to which it will need additional asset managers. For detailed status information on new, ongoing, and completed Treasury contracts and agreements as of June 1, 2009, see GAO-09-707SP.[79]

Treasury encourages small businesses, including minority- and women-owned businesses, to pursue procurement opportunities on TARP contracts and financial agency agreements.[80] OFS has considered potential vendors' efforts to utilize small businesses as part of its selection criteria on most contracts and some financial agency agreements. As of June 1, 2009, Treasury has awarded nine of its 40 prime contracts or financial agency agreements (23 percent) to small or minority- and women-owned businesses. Two of the new prime contracts awarded since our March 2009 report were awarded to small businesses for credit reform analysis and OFS facilities services, one was awarded to a small minority/women-owned business for legal support to PPIP, and two of the new financial agency agreements are with minority- and women-owned businesses for asset management services. To date, however, the majority of small or

[77]This total does not include a recent contract with Phacil Inc., for which Treasury did not provide information. The Competition in Contracting Act authorizes agencies to limit competition when, for example, an unusual and compelling urgency precludes the use of full and open competition. 41 U.S.C. § 253.

[78]The total does not include a contract with Heery International Inc., for which Treasury did not provide information. The Federal Supply Schedule program is managed by the General Services Administration and provides federal agencies with a simplified process for obtaining commercial supplies and services at prices associated with volume buying.

[79]GAO-09-707SP.

[80]For example, according to Treasury, it hosted an Industry Day and Small Business Networking event on May 27, 2009, related to a planned omnibus acquisition for legal services to present information, address questions, and provide a forum for small businesses to pursue partner arrangements to enhance their capability to compete for the acquisition. According to Treasury, approximately 40 interested firms attended the event, and 11 small business firms presented their capabilities to the audience.

minority- and women-owned businesses participating in TARP are subcontractors with TARP prime contractors. According to OFS officials, as of June 1, 2009, 30 of 42 TARP subcontractors (71 percent) represented small or minority- and women-owned business categories, as shown in table 12.[81]

Table 12: TARP Contracts, Financial Agency Agreements, and Subcontracts with Minority-Owned, Women-Owned, and Other Small Businesses, as of June 1, 2009

Socioeconomic business category	Prime contracts and financial agency agreements[a]	Subcontracts[b]	Total
Minority-owned[c]	4	9	**13**
Women-owned	2	11	**13**
Other Small	3	10	**13**
Total	**9**	**30**	**39**

Source: GAO analysis of Treasury data.

[a]As of June 1, 2009, 40 TARP prime contracts and financial agency agreements have been issued.

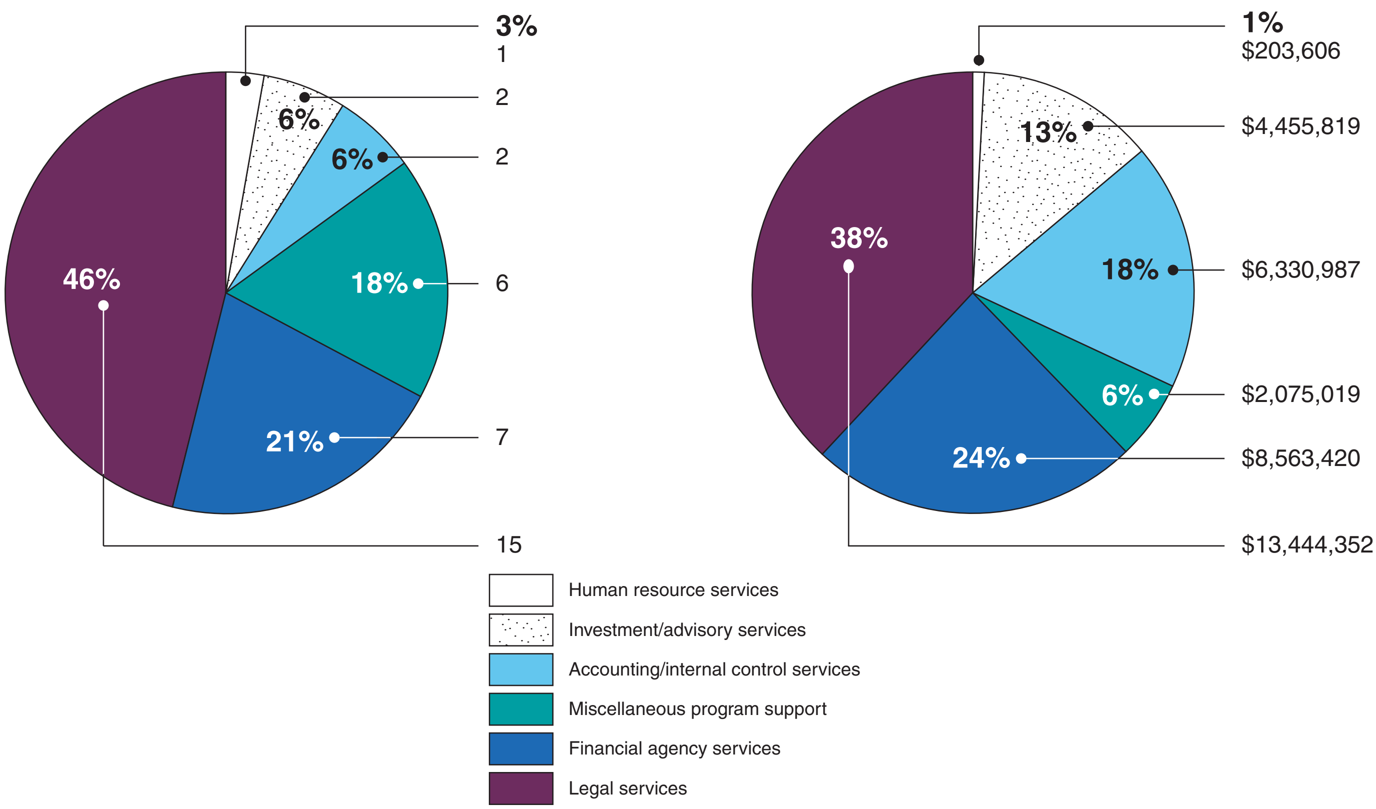
[b]As of June 1, 2009, prime contractors have awarded 42 TARP subcontracts, excluding 3 subcontractors for Fannie Mae.

[c]Includes combination minority- and women-owned businesses.

As of June 1, 2009, legal services contracts and financial agency agreements continue to account for the majority (67 percent) of services used to directly support OFS's administration of TARP, as shown in figure 4. As of the same date, Treasury had expended $48,894,415 for actions related to contracts and agreements—a $37 million increase in contract and financial agency agreement expenses in the last 2 months alone. The largest share of the total (38 percent) was for legal services, and the second-largest share (24 percent) was for services provided by financial agents.

[81]The total of 42 subcontractors excludes three subcontractors for Fannie Mae.

Figure 4: Number of and Expenses for OFS Contracts and Agreements, as of June 1, 2009



Source: GAO analysis of Treasury data.

Note: These figures reflect 33 contracts, financial agency agreements, and interagency agreements for services that have directly supported OFS's administration of TARP, including 2 contracts that expired as of June 1, 2009. This figure does not reflect contracts for, among other things, property leases, a human resources advertisement, internal information technology services, and the purchase of office equipment.

Since our March 2009 report, Treasury has increased its fiscal year 2009 budget estimate from $175 million to $263 million to cover higher anticipated costs for OFS's use of contractors and financial agents, interagency agreement obligations, information technology services, office rental, and other facilities costs. According to OFS budget officials, the estimated $88 million budget increase is due primarily to financial agency agreement costs for Fannie Mae and Freddie Mac, the addition of new TARP programs, and the realignment of some budget categories.[82]

Treasury provides a basic descriptive listing of information on its contracts and financial agency agreements through its TARP Web site and its monthly report to Congress pursuant to section 105(a) of the act. However, this reporting lacks the detail Congress and other interested stakeholders need to track the progress of individual contracts and agreements—such as a breakdown of obligations and/or expenses, in dollars, by each entity. As OFS's capacity to manage and monitor TARP contracts and other agreements continues to grow, making this type of information public on a regular basis would be useful, in addition to the information Treasury already reports.[83]

Some of the principal federal banking regulators involved in activities related to TARP (Federal Reserve, FDIC, OCC, and OTS) currently use or plan to use contractors in support of activities related to the program. Officials reported that, as of June 1, 2009, the Federal Reserve was contracting with four firms to provide support for AGP, including financial evaluation and accounting services related to Federal Reserve loans made to Citigroup and Bank of America.[84] In addition, FDIC plans to obtain future contractor support to assist with activities related to PPIP's Legacy Loans Program. Though this program is still in development, FDIC anticipates that contractor services in support of the program may include financial advisory services, asset valuation, oversight and compliance monitoring, title assignment, trustee services, and master servicer responsibilities.

[82]In February 2009, Treasury selected Fannie Mae to administer, maintain records for, and serve as the paying agent for its homeowner assistance programs and Freddie Mac as the compliance agent to oversee servicers' home mortgage modifications.

[83]To enhance the level of information provided to the public, we have provided through our reports detailed status information on each new, ongoing, and completed TARP-related financial agency agreement, contract, blanket purchase agreement, and interagency agreement, including obligation and expense information, in dollars, provided to us by Treasury.

[84]The Federal Reserve's contractors for the Asset Guarantee Program are Cleary Gottlieb Steen & Hamilton, Pacific Management Investment Company (PIMCO), BlackRock, and Ernst & Young.

OFS Has Continued to Make Progress in Managing and Monitoring Conflicts of Interest among Contractors and Financial Agents

OFS continues to implement its system of compliance to manage and monitor potential conflicts of interest that may arise with contractors and financial agents seeking or performing work under TARP.[85] In response to the January 2009 TARP conflicts-of-interest interim rule,[86] OFS received nine comments before the public comment period ended March 23, 2009. OFS anticipates that the process of developing a final rule on conflicts of interest may take several months to complete.

We continue to track the actions OFS has taken to address two prior recommendations: (1) to complete the review of, and as necessary renegotiate, the four vendor conflicts-of-interest mitigation plans that predated Treasury's interim rule to enhance specificity and conformity with the interim rule and (2) to issue guidance requiring that key communications and decisions concerning potential or actual vendor-related conflicts of interest be documented.

Since March, OFS has made progress toward completing the review, and as necessary renegotiation, of four pre-existing vendor conflicts-of-interest mitigation plans. In addition, Treasury extended the period of performance for two existing legal services contracts in March 2009. Of these six required reviews, two were completed as of May 2009, resulting in updated contract language and revised mitigation plans. OFS anticipates completing all remaining reviews and any necessary renegotiations by the end of July 2009.

The two contracts OFS revised now include specific language mirroring the interim rule and provide more details regarding required disclosures and certifications. The revised language also added provisions such as

[85]In addition to the contractors and financial agents performing work for OFS under TARP, in December 2008 OFS established an interagency agreement with the Pension Benefit Guaranty Corporation to obtain financial advisory services from Rothschild Inc. related to the TARP-assisted domestic auto industry restructurings. Part of this agreement includes Rothschild's Conflicts of Interest Statement addressing OFS requirements for nondisclosure of TARP information and identifying and preventing organizational and personal conflicts of interest. While the statement addresses some of the same issues as the TARP conflicts-of-interest interim rule, according to OFS, since Treasury does not directly contract with Rothschild for financial advisory services, the interim rule does not apply. As of May 31, 2009 Treasury's obligations and expenses under this agreement were $7,770,000 and $4,303,000, respectively.

[86]See 74 Fed. Reg. 3431-3436 (Jan. 21, 2009).

- requirements for conflicts-of-interest training for staff working under the agreement,
- prohibitions on offers of future employment or gifts to Treasury employees, and
- requirements that conflicts-of-interest rules apply to subcontractors and consultants.

