

**Accountability for the  
Troubled Asset Relief Program**

The Second Report of the  
Congressional Oversight Panel

January 9, 2009

# Congressional Oversight Panel

## Panel Members

Elizabeth Warren, Chair

Rep. Jeb Hensarling<sup>1</sup>

Richard H. Neiman

Damon Silvers

Sen. John E. Sununu

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<sup>1</sup> Rep. Hensarling did not approve this report.

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## EXECUTIVE SUMMARY

In its first report to Congress on December 10, 2008, the Congressional Oversight Panel (COP or the Panel) posed ten basic questions – in effect asking for an explanation of the U.S. Department of Treasury’s goals and methods for the Troubled Asset Relief Program (TARP). The Panel’s questions, in turn, included a number of subsidiary questions, which sought additional details from the Treasury. In total, the Panel sought responses to 45 separate questions about the execution of the authority granted to Treasury under the Emergency Economic Stabilization Act (EESA) and the \$350 billion in taxpayer funds that has been “effectively allocated” under that program. On December 30, 2008, Treasury responded to the Panel with a 13-page letter. While the letter provided responses to some of the Panel’s questions and shed light on Treasury’s decision-making process, it did not provide complete answers to several of the questions and failed to address a number of the questions at all. To gain a more complete understanding of what Treasury is doing and why, the Panel asks Treasury to provide additional information clarifying its earlier responses.

In order to exercise its legally-mandated oversight functions, the Panel has initiated a number of fact-finding efforts and independent investigations that will be the subject of future reports. But the Panel’s independent work does not eliminate the need for Treasury to respond to the Panel’s questions. Some of these questions can be answered only by Treasury (e.g., Treasury’s strategic plans) and others seek to clarify what appear to be significant gaps in Treasury’s monitoring of the use of taxpayer money (e.g., asking financial institutions to account for what they have done with taxpayer funds).

To ease the burden on Treasury and to make it clear precisely which questions remain to be answered, the Panel has constructed a grid with its original questions and Treasury’s responses. Although many questions remain outstanding, the Panel highlights four specific areas that it believes deserve special attention:

(1) **Bank Accountability.** The Panel still does not know what the banks are doing with taxpayer money. Treasury places substantial emphasis in its December 30 letter on the importance of restoring confidence in the marketplace. So long as investors and customers are uncertain about how taxpayer funds are being used, they question both the health and the sound management of all financial institutions. The recent refusal of certain private financial institutions to provide any accounting of how they are using taxpayer money undermines public confidence.<sup>2</sup> For Treasury to advance funds to these institutions without requiring more transparency further erodes the very confidence Treasury seeks to restore. Finally, the recent loans extended by Treasury to the auto industry, with their detailed conditions affecting every aspect of the management of those businesses, highlights the absence of any such conditions in the vast majority of TARP transactions. EESA does not require recipients of TARP funds to make reports on the use

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<sup>2</sup> See, e.g., Matt Apuzzo, *Where’d the Bailout Money Go? Shhhh, It’s a Secret*, Associated Press (Dec. 22, 2008) (online at [apnews.myway.com/article/20081222/D957QL700.html](http://apnews.myway.com/article/20081222/D957QL700.html)).

of funds. However, it is within Treasury's authority to make such reports a condition of receiving funding, to establish benchmarks for TARP recipient conduct, or to have formal procedures for voluntary reporting by TARP recipient institutions or formal guidelines on