One of the two contracts was revised to include more specificity in the conflicts-of-interest mitigation plan regarding steps to mitigate potential organizational and personal conflicts, codes of ethics, and gift policies. Based on our review, the revised requirements in these contracts match those in new contracts that were awarded after the interim rule was issued.

OFS concurred with, and has taken initial steps to implement, the second recommendation that it issue guidance requiring that key communications and decisions concerning vendor-related conflicts of interest be documented, but it has yet to complete this task. OFS has drafted the process flows for the formal inquiry process, illustrating how OFS tracks and documents decisions concerning vendor-related conflicts of interest. OFS plans to discuss implementation of this process at an internal training of its contracting officer's technical representatives and financial agent relationship managers on June 23, 2009.

Indicators Generally Suggest Positive Developments in Credit Markets, but Isolating the Impact of TARP Continues to Present Challenges

While isolating and estimating the effect of TARP programs continues to present a number of challenges, indicators of perceptions of risk in credit markets generally suggest improvement since our March 2009 report, although the cost of credit has risen in some markets. As we have noted in prior reports, if TARP is having its intended effect, a number of developments might be observed in credit and other markets over time, such as reduced risk spreads, declining borrowing costs, and more lending activity than there would have been in the absence of TARP. However, a slow recovery does not necessarily mean that TARP is failing, because it is not clear what would have happened without the programs. In particular, several market factors helping to explain slow growth in lending include weaknesses in securitization markets and the balance sheets of financial intermediaries, a decline in the demand for credit, and the reduced creditworthiness among borrowers. Nevertheless, credit market indicators we have been monitoring suggest that while some rates have increased since our March 2009 report, there has been broad improvement in interbank, mortgage, and corporate debt markets in terms of perceptions of risk (as measured by premiums over Treasury securities). In addition, empirical analysis of the interbank market, which showed signs of significant stress in 2008, suggests that CPP and other programs outside TARP that were announced in October of 2008 have resulted in a statistically significant improvement in risk spreads even when other important factors were considered. Although foreclosures continue to highlight the challenges facing the U.S. economy, total mortgage originations rose roughly 70 percent over the fourth quarter of 2008. Similarly, while the Federal Reserve data show that lending standards remain tight, our analysis of Treasury's new loan survey indicate that the largest 21 CPP recipients extended roughly $260 billion, on average, each month in new loans to consumers and businesses in the first quarter of 2009.

TARP Programs Could Have a Number of Effects on Credit Markets and the Economy

In our previous reports, we highlighted the rationale for CPP, CAP, TALF, and the Home Affordability Mortgage Program (HAMP) and the intended effects of these programs. Among other improvements, the TARP programs, if effective, should jointly result in the following:

- improvement in credit market conditions, including declining risk premiums (the difference between risky and risk-free interest rates, such as rates on U.S. Treasury securities) for interbank lending and bank debt and lower borrowing costs for business and consumers.
- improvement in banks' balance sheets, enhancing lenders' ability to borrow, raise capital, and lend to creditworthy borrowers; however, as we have discussed in previous reports, tension exists between promoting lending and improving banks' capital position.
- fewer foreclosures and delinquencies than would otherwise occur in absence of TARP.
- improvements in asset-backed securities markets, a development that should increase the availability of new credit to consumers and businesses, lowering rates on credit card, automobile, small business, student, and other types of loans traditionally facilitated by securitization.

While TARP's activities could improve market confidence in participating banks and have other beneficial effects on credit markets, we have also noted in our previous reports that several factors will complicate efforts to measure any impact. For example, any changes attributed to TARP may well be changes that (1) would have occurred anyway; (2) can be attributed to other policy interventions, such as the actions of FDIC, the Federal Reserve, or other financial regulators; or (3) have been enhanced or counteracted by other market forces, such as the correction in housing markets and revaluation of mortgage-related assets. Consideration of market forces is particularly important when using bank lending as a measure of CPP's and CAP's success because it is not clear what would have happened in absence of TARP. Weaknesses in the balance sheets of financial intermediaries, a decline in the demand for credit, reduced creditworthiness among borrowers, and other market fundamentals suggest lower lending activity relative to the expansion phase of the business cycle. Similarly, nonbank financial institutions, which have accounted for a significant portion of lending activity over the past two decades, have been constrained due to weak securitization markets.[87] Because it is unlikely that any increase in loans originated by banks would completely offset the decline in nonbank activity, the weakness in securitization markets suggests that growth in aggregate lending will be slow. Success in supporting nonbank financial institutions and revitalizing the securitization market will depend in part on the success of TALF. Lastly, because the extension of credit to less-than-creditworthy borrowers appears to have been an important factor in the current financial crisis, it is not clear that lending should return to precrisis levels.

As discussed in our March 2009 report, Treasury has introduced PPIP to facilitate the purchase of legacy loans and securities. The program aims not only to reduce uncertainty about the solvency of holders of these assets but also to encourage price discovery in markets for these assets, assuming current market prices are below what they would otherwise be in a normally functioning market. The impact of PPIP will depend in particular on the pricing of the purchased assets. Sufficiently high prices will allow financial institutions to sell assets, deleverage, and improve their capital adequacy.[88] To the extent that markets are underpricing such

[87]Asset-backed security (ABS) issuance has become an important means by which financial institutions fund loans to businesses and households. However, according to Security Industry and Financial Markets Association estimates there has been very little activity in private label mortgage backed-security (MBS) or ABS markets in general, outside of MBS with government sponsorship.

[88]Prices at or below what financial institutions are currently valuing these loans or securities would provide limited incentive for them to sell. To the extent that nonrecourse funding and FDIC-guaranteed debt provide an implicit subsidy (e.g., through offering below-market loan terms) to potential buyers of legacy loans and securities, buyers would likely be willing to pay higher prices for these assets.

assets or prices are suppressed due to illiquidity, higher prices may be more reflective of the underlying value or cash flows associated with the assets (and therefore aid in price discovery). However, all other things being equal, higher prices impose certain risks on Treasury, FDIC, and the Federal Reserve if prices paid are too high, as these agencies will absorb losses beyond the equity supplied by investors. The contribution of private-sector equity capital reduces incentives to overpay for assets, depending on the proportion of equity supplied, because greater equity contributions entail greater downside risk for buyers. In addition to providing more transparent pricing to these assets, PPIP, if it is effective, should have effects broadly similar to the intended effects of CPP and CAP: improved solvency at participating institutions, reduced uncertainty about their balance sheets, and improved investor confidence, allowing these institutions to borrow and lend at lower rates and raise additional capital from the private sector.

Changes in Selected Indicators Suggest General Improvement in Credit Market Conditions, but These Changes Cannot Be Attributed Exclusively to TARP

We continue to consider a number of indicators that, although imperfect, may be suggestive of TARP's impact on credit and other markets. Improvements in these measures would indicate improving conditions, even though those changes may be influenced by general market forces and cannot be exclusively linked to any one program or action being undertaken to stabilize and improve the economy. Table 13 lists the indicators we have reported on in previous reports, as well as the changes since the March 2009 report and the changes since the announcement of CPP, the first TARP program. In general, the indicators illustrate that the cost of credit and perceptions of risk have declined in corporate debt, mortgage, and interbank markets since mid-October 2008 although the cost of credit has risen in some markets since our March 2009 report. For example, the cost of interbank credit (LIBOR) has declined by 38 basis points since our March 2009 report, and the TED spread, which captures the risk perceived in interbank markets, has declined by 57 basis points. Since the announcement of CPP, the LIBOR and TED spreads have fallen by approximately 400 basis points. Since the announcement of CPP, corporate bond spreads have declined, and there have been significant decreases of 101 and 207 basis points for high-quality (Aaa) and moderate-quality (Baa) corporate spreads, respectively, since our March 2009 report, indicating reduced risk perceptions.[89] Although the Aaa bond market rate

[89]A basis point is a common measure used in quoting yield on bills, notes, and bonds and represents 1/100 of a percent of yield. An increase from 4.35 percent to 4.45 percent would be an increase of 10 basis points.

has increased somewhat since our March 2009 report, both Aaa and Baa bond rates have declined since the announcement of CPP, indicating an decrease in the cost of credit for businesses. Similarly, the improvement in the mortgage market is consistent across rates and spreads although rates have been rising dramatically recently. Mortgage rates were up 61 basis points since our March 2009 report largely due to significant increases over the last two weeks. However, the mortgage spread is down 53 basis points. Since the announcement of CPP the improvement in the mortgage market was consistent across rates and spreads—down 87 basis points and 74 basis points, respectively. (See our December and January reports for a more detailed description and motivation for the indicators.)[90] Recent trends in these metrics are consistent with indicators monitored by GAO but not reported and those tracked by other researchers. For example, although not reported, the credit default swap index for the banking sector has declined significantly since March 2009.[91] As discussed above, changes in credit market conditions may not provide conclusive evidence of TARP's effectiveness, as other important policies, interventions, and changes in underlying economic conditions can influence these markets.

Table 13: Select Credit Market Indicators, as of June 12, 2009

Credit market rates and spreads			
Indicator	**Description**	**Basis point change since GAO March 2009 report**	**Basis point change since October 13, 2008**
LIBOR	3-month London interbank offered rate (an average of interest rates offered in dollar-denominated loans)	Down 38	Down 388
TED spread	Spread between 3-month LIBOR and 3-month Treasury yield	Down 57	Down 407
Aaa bond rate	Rate on highest quality corporate bonds	Up 22	Down 62
Aaa bond spread	Spread between Aaa bond rate and 10-year Treasury yield	Down 101	Down 61

[90] GAO-09-161 and GAO-09-296.

[91] The credit default swap (CDS) index provides an indicator of the credit risk associated with U.S. banks, as judged by the market. Therefore, declines in this index suggest lower perceived risk in the U.S. banking sector. Thompson Datastream data show that the 5-year CDS index dropped significantly after the initial passage of the act and again after the announcement of CPP, before trending up again. However, from the end of March 2009 to June 1, 2009, the bank CDS index fell by roughly 55 percent. Similarly, the Chicago Board of Option Exchange VIX index, which measures expected stock market volatility, has fallen considerably since late November 2008.

Credit market rates and spreads			
Indicator	**Description**	**Basis point change since GAO March 2009 report**	**Basis point change since October 13, 2008**
Baa bond rate	Rate on corporate bonds subject to moderate credit risk	Down 84	Down 108
Baa bond spread	Spread between Baa bond rate and 10-year Treasury yield	Down 207	Down 107
Mortgage rates	30-year conforming loans rate	Up 61	Down 87
Mortgage spread	Spread between 30-year conforming loans rate and 10-year Treasury yield	Down 53	Down 74
Quarterly mortgage volume and defaults			
Indicator	**Description**	**Change from December 31, 2008 to March 31, 2009 (latest available date)**	
Mortgage originations	New mortgage loans	Up $185 billion to $445 billion	
Foreclosure rate	Percentage of homes in foreclosure	Up .55 basis points to 3.85 percent	

Sources: GAO analysis of data from Global Insight, *Inside Mortgage Finance*, and Thomson Datastream.

Note: Rates and yields are daily, except for mortgage rates, which are weekly. Higher spreads (measured as premiums over Treasury securities of comparable maturity) represent higher perceived risk in lending to certain borrowers. Higher rates represent increases in the cost of borrowing for relevant borrowers. As a result "down" suggests improvement in market conditions for credit market rates and spreads. Foreclosure rate and mortgage origination data are quarterly. See previous TARP reports for a more detailed discussion (GAO-09-161 and GAO-09-296).

To examine further whether the decline in the TED spread could be attributed in part to CPP, we conducted additional analysis using a simple econometric model to address one of the most obvious threats to validity. Because the TED spread reached extreme values leading up to the CPP announcement (over 450 basis points), it is possible there would have been declines from these peaks even in the absence of CPP simply because extreme values have a tendency to return to normal levels.[92] However, even when we accounted for this possibility and the general state of the economy using variables such as stock market performance and the spread between long- and short-term Treasuries, we found that CPP, announced on October 14, 2008, had a statistically significant

[92]This phenomenon is often referred to as "regression to the mean" or "regression artifacts." Failure to acknowledge this phenomenon can lead to invalid inferences about a program's impact when analyzing time series data. We found that since 1982 the TED spread exceeded 200 basis points only 3.2 percent of the time, underscoring the fact that 450 basis points is extreme and indicates the significant stress present in the interbank market at the time of the CPP announcement.

negative impact on changes in the TED spread.[93] Even so, the associated improvement in the TED spread (or LIBOR) cannot be attributed solely to TARP because the October 14 announcement was a joint announcement that introduced other Federal Reserve and FDIC programs in addition to CPP. Moreover, the model we used is relatively simple and did not attempt to account for all of the important factors that might influence the TED spread. Omitting such variables could bias the results in unpredictable ways. (See appendix III for additional information and limitations.)

We continue to monitor mortgage originations and foreclosures as potential measures of TARP's effectiveness. As table 13 indicates, mortgage originations increased over 70 percent, from $260 billion in the fourth quarter of 2008 to $445 billion in the first quarter of 2009 (see also fig. 5). We noted in previous reports that if TARP worked as intended, we expected mortgage originations to stop declining and eventually rise.[94] While the volume of new mortgage lending may reflect the availability of credit, it may also indicate changes in credit risk or the demand for credit. As figure 5 illustrates, mortgage applications also increased in the first quarter, principally due to refinancing.[95] Although originations were still below the level in the first quarter of 2008, it is not clear that originations would or should return to the level seen in the period leading up to the credit market turmoil. Similarly, foreclosure data, although also influenced by general market forces like falling housing prices and job loss, should provide an indication of the effectiveness of HAMP and CPP to the extent that improved market conditions enhance the ability of creditworthy

[93]The model used changes in the TED spread as the dependent variable regressed on a CPP indicator variable, a time trend, lagged values of changes in the S&P 500, the term spread (structure), and the default risk premium—a dummy variable that denoted whether the TED spread exceeded 200 basis points—as well as a counter variable that indicated the number of consecutive days, including the day in question, that the TED spread became extreme. However, the results were robust to a number of different econometric specifications, including a two-stage approach that allowed us to generate the unexpected value of the TED spread (as well as other spreads variables) by extracting the predictable component from the variables using an autoregression model fit to each series. Like our primary regressions modeling changes in the TED spread, the CPP indicator variable had a statistically significant impact on the unexpected level of the TED spread, even when we controlled for other potentially confounding factors.

[94]It should also be noted that the increase in mortgage activity coincides with a drop in mortgage rates associated with the Federal Reserve's expanded program for the purchase of agency MBS.

[95]The mortgage application index is not seasonally adjusted here, to provide a more appropriate comparison to the unadjusted mortgage origination data.

borrowers to refinance mortgages. However, it is too soon to expect material changes in this area given that HAMP was only recently implemented. As table 13 shows, the percentage of loans in foreclosure reached an unprecedented high of 3.9 percent at the end of the first quarter of 2009, up from 3.3 percent the previous quarter. The foreclosure rate on subprime loans rose to 14.3 percent from 13.7 percent (the rate for adjustable-rate subprime loans is now over 23 percent). We will provide additional information on foreclosures and general conditions in mortgage markets in future TARP-related and other reports to Congress.

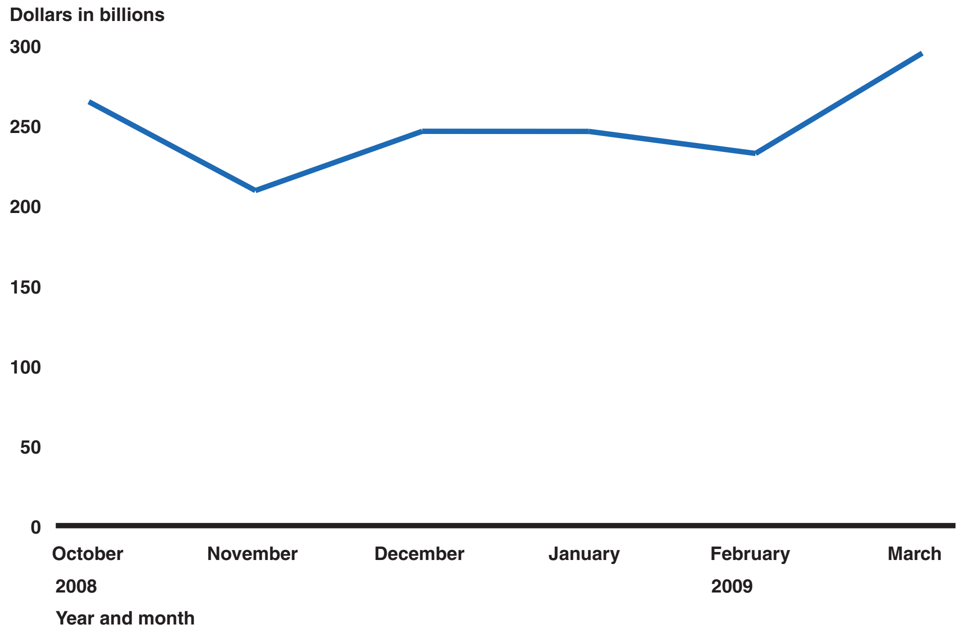
Figure 5: Mortgage Applications and Originations, First Quarter of 2004 through First Quarter of 2009

Sources: *Inside Mortgage Finance* estimates and Global Insight.

New Lending at the 21 Largest Participants in CPP

Our analysis of Treasury's loan survey showed that the largest CPP recipients continued to extend loans to consumers and businesses, roughly $260 billion on average each month in 2009. Because these data are unique, we were not able to benchmark the origination levels against historical lending or seasonal patterns at these institutions. As illustrated in figure 6, new lending at the 21 largest institutions participating in CPP fell 6 percent in February and rose 27 percent in March, month over month.[96]

Figure 6: Total New Lending at the 21 Largest Recipients of CPP, from October 1, 2008, through March 2009



Source: GAO analysis of Treasury loan survey data.

Note: Lending levels may be affected by merger activity.

Although lending normally drops during a recession and lending standards for consumer and business credit remained tight, our analysis of the April 2009 release of the Federal Reserve's loan officer survey found that aggregate new lending by these institutions in March amounted to roughly $295 billion (see table 14), or 41 percent higher than the low recorded in

[96]New lending includes new home equity lines of credit; mortgage, credit card, and other consumer originations; new or renewed commercial and industrial loans, and commercial real estate loans.

November 2008.[97] Consistent with the trends in aggregate mortgage originations discussed above, total mortgage originations for the largest CPP banks rose 15 percent to roughly $117 billion.[98] The reporting institutions generally received CPP funds on October 28, 2008, or November 14, 2008, with a few institutions receiving funds on December 31, 2008, or January 9, 2009.

Table 14: New Lending at the 21 Largest CPP Recipients, First Quarter of 2009, by Institution

Dollars in millions

			New lending		
Institution	**Date of CPP**	**Size of CPP**	**January**	**February**	**March**
Citigroup, Inc.	10/28/2008	$25,000	$18,814	$14,692	$18,945
JPMorgan Chase	10/28/2008	25,000	46,785	39,543	65,445
Wells Fargo Bank	10/28/2008	25,000	50,560	56,051	64,810
Bank of America	10/28/2008	15,000	60,624	58,201	66,031
Goldman Sachs	10/28/2008	10,000	6,487	744	3,631
Morgan Stanley	10/28/2008	10,000	3,551	2,614	4,022
Bank of New York Mellon	10/28/2008	3,000	730	816	360
State Street	10/28/2008	2,000	289	1,170	1,457
U.S. Bancorp	11/14/2008	6,599	13,866	13,256	16,272
Capital One	11/14/2008	3,555	2,531	2,275	2,344
Regions	11/14/2008	3,500	4,983	4,867	5,800
SunTrust	11/14/2008	3,500	6,511	7,585	8,875
BB&T	11/14/2008	3,134	5,976	6,399	7,202
KeyCorp	11/14/2008	2,500	3,065	2,241	2,501
Comerica	11/14/2008	2,250	1,425	1,661	2,534
Marshall & Ilsley	11/14/2008	1,715	960	898	884

[97]The Federal Reserve Senior Loan Officer survey asks senior loan officers at U.S. banks about changes in lending standards, lending terms, and the state of business and household demand for loans (see our March report for additional information or http://www.federalreserve.gov/boarddocs/snloansurvey/). The most recent survey conducted in April 2009 suggests that although the percentage of banks tightening credit remains above previous peaks, the net percentage of respondents reporting having tightened their credit standards in approving applications has continued to trend downward from the October 2008 survey for most business and consumer loans.

[98]This trend occurred even though the net percentage of banks that tightened lending standards actually increased for prime and nontraditional mortgages from January to April 2009 according to Federal Reserve Senior Loan Officer Surveys.

Dollars in millions					
			New lending		
Institution	**Date of CPP**	**Size of CPP**	**January**	**February**	**March**
Northern Trust	11/14/2008	1,576	1,270	1,278	1,641
PNC	12/31/2008	7,579	8,170	7,991	9,851
FifthThird Bancorp	12/31/2008	3,408	5,070	5,467	7,082
CIT	12/31/2008	2,330	3,429	3,497	3,832
American Express	1/9/2009	3,389	889	845	1,303
Total		**$160,035**	**$245,984**	**$232,089**	**$294,822**

Source: GAO analysis of Treasury loan survey.

Note: The table features the 21 largest recipients of CPP funds that had received funds as of March 31, 2009. New lending includes new home equity lines of credit; mortgage, credit card, and other consumer originations; new or renewed commercial and industrial loans; and commercial real estate loans. However, new lending does not include other important activities that these institutions may undertake to facilitate credit intermediation, including underwriting and purchasing MBS and ABS. In addition, lending levels may be affected by merger activity. Date and size of CPP refers to the initial infusion of CPP funds. Citigroup and Bank of America have received additional TARP funds.

Automobile Lending

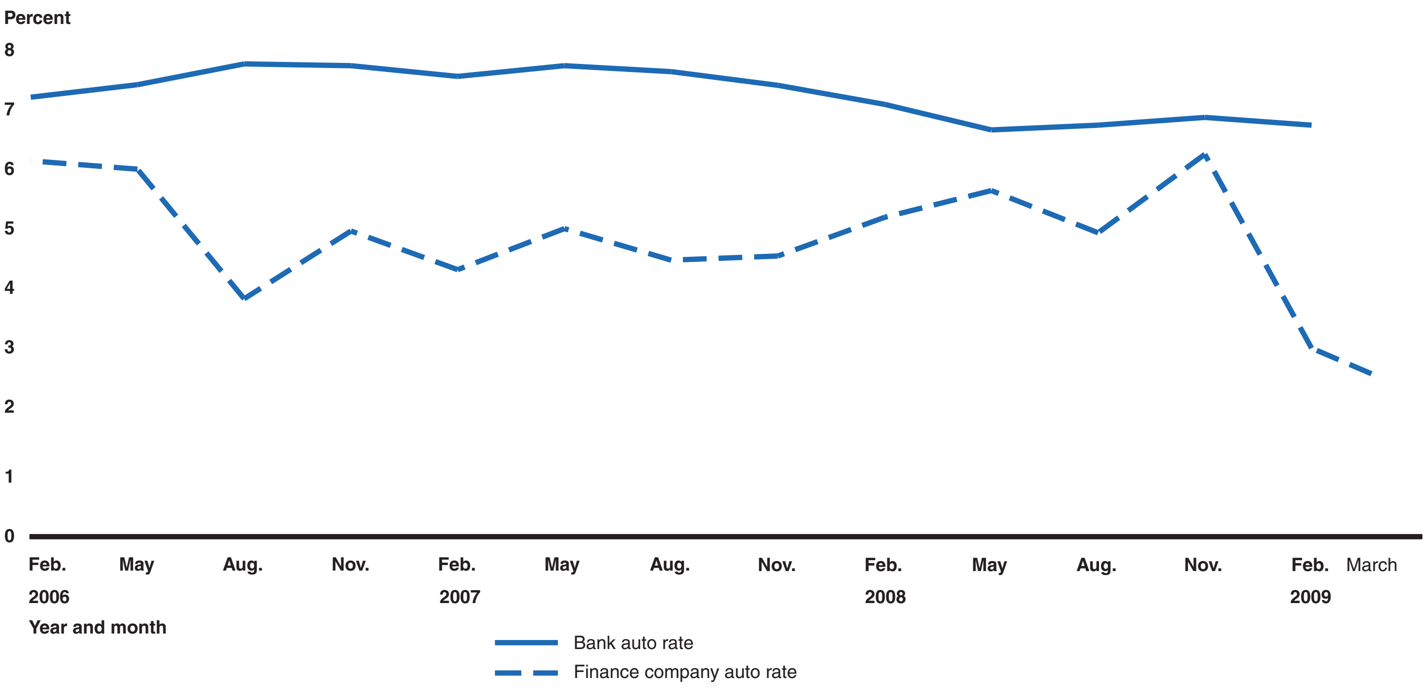
As we discussed in the March report, TALF support to securitization markets should, if effective, result in lower rates and increased availability of credit for the businesses and households that receive the underlying loans. The primary consumer ABS markets include ABS backed by auto loans, credit card receivables, and student loans. Although TALF is in its beginning stages, we have begun monitoring lending activity at the institutions most likely to be impacted by conditions in securitization markets. For example, because stand-alone auto finance companies are more heavily reliant on securitization than commercial banks, we noted that changes in the trends in their automobile loan rates could partially reflect the issues in securitization markets that TALF is intended to address.[99] As figure 7 shows, the average finance company auto rate has been consistently below commercial bank auto rates. However, from August to November 2008 the average finance company rate increased significantly, rising by 132 basis points, while the average bank rate increased just slightly (13 basis points).[100] In contrast, from November 2008 to February 2009, the finance company rate declined significantly

[99]However, changes in these trends could also reflect the success of the CPP (or CAP) in lowering or preventing a rise in bank auto rates. Note also that the bank rate reflects 48-month loans, while the average maturity for the finance rate is between 59 and 67 months over the time period surveyed.

[100]Although not included in the figure because comparable data were not available for the banks, the finance rate increased to 8.42 percent in December 2008.

(326 basis points) to 3.2—well below the bank rate, which fell only 13 basis points. The average rate for new automobile loans at finance companies declined another 43 basis points to 2.74 percent during March.[101] While these declines correlate with the launching of TALF, the finance rate could also reflect the attempt by auto finance companies to attract buyers in a weak market, as well as other forces. We will continue to monitor these trends as well as data on credit card debt and other consumer and business loan markets. Moreover, because TALF has been expanded to other assets, including commercial MBS, other measures of lending activity and loan rates may become more appropriate indicators as time progresses.

Figure 7: Average Finance Rate for New Cars at Auto Finance Companies and Banks, from February 1, 2006, through March 2009



Source: GAO analysis of Federal Reserve data.

Note: Bank finance rate reflects 48-month loans, while the average maturity for the finance company rate is between 59 and 67 months.

[101]March data were unavailable for commercial bank auto rates for inclusion in this report.

Conclusions

Treasury has continued to take steps to refine some TARP programs and finalize others. In doing so, it has taken steps to address our previous recommendations. Some areas, however, require ongoing attention. For example, Treasury has hired the asset managers that will have a role in monitoring compliance with the terms of CPP and other programs, but it is continuing to develop a comprehensive oversight program for all TARP program recipients. Consistent with our recommendation for greater disclosure of monies paid to Treasury by TARP participants, Treasury now includes dividends and interest received in its periodic reports to Congress that are also posted to the www.financialstaility.gov Web site and plans to provide dividend information by institution on the Web site. OFS has also made progress in filling key positions in most areas but some vacancies continue to be more challenging to fill. Finally, Treasury has made additional progress in improving its communication strategy, including hiring an individual who will be responsible for managing OFS's relationships with Congress, among other duties, but continued progress in this area would further improve the transparency of the program. Appendix II provides our assessment of Treasury's implementation of our previous recommendations.

Since our March 2009 report, Treasury has hired its first asset managers to help manage its investment portfolio and help monitor compliance with limitations on dividend payments and stock repurchases. However, Treasury has yet to clearly identify the role that asset managers will have in monitoring compliance; it has only noted that the asset managers will have a limited role in the area of executive compensation oversight. While hiring these managers is an important step, Treasury has yet to develop a structured process to oversee compliance with program requirements and the act. As noted in prior reports, we will continue to monitor developments in this area, which is critical to ensuring the accountability and integrity of the program.

The Federal Reserve's completion of the stress tests for the 19 largest bank holding companies was a significant milestone for CAP. While stress test results revealed that about half of the banks needed to raise additional capital to ensure their ability to continue lending to creditworthy borrowers and maintain sufficient capital against losses, it remains unclear whether any of the institutions will have to use CAP to raise additional capital. The results of the stress test provided a rare glimpse into the condition of these institutions, but questions have been raised about the stress test assumptions, given the ongoing challenges in financial markets. Moreover, the Federal Reserve does not plan to provide any additional information on the condition of the banks over the next 18 months that could show whether the banks had met their projected performance and loss levels. The extent to which the institutions will disclose additional information is unclear. As a result, the information provided could be selective and difficult to compare across institutions, raising questions not only about transparency of SCAP but also CAP. Moreover, the Federal Reserve did not provide OFS staff with information about SCAP prior to its public release and has no plans to share ongoing information about any of the SCAP institutions that continue to be CPP or CAP participants. Without such information, OFS lacks information needed to adequately monitor these programs.

Although several banks have repurchased or announced plans to repurchase their preferred shares and warrants, the regulators' repurchase approval criteria have lacked adequate transparency. The Federal Reserve has provided criteria for the 19 largest bank holding companies, but the other regulators have not consistently provided details about how they have made repurchase determinations and how they will make future determinations. Clearly articulated and consistently applied criteria are indicative of a robust decision-making process, and without them, Treasury's ability to help ensure consistent treatment of institutions requesting repurchase of their shares is limited.

Similarly, Treasury has provided limited information about the warrant repurchase process on its www.financialstability.gov Web site. We recognize the challenges associated with valuing warrants in the absence of readily available markets for these instruments. For this reason, and because the valuation process can be assumption driven, a well-designed, fully vetted transparent process becomes critical to defusing questions about the warrant valuation process and whether the resulting prices paid by the institutions reflect the taxpayers' best interests. While Treasury has provided some limited information about the valuation process, it has yet to provide the level of transparency at the transaction level that would begin to address such questions. Additional information, such as the institution's initial offer and Treasury's final valuation, would begin to address some of these issues.

Treasury has taken steps toward implementing a communication strategy, such as developing a new Web site and developing a media relations position dedicated to TARP. Treasury has also included its public affairs and legislative affairs staff in regular meetings with OFS to ensure that communication and operations are better integrated. However, Treasury's current communication strategy may not be as effective as it could be. Treasury has recognized the importance of reaching out to congressional stakeholders on a regular and proactive basis and planned to do more to ensure that all committees of jurisdiction receive regular communication about TARP. However, until this strategy is fully implemented, congressional stakeholders may not receive information in a consistent or timely manner. In addition, although Treasury has said that the new www.financialstability.gov Web site is a key component of its efforts to improve communication on TARP, it has not yet taken steps to determine whether the site is user-friendly or whether visitors to the site are finding the information they seek. Usability testing and customer satisfaction surveys are recognized best practices for improving the usefulness of Web sites. While Treasury is in the process of exploring the use of such tools, these efforts should be implemented as quickly as possible to gauge the effectiveness of its communication efforts.

Treasury has continued to make progress in establishing its management infrastructure and has responded to our two most recent contracting recommendations and continued to respond to the others.

- In the hiring area, Treasury has continued to establish its management infrastructure, including hiring more staff. In accordance with our prior recommendation that it expeditiously hire personnel to OFS, Treasury continued to use direct-hire and various other appointments to bring a number of career staff on board quickly. Since our March 2009 report, Treasury has continued to increase the total number of OFS staff overall, including the number of permanent staff. However, continued attention to hiring remains important because some offices within OFS, such as the offices of Homeownership and Risk and Compliance, continue to have a number of vacancies that need to be filled as TARP programs become fully implemented.

- In the internal controls area, consistent with our previous report recommendation that Treasury update guidance available to the public on determining warrant exercise prices to be consistent with actual practices applied by OFS, Treasury updated its frequently asked questions on its Web site to clarify the process it follows for determining the prices. However, there continues to be inconsistent guidance available on the Web site for calculating the exercise prices. Treasury told us that any new CPP applicants would most likely be non-public institutions for which these guidance documents would not apply. As such, Treasury does not believe the inconsistent guidance is a significant issue and therefore does not plan on further addressing the inconsistency. If this warrant exercise price guidance is no longer needed, then we believe that Treasury should remove these guidance documents from its Web site to alleviate any inconsistent descriptions of its process pertaining to warrant exercise price calculations for public institutions. If Treasury chooses to leave the documents on its Web site, then, as we previously recommended, Treasury should make these documents consistent with respect to the warrant exercise price calculations.

- Treasury has continued to build a network of contractors and financial agents to support TARP administration and operations and has an opportunity to enhance transparency through its existing reporting mechanisms. Treasury issues a number of reports and uses other mechanisms, such as public announcements and its Web site, to provide information to the public. Useful details are still lacking, however, on the costs of procurement contracts and financial agency agreements, such as a breakdown obligated and expenses for each entity. These contracts and agreements are key tools OFS has used to help develop and administer its TARP programs. By not providing this information, Treasury is missing an opportunity to provide additional transparency about the cost of TARP operations.

Finally, while again noting the difficulty of measuring the effect of TARP's activities, some indicators suggest general improvements in various markets since our March 2009 report although the cost of credit has risen in some cases. Specifically, the Baa corporate bond rate and LIBOR have declined but mortgage and Aaa bond rates have risen. However, perceptions of risk in credit markets (as measured by premiums over Treasury securities) have decreased in interbank, mortgage, and corporate bond markets, while total mortgage originations have increased. Empirical analysis of the interbank market, which showed signs of significant stress in 2008, suggests that CPP and other programs outside of TARP that were announced in October 2008 resulted in a statistically significant improvement in risk spreads, even when other important factors were considered. In addition, although Federal Reserve survey data suggest that lending standards remained tight, collectively the largest CPP recipients extended roughly $260 billion on average each month in new loans to consumers and businesses in the first quarter of 2009, according to the Treasury's loan survey. However, attributing any of these changes directly to TARP continues to be problematic because of the range of actions that have been and are being taken to address the current crisis. While these indicators may be suggestive of TARP's ongoing impact, no single indicator or set of indicators can provide a definitive determination of the program's impact.

Recommendations for Executive Action

While the Department of the Treasury has taken actions to address our previous recommendations, we continue to identify areas that warrant ongoing attention and focus. Therefore, we recommend that Treasury take the following five actions as it continues to improve TARP and make it more accountable and transparent:

- Ensure that the warrant valuation process maximizes benefits to taxpayers and consider publicly disclosing additional details regarding the warrant repurchase process, such as the initial price offered by the issuing entity and Treasury's independent valuations, to demonstrate Treasury's attempts to maximize the benefit received for the warrants on behalf of the taxpayer.

- In consultation with the Chairmen of the Federal Deposit Insurance Corporation and the Federal Reserve, the Comptroller of the Currency, and the Acting Director of the Office of Thrift Supervision, ensure consideration of generally consistent criteria by the primary federal regulators when considering repurchase decisions under TARP.

- Fully implement a communication strategy that ensures that all key congressional stakeholders are adequately informed and kept up to date about TARP.

- Expedite efforts to conduct usability testing to measure the quality of users' experiences with the financial stability Web site and measure customer satisfaction with the site, using appropriate tools such as online surveys, focus groups, and e-mail feedback forms.

- Explore options for providing to the public more detailed information on the costs of TARP contracts and agreements, such as a dollar breakdown of obligations and/or expenses.

Finally, to help improve the transparency of CAP—in particular the stress tests results—we recommend that the Director of Supervision and Regulation of the Federal Reserve consider periodically disclosing to the public the aggregate performance of the 19 bank holding companies against the more adverse scenario forecast numbers for the duration of the 2-year forecast period and whether or not the scenario needs to be revised. At a minimum, the Federal Reserve should provide the aggregate performance data to OFS program staff for any of the 19 institutions participating in CAP or CPP.

Agency Comments and Our Evaluation

We provided a draft of this report to Treasury for review and comment. We also provided excerpts of the draft to the FDIC, Federal Reserve, OCC, and OTS. We received written comments from Treasury that are reprinted in Appendix I. The Federal Reserve provided oral comments, which we discuss later. We also received technical comments from Treasury, the Federal Reserve, and FDIC that we incorporated, as appropriate.

In its written comments, Treasury described steps it had taken in the last 60 days to address the extraordinary economic challenges, including the Treasury financed restructurings of GM and Chrysler among others. Treasury also noted the progress it has made in addressing our previous recommendations. It also noted that the recommendations in this report were constructive as it implements its programs and enhances OFS's performance. Moreover, they said several initiatives underway are consistent with our recommendations. According to Treasury, among other things, it is in the process of expanding its public disclosure about the warrant repurchase process, implementing a communication strategy that will provide all key congressional stakeholders more current information about TARP, and planning a usability test to measure satisfaction with its new Web site. We will continue to monitor Treasury's progress in implementing these and other planned initiatives in future reports.

On June 12 and 15, 2009, we received oral comments from the Senior Advisor to the Director of the Division of Banking Supervision and Regulation on excerpts of the draft pertaining to the Federal Reserve. The official expressed concern that our recommendation to consider periodically disclosing aggregate information to the public on the performance of the 19 U.S. bank holding companies against the more adverse scenario would be operationally difficult and potentially misleading. Specifically, the official said the SCAP loss estimates were developed as aggregate 2-year estimates, without attempting to forecast the quarter-to-quarter path of such losses over the 2009 to 2010 period. Further, the official expressed concern that the size and character of the bank holding companies' on- and off-balance sheet exposures may change materially over the 2-year period and that the Federal Reserve never intended that the one-time SCAP estimates be used as a tool for measuring U.S. bank holding company performance during the 2009 to 2010 period.

We understand that while this analysis would pose some operational challenges for the Federal Reserve because the exercise was intended to calculate a one-time capital buffer needed to withstand a more adverse economic scenario and that the on-and off-balance sheet exposure of the

19 institutions may change materially over time. However, given the dynamic economic environment, we see great value in periodically measuring and reporting U.S. bank holding company performance against the adverse scenario and whether the adverse scenario is more or less adverse compared against changing economic conditions. Although this would periodically require additional calculations, we believe this analysis would provide useful trend information on the aggregate health of these important institutions. As we previously stated, without such analysis, the public will not have reliable information that can be used to gauge the accuracy of the stress test projections on a more detailed basis than what has been disclosed in the SCAP papers. Further, it could counter any adverse affect of any selective reporting by individual institutions. Finally, such periodic reporting would be useful in the measurement of the effectiveness of SCAP and CAP.

We are sending copies of this report to the Congressional Oversight Panel, Financial Stability Oversight Board, Special Inspector General for TARP, interested congressional committees and members, Treasury, the federal banking regulators, and others. The report also is available at no charge on the GAO Web site at http://www.gao.gov.

If you or your staffs have any questions about this report, please contact Richard J. Hillman at (202) 512-8678 or hillmanr@gao.gov, Thomas J. McCool at (202) 512-2642 or mccoolt@gao.gov, or Orice Williams Brown at (202) 512-8678 or williamso@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix VI.

Gene L. Dodaro
Acting Comptroller General
of the United States

List of Committees

The Honorable Daniel K. Inouye
Chairman
The Honorable Thad Cochran
Vice Chairman
Committee on Appropriations
United States Senate

The Honorable Christopher J. Dodd
Chairman
The Honorable Richard C. Shelby
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable Kent Conrad
Chairman
The Honorable Judd Gregg
Ranking Member
Committee on the Budget
United States Senate

The Honorable Max Baucus
Chairman
The Honorable Charles E. Grassley
Ranking Member
Committee on Finance
United States Senate

The Honorable David R. Obey
Chairman
The Honorable Jerry Lewis
Ranking Member
Committee on Appropriations
House of Representatives

The Honorable John M. Spratt, Jr.
Chairman
The Honorable Paul Ryan
Ranking Member
Committee on the Budget
House of Representatives

The Honorable Barney Frank
Chairman
The Honorable Spencer Bachus
Ranking Member
Committee on Financial Services
House of Representatives

The Honorable Charles B. Rangel
Chairman
The Honorable Dave Camp
Ranking Member
Committee on Ways and Means
House of Representatives

Appendix I: Comments from the Department of the Treasury

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

June 15, 2009

Thomas J. McCool
Director, Center for Economics
Applied Research and Methods
U.S. Government Accountability Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. McCool:

The Treasury Department (Treasury) appreciates the opportunity to review GAO's latest report on Treasury's Troubled Assets Relief Program, entitled *June 2009 Status of Efforts to Address Transparency and Accountability Issues.* Treasury welcomes the recognition by the GAO that Treasury "has taken steps to address our previous recommendations" as it continues to refine, finalize and implement its financial stability programs and improve the Office of Financial Stability's (OFS) procedures and operations. There is important work ahead, and GAO's recommendations are a thoughtful step forward.

Treasury has made significant progress in the last sixty days to address extraordinary financial sector and economic challenges. In order to prevent collapse of the systemically significant automotive industry, Treasury financed the restructurings of General Motors and Chrysler, and provided support for their automotive suppliers, vehicle warranties and automotive finance companies. The Term Asset Backed Lending Facility (TALF), which has already stimulated increased securitization activity, was expanded to provide liquidity for commercial mortgage loans and insurance premium financing, and TALF loan terms were extended for certain asset classes. Treasury finalized and completed transactions that improved the capital structures of AIG and Citigroup and made available additional capital to AIG. Treasury also made significant progress toward selecting fund managers and finalizing investment terms and conflict rules for Public-Private Investment Partnerships, which are intended to catalyze markets for the legacy assets that currently clog bank balance sheets. In addition to launching these new programs, Treasury continued to make investments in viable institutions through the Capital Purchase Program, while extending the application deadline and increasing maximum funding levels for small banks and finalizing investment terms for mutual institutions.

In taking these actions to stabilize the financial system and restore the flow of credit, Treasury remained focused on addressing GAO's recommendations in the last report. Treasury made significant progress in implementing every GAO recommendation. Notably, Treasury expanded its lending survey of CPP participants to include all CPP banks, meeting a key GAO request, while continuing to publish and also expand its survey on the lending and intermediation activities of the largest banks. Treasury also made considerable progress on other GAO recommendations, including the following important measures: OFS increased its permanent staff by more than 50%; refined and began using its internal controls framework to guide establishment of controls for new programs; developed a prioritized risk matrix and began implementing plans to eliminate or mitigate risks; hired and trained additional staff to oversee contractor performance; renegotiated contracts to standardize conflict-of- interest requirements and formalized procedures for dealing with conflict-of-interest inquiries. Treasury also continued to make progress on the GAO recommendation to improve its communications with Congress and the public. In addition to expanding the content of Treasury's FinancialStability.gov website, Treasury became more proactive in briefing its oversight bodies and Congress, including by conducting pre-release briefings on stress test results, auto industry announcements, and program design issues and initiating what is expected to be a series of regular monthly briefings for Congressional staff.

The recommendations in GAO's latest report are constructive as Treasury continues to implement its financial stability programs and enhance OFS performance. The GAO recommendations also track several initiatives that Treasury is already undertaking. Among other things, Treasury is in the process of preparing expanded public disclosure about the warrant repurchase process, implementing a communication strategy that will provide all key congressional stakeholders more current information about TARP, and planning for usability testing to measure customer satisfaction with its new Web site.

Once again, Treasury appreciates the opportunity to review the report and GAO's thoughtful recommendations. We look forward to demonstrating further progress in your next report.

Sincerely,

Duane D. Morse
Chief Risk and Compliance Officer

Appendix II: Status of Prior GAO Recommendations

GAO recommendations	Status
December 2, 2008, report	
Work with the bank regulators to establish a systematic means of monitoring and reporting whether financial institutions' activities are generally consistent with the purposes of CPP and help ensure an appropriate level of accountability and transparency.	Implemented
Develop a means to ensure that institutions participating in CPP comply with key program requirements (for example, executive compensation, dividend payments, and the repurchase of stock).	Partially implemented
Formalize the existing communication strategy to ensure that external stakeholders, including Congress, are informed about the program's current strategy and activities and understand the rationale for changes in this strategy to avoid information gaps and surprises.	Partially implemented
Facilitate a smooth transition to the new administration by building on and formalizing ongoing activities, including ensuring that key Office of Financial Stability (OFS) leadership positions are filled during and after the transition.	Implemented
Expedite OFS's hiring efforts to ensure that Treasury has the personnel needed to carry out and oversee Troubled Asset Relief Program (TARP).	Partially implemented
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.	Implemented
Continue to develop a comprehensive system of internal control over TARP, including policies, procedures, and guidance that are robust enough to protect taxpayers' interests and ensure that the program objectives are being met.	Partially implemented
Issue final regulations on conflicts of interest involving Treasury's financial agents, contractors, and their employees and related entities as expeditiously as possible, and review and renegotiate vendor mitigation plans, as necessary, to enhance specificity and compliance with the new regulations once they are issued.	Partially implemented
Institute a system to effectively manage and monitor the mitigation of vendor-related conflicts of interest.	Implemented
January 30, 2009 report	
Expand the scope of planned monthly CPP surveys to include collecting at least some information from all institutions participating in the program.	Implemented
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.	Partially implemented
Establish a process to ensure compliance with all CPP requirements, including those associated with limitations on dividends and stock repurchase restrictions.	Partially implemented
Communicate a clearly articulated vision for TARP and how all individual programs are intended to work in concert to achieve that vision. This vision should incorporate actions to preserve homeownership. Once this vision is clearly articulated, Treasury should document needed skills and competencies.	Partially implemented
Continue to expeditiously hire personnel needed to carry out and oversee TARP.	Partially implemented
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.	Implemented
Develop a comprehensive system of internal control over TARP activities, including policies, procedures, and guidance that are robust enough to ensure that the program's objectives and requirements are met.	Partially implemented
Develop and implement a well-defined and disciplined risk-assessment process, as such a process is essential to monitoring program status and identifying any risks of potential inadequate funding of announced programs.	Partially implemented

GAO recommendations	Status
Review and renegotiate existing vendor conflict-of-interest mitigation plans, as necessary, to enhance specificity and conformity with the new interim conflicts-of-interest regulation, and take continued steps to manage and monitor conflicts of interest and enforce mitigation plans.	Partially implemented
March 31, 2009 report:	
Develop a communication strategy that includes building an understanding and support for the various components of the program. Specific actions could include hiring a communications officer, integrating communications into TARP operations, scheduling regular and ongoing contact with congressional committees and members, holding town hall meetings with the public across the country, establishing a counsel of advisers, and leveraging available technology.	Partially implemented
Require that AIG seek concessions from stakeholders, such as management, employees, and counterparties, including seeking to renegotiate existing contracts, as appropriate, as it finalizes the agreement for additional assistance.	Closed, not implemented
Update OFS documentation of certain internal control procedures and the guidance available to the public on determining warrant exercise prices, to be consistent with actual practices applied by OFS.	Partially implemented
Improve transparency pertaining to TARP program activities by reporting publicly the monies, such as dividends, paid to Treasury by TARP participants.	Implemented
Complete the review of, and as necessary renegotiate, the four existing vendor conflicts-of-interest mitigation plans to enhance specificity and conformity with the new interim conflicts-of-interest rule.	Partially implemented
Issue guidance requiring that key communications and decisions concerning potential or actual vendor-related conflicts of interest be documented.	Partially implemented

Source: GAO.

Appendix III: Econometric Analysis of TED Spread

We conducted an econometric analysis to assess the impact of Capital Purchase Program (CPP) on the TED spread. Our multivariate econometric model uses a standard interrupted time series design using daily data on the TED spread. In lieu of relying on graphing and identifying trends in the data before and after the announcement, the goal of this exercise was to determine whether the large decline in the TED spread could be associated with CPP in a statistically significant way when other important variables were also considered, including a time trend and a variable thought to control for the tendency of extreme values to revert to more normal levels. To carry out the exercise as validly as possible, we conducted tests to ensure the stationarity of the variables in the model, used heteroskedasticity and autocorrelation-consistent (HAC) standard errors and conducted sensitivity analysis.[1]

The primary regressions model changes in the TED spread as a function of lagged values of changes in the term structure (spread between short- and long-term bonds), default spread (spread between lower quality and higher quality bonds), target federal funds rate, and the S&P 500, as well as a variable that indicates whether CPP was in place (starting with the announcement date). We also include a time trend, an indicator variable that indicates whether the TED spread was at an extreme value the day before (defined as 200 basis points or greater) and a counter variable that indicated the number of consecutive days, including the day in question, that the TED spread had taken on an extreme value. The latter variable was included to control for a potential "regression to the mean" effect. As a robustness check, we also ran a variation of the model using a two-step procedure where we (1) extract the predictable component from the TED spread, term structure and default risk premium and (2) use the unpredicted spreads in the regression. We also ran the model on various time periods. In all cases, we found CPP to have a statistically significant impact on the TED spread. However, it should be noted that we did not attempt to capture all potential factors that might explain movements in the TED spread, and, therefore, omitted variable bias remains a concern. Moreover, since other programs were put in place from October 2008 to

[1]It has been shown that carrying out an HAC adjustment in an event study context with dichotomous event variables (pulse dummies) can result in inconsistent standard errors and spurious findings under certain conditions. For example, see T. Fromby and J. Murfin, "Inconsistency of HAC Standard Errors in Event Studies with i.i.d. errors," *Applied Financial Letters*, vol. 1 (2005). Our results were not sensitive to this adjustment; however, the correction did result in smaller standard errors and larger t-statistics for the CPP variable.

February 2009, further analysis that attempts to control for these interventions would provide more definitive results.

Appendix IV: Overview of Treasury's CPP Repurchase Process

As participants have started to repay their assistance as permitted by the Emergency Economic Stabilization Act of 2008 (the act), as amended by the American Recovery and Reinvestment Act of 2009, the Department of the Treasury (Treasury) has developed standard processes for each type of security. The following provides an overview of the repurchase process for preferred shares and subordinated debt and warrants.

Preferred Stock and Subordinated Debt Repurchase Process

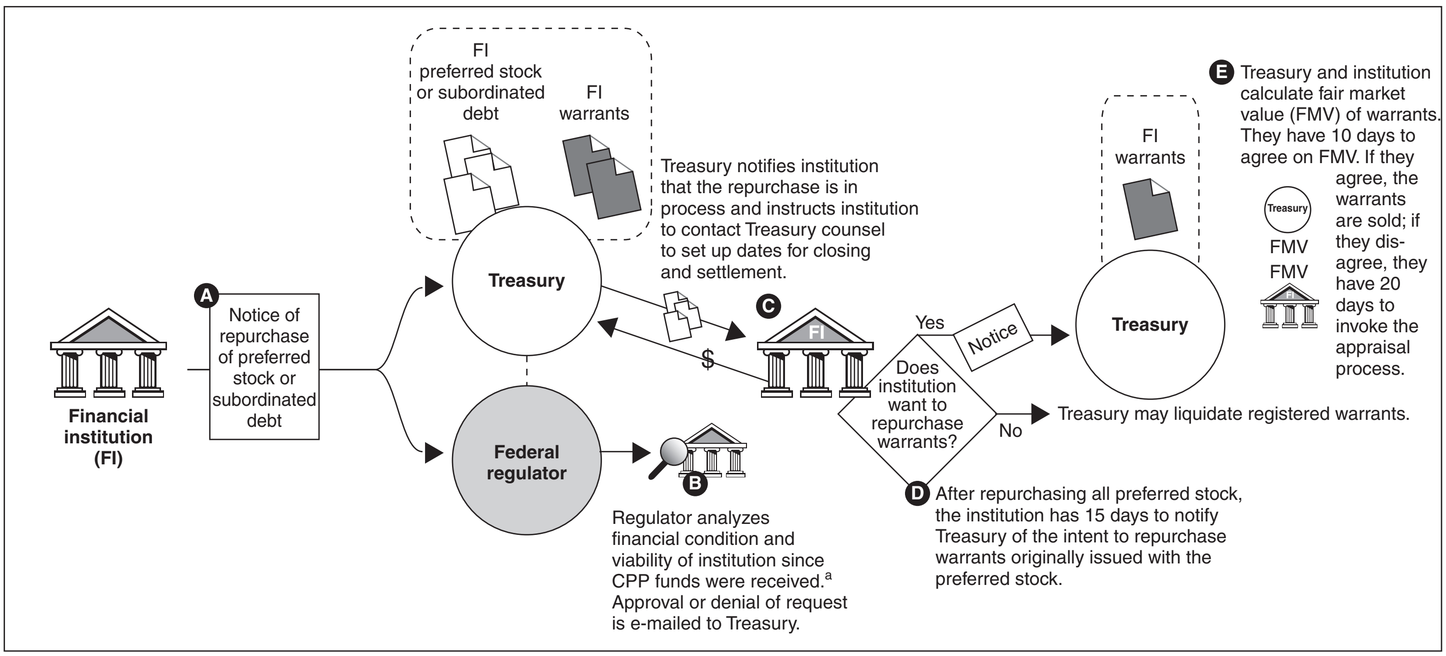
In a repurchase, the financial institution buys back preferred stock or subordinated debt from Treasury that was issued under Treasury's Capital Purchase Program (CPP) to stabilize the financial system. Under the original terms of CPP, financial institutions were prohibited from repurchasing such stock and debt within the first 3 years unless they completed a qualified equity offering.[1] Under the act, as amended, Treasury must permit a financial institution to repurchase the preferred stock or subordinated debt issued to Treasury at any time, subject to Treasury's consultation with the primary federal banking regulator. In Treasury's public guidance (FAQs) on repurchases, it states that financial institutions should give notice of their intent to repurchase to their primary banking regulator, which will apply existing supervisory procedures to determine whether to approve the repurchase.

As shown in figure 8, the process begins when Treasury and the primary federal regulator receive written notification (e-mail or letter) from the financial institution of its intent to repurchase in full or in part its preferred stock or other securities from Treasury. The primary federal regulator performs an analysis using available supervisory information and information provided by the institution to gauge its current financial condition and prospects, such as whether there has been a significant change in a financial institution's financial condition and viability since it received CPP funds. This analysis allows the regulator to determine if the repurchase request should be approved or denied. In addition, the 19 largest U.S. bank holding companies that were subject to the stress test must also be able to demonstrate access to common equity through public issuance in the equity capital markets, and successfully issue senior unsecured debt for a term greater than 5 years and not backed by Federal Deposit Insurance Corporation (FDIC) guarantees, in amounts sufficient to demonstrate a capacity to meet funding needs independent of FDIC

[1]A qualified equity offering is the sale and issuance of Tier 1 qualifying perpetual preferred stock, common stock, or a combination of such stock for cash.

guarantees. According to Treasury, the consultation consists of the primary federal regulator informing Treasury of its decision to approve or deny the request via e-mail. If the federal regulator of the entity that issued the preferred stock or other securities to the Treasury indicates it has no objection to, or approves of, the repurchase, Treasury then notifies in writing the financial institution that the repurchase is in process and instructs the financial institution to contact its Treasury counsel to set up dates for closing and settlement. If the repurchase is denied, Treasury notifies the institution.

Figure 8: Treasury's Repurchase Process



Sources: GAO; Art Explosion.

[a]The 19 largest bank holding companies must also demonstrate their financial strength by issuing senior unsecured debt for a term greater than 5 years not backed by FDIC guarantees, in amounts sufficient to demonstrate a capacity to meet funding needs independent of FDIC guarantees.

All four primary federal regulators noted that their role in the repurchase process followed existing regulations and procedures for evaluating requests by any financial institution regardless of whether they participate in CPP. The Federal Reserve has established instructions for processing capital repurchase requests for CPP and other government capital programs by bank holding companies.[2] For the 19 U.S. bank holding companies that participated in the Supervisory Capital Assessment Program, on June 1, 2009, the Federal Reserve released the criteria it planned to use to evaluate applications to repurchase Treasury's capital investments. The Federal Reserve in consultation with the U.S. bank holding companies' primary bank regulator and FDIC informed Treasury on June 9, 2009, that it had no objection to the repurchase of preferred shares by 9 of the SCAP bank holding companies. Also on June 9, 2009, Treasury announced that these 9 U.S. bank holding companies, and one other large institution, met the requirements for repayment and would be eligible to repay about $68 billion to Treasury. An Office of Financial Stability official noted that Treasury plays a limited role in this determination process.

Warrant Repurchase Process

If a financial institution repurchases all of its senior preferred shares, it can repurchase some or all of its other equity securities held by Treasury. The treatment of warrants differs in the standard securities purchase agreements, depending on whether the firm that issues the warrants is privately held or publicly traded. For privately held institutions, Treasury immediately exercises the warrants at the time of the capital investment and receives additional preferred shares. The financial institution repurchases these warrant preferred shares after it repurchases the senior preferred shares from Treasury. Publicly traded institutions have the option to repurchase outstanding and unexercised warrants after the senior preferred shares are repurchased. Although Treasury can sell the warrants at any time, Treasury is required to notify the financial institution 30 days prior to a sale. Following a repurchase of the senior preferred shares held by Treasury, an institution can repurchase the warrants at fair market value (FMV), as defined in section 4.9 of the Securities Purchase Agreement. If the financial institution chooses not to repurchase the warrants, Treasury may liquidate the registered warrants.

[2]Federal Reserve's supervisory letter SR 09-4, dated February 24, 2009, and revised March 27, 2009, *Applying Supervisory Guidance and Regulations on the Payment of Dividends, Stock Redemptions, and Stock Repurchases at Bank Holding Companies* and related frequently asked questions. According to the letter, the revision is intended to provide greater clarity on the priority of dividend payments on Tier 1 capital instruments and the repurchase of capital instruments issued by bank holding companies under government investment programs (such as CPP).

According to the Securities Purchase Agreement, financial institutions have 15 days from the date of a repurchase of preferred stock to give notice to Treasury of the intent to repurchase the warrants that were originally issued with the stock. If the financial institution does not wish to repurchase the outstanding warrants, Treasury may proceed with liquidating the warrants at the current market price. If the financial institution decides to repurchase the warrants, the institution's board of directors determines the FMV, acting in good faith and relying on an opinion of a nationally recognized independent investment banking firm retained by the financial institution for such purpose and certified in a resolution to Treasury. Through the use of market quotes from market participants, financial modeling, fundamental research, and a third-party consultation, Treasury makes an independent determination of the FMV of the warrants. If Treasury does not agree with the financial institution's determination, it may object in writing within 10 days of receipt of the financial institution's FMV determination, and the two parties must work together to resolve any issues and agree on an FMV. If they are unable to agree on an FMV in 10 days, either party has 20 more days to invoke the appraisal procedure by delivery of written notice.

Under the appraisal procedure, Treasury and the financial institution each choose an independent appraiser to determine the estimated FMV and notify each other of their choices within 10 days. If the two appraisers are unable to agree upon an FMV for the warrants within 30 days of their appointment, the appraisers have 10 additional days to select and appoint a third independent appraiser. The third appraiser then has 30 days to render its estimated FMV. The three estimated FMVs are to be averaged unless the larger of the differences between the higher FMV and middle valuations and the middle and lower valuations is more than 200 percent of the smaller difference. If the larger difference exceeds 200 percent of the smaller, the outlying valuation that triggers the exception is to be excluded and the remaining two are to be averaged.[3] The average will become the binding FMV for Treasury and the financial institution; the financial institution will be responsible for paying the costs of the appraisal procedure.

[3]For example, if the FMVs are $75 million, $50 million, and $40 million, the $75 million FMV would be excluded because the difference between $75 million and $50 million ($25 million) is more than 200 percent of the difference between $50 million and $40 million ($10 million).

Appendix V: Synopsis of Citigroup's Financial Condition

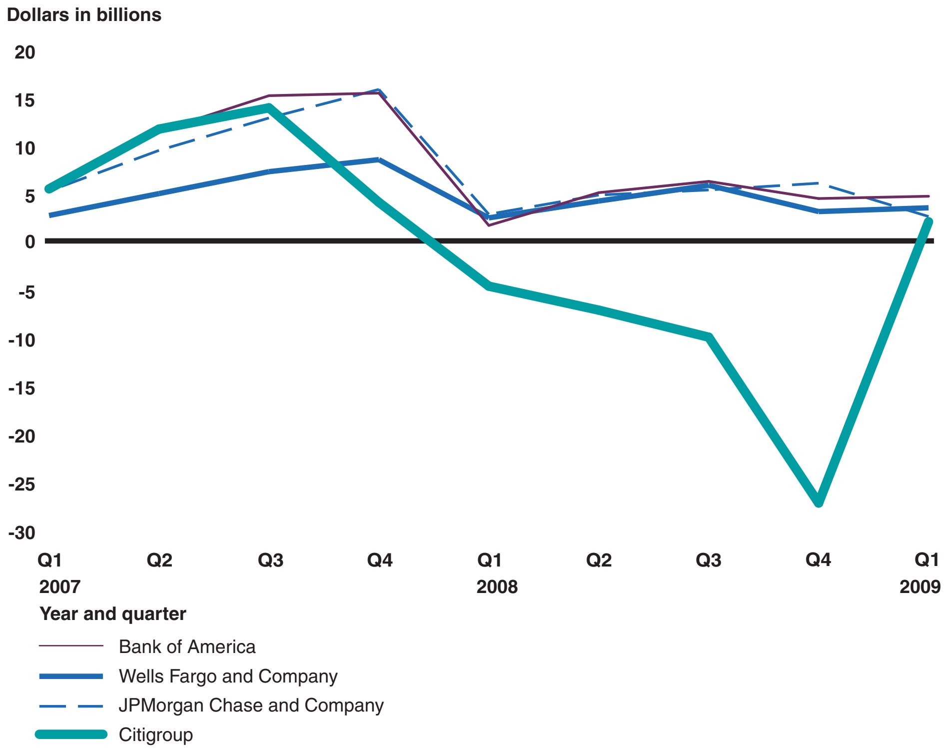
Citigroup, Inc. (Citigroup) is one of the few institutions that has participated in multiple Troubled Asset Relief Program (TARP) programs. As of June 12, 2009, it is participating in the Capital Purchase Program (CPP), the Targeted Investment Program (TIP), and the Asset Guarantee Program (AGP). Its participation in multiple programs has raised a number of questions about Citigroup's financial condition. To analyze Citigroup's financial condition, we compared Citigroup with three similar institutions that also received initial TARP funds through CPP in October 2008: Bank of America Corporation, JPMorgan Chase, and Wells Fargo Company.[1] As of March 31, 2009, these four institutions were the largest U.S. bank holding companies.

This appendix compares selected data on Citigroup's financial condition from 2007 through the first quarter 2009 with that of the other three bank holding companies.[2] Regarding net income, during all four quarters of 2008, Citigroup recorded growing losses, while the other three bank holding companies continued to record profits. By the fourth quarter of 2008, Citigroup's quarterly loss had increased to $27 billion (see fig. 9).

[1]Four additional financial institutions received initial TARP funds: The Bank of New York Mellon, the Goldman Sachs Group, Inc., Morgan Stanley, and State Street Corporation.

[2]Net income is the amount of income after applicable taxes, minority interest, extraordinary items, and adjustments.

Figure 9: Net Income (Loss) of the Four Largest U.S. Bank Holding Companies, First Quarter of 2007 through First Quarter of 2009

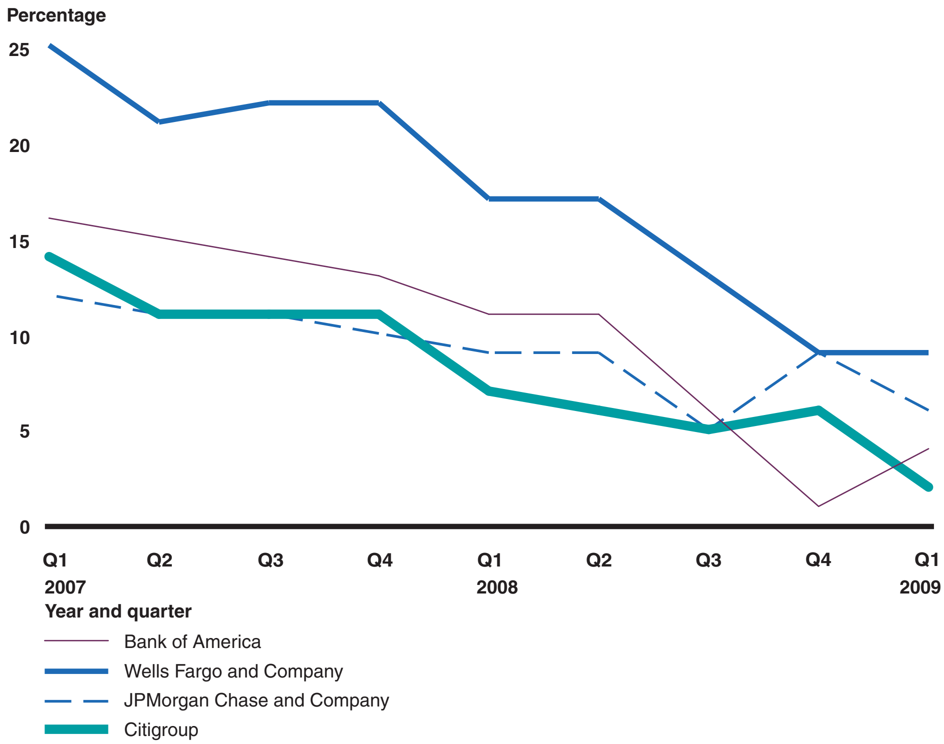


Source: GAO analysis of data from Consolidated Financial Statements for Bank Holding Companies, FR Y-9C from First Quarter 2007 through First Quarter 2009, Board of Governors of the Federal Reserve System.

Since the beginning of 2007, all four of the bank holding companies experienced a decline in the market value of their equity as a percentage of their total assets (see fig. 10).[3] However, since the beginning of 2008, Citigroup's ratio has been the lowest of the four.

[3]Market value equity is the share price multiplied by the number of ordinary shares in an issue. The amount in issue is updated whenever new tranches of stock are issued or after a capital change.

Figure 10: Market Value of Equity (Common) as Percentage of Total Assets of the Four Largest U.S. Bank Holding Companies, First Quarter of 2007 through First Quarter of 2009

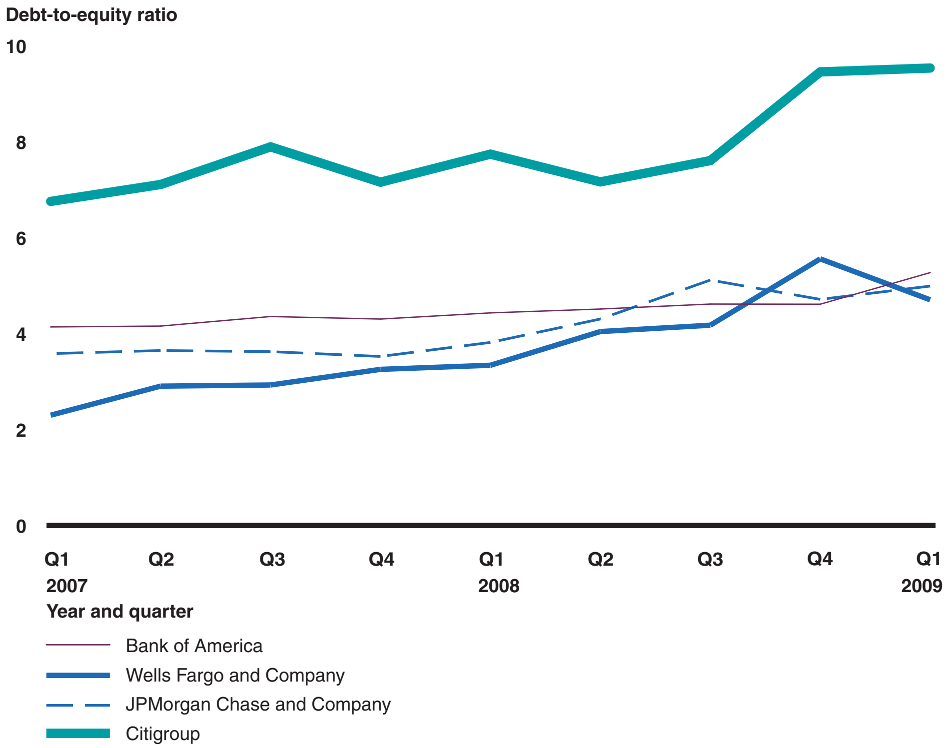


Source: GAO analysis of Thomson Datastream data.

We also reviewed the four bank holding companies' debt-to-equity ratios for the same period.[4] We calculated the debt-to-equity ratio as the holding company liabilities or debt divided by the equity shareholder funds. A higher ratio generally indicates a higher amount of financing with debt. Citigroup's debt-to-equity ratio was significantly higher than the other three holding companies' ratios, as shown in figure 11. From the fourth quarter 2008 through the first quarter 2009, Citigroup's ratio increased slightly from 9.4:1 to about 9.5:1.

[4]Equity (common) represents common shareholders' investment in a company.

Figure 11: The Ratio of Debt to Equity of the Four Largest U.S. Bank Holding Companies, First Quarter of 2007 through First Quarter of 2009

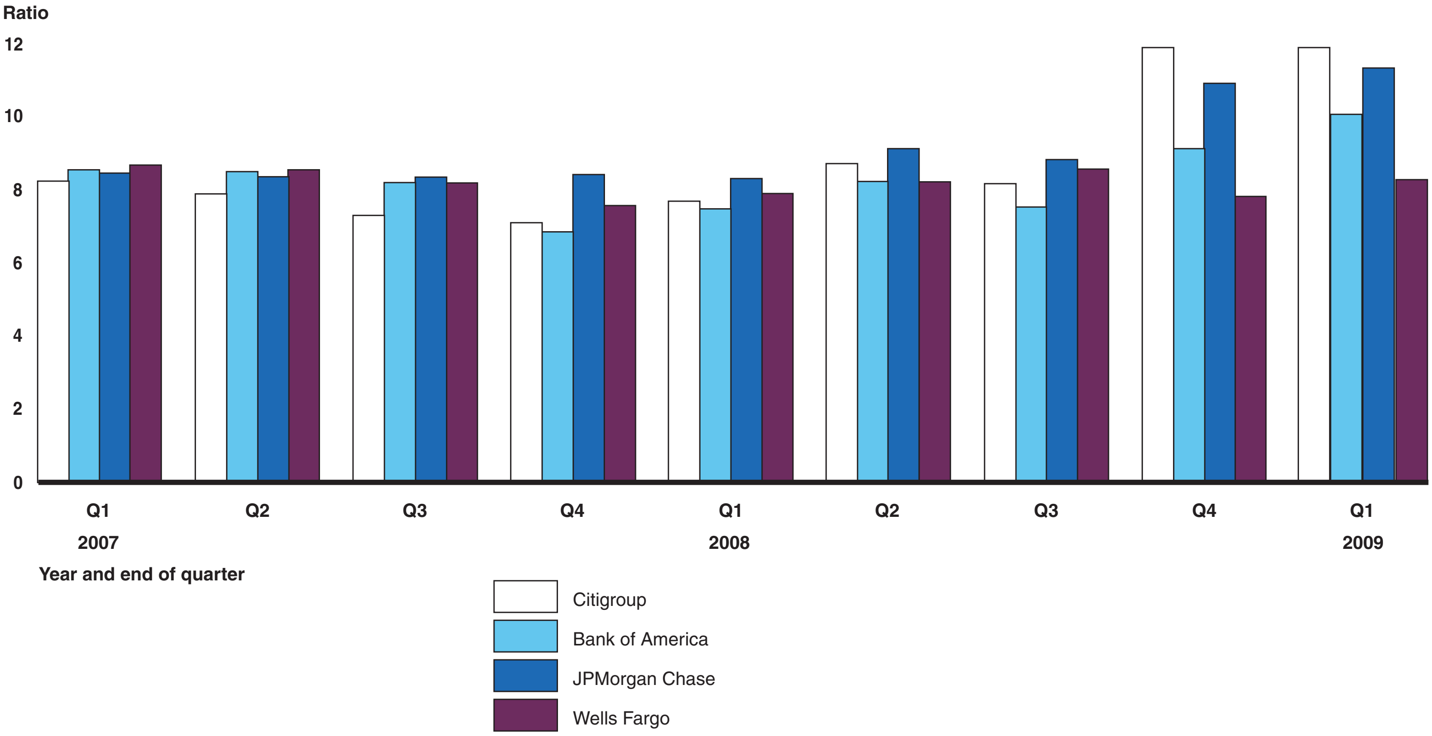


Source: GAO analysis of Thomson Datastream data.

One indicator of capital adequacy is the tier 1 risk-based capital ratio.[5] Using this measure, before TARP funding, Citigroup's tier 1 capital ratio was similar to that of the three other large bank holding companies (see fig. 12). In the third quarter of 2008, the capital ratios of the four bank holding companies ranged from 8.9 percent to 7.6 percent, with Citigroup reporting a tier 1 risk-based capital ratio of 8.2 percent.

[5]Tier 1 capital is the core measure of a bank's financial strength from a regulator's point of view. It is considered the most stable and readily available capital for supporting a bank's operations. The preferred shares purchased by Treasury under TARP counted as tier 1 capital.

Figure 12: Tier 1 Risk-Based Capital Ratio of the Four Largest U.S. Bank Holding Companies, First Quarter of 2007 through First Quarter of 2009

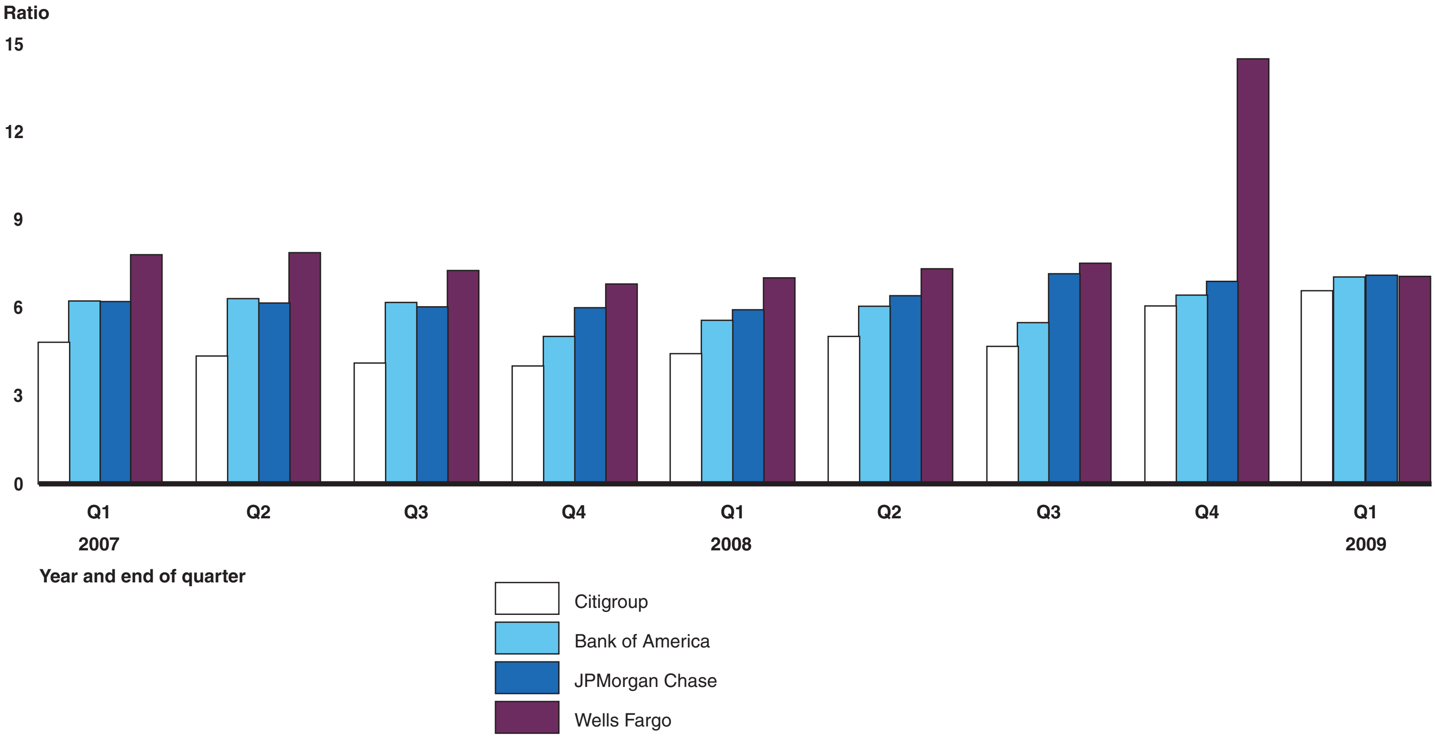


Source: GAO analysis of data from Consolidated Financial Statements for Bank Holding Companies, FR Y-9C from First Quarter 2007 through First Quarter 2009, Board of Governors of the Federal Reserve System. .

A different measure of capital adequacy is the tier 1 leverage ratio. [6] Using this measure, Citigroup had the lowest ratio for the entire period compared with the other three bank holding companies. Citigroup's tier 1 leverage ratio ranged from a low of about 4 percent in the fourth quarter of 2007 to a high of just over 6.6 percent in the first quarter of 2009. In the third quarter of 2008 and before TARP funding, Bank of America, JPMorgan Chase, and Wells Fargo reported their tier 1 leverage ratio as 5.5 percent, 7.2 percent, and 7.5 percent, respectively, while Citigroup reported a tier 1 leverage ratio of 4.7 percent as show in figure 13.

[6] Tier 1 leverage ratio is tier 1 capital divided by average total assets for leverage capital purposes.

Figure 13: Tier 1 Leverage Capital Ratio of the Four Largest Bank Holding Companies, First Quarter of 2007 through First Quarter of 2009



Source: GAO analysis of data from Consolidated Financial Statements for Bank Holding Companies, FR Y-9C from First Quarter 2007 through First Quarter 2009, Board of Governors of the Federal Reserve System. .

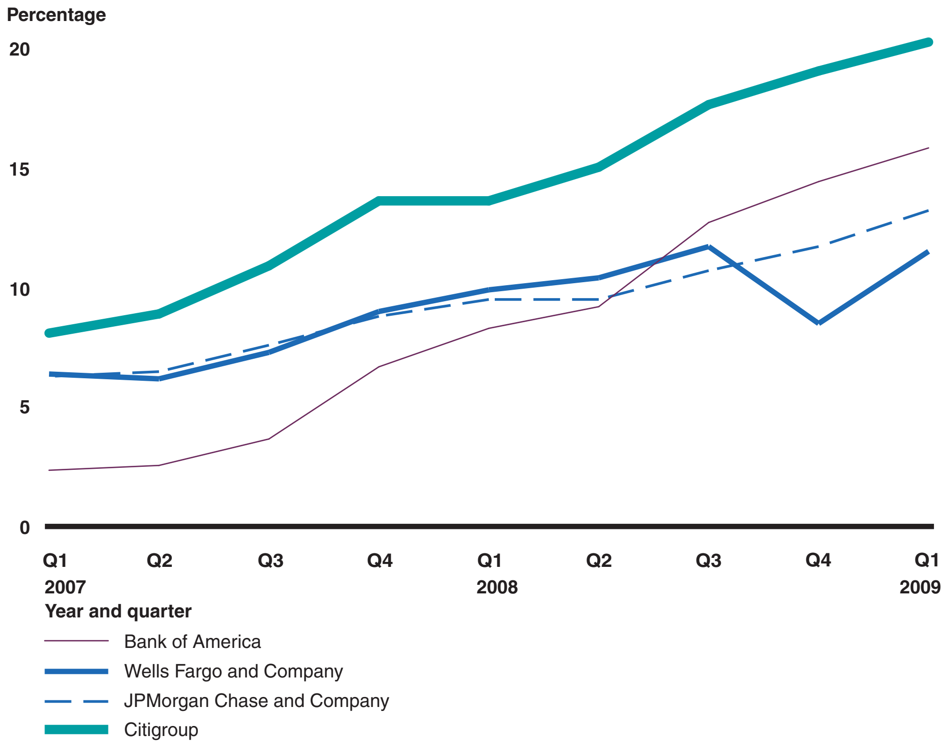
In addition to capital, a bank holding company has a cushion against losses in its "allowance for loan and lease losses" (ALLL), which must be maintained by the bank holding company to cover expected losses in its loan and lease portfolio.[7] For Citigroup and the other three companies, we examined the data on assets that already reflected repayment problems ("nonaccrual loans" plus "other real estate owned") and compared this to the companies' tier 1 capital plus ALLL.[8] The data for the first quarter 2007 through the first quarter 2009 are shown in figure 14. Throughout this

[7]For loans that a bank holding company intends to hold for the foreseeable future until maturity or payoff, the allowance for loan and lease losses is the amount it maintains to cover estimated credit losses.

[8]Nonaccrual loans are loans for which payment in full of interest or principal is not expected. "Other real estate owned" is the value of all real estate other than premises actually owned by the bank holding company or its consolidated subsidiaries. This includes real estate acquired in satisfaction of debts previously contracted.

period, Citigroup's assets with repayment problems as a percentage of this cushion was consistently higher than that of the other three bank holding companies.

Figure 14: Selected Problem Assets as a Percentage of Tier 1 Capital and Loan Loss Allocation, First Quarter of 2007 through First Quarter of 2009



Source: GAO analysis of data from Consolidated Financial Statements for Bank Holding Companies, FR Y-9C from First Quarter 2007 through Third Quarter 2008, Board of Governors of the Federal Reserve System.

Appendix VI: GAO Contacts and Staff Acknowledgments

GAO Contacts

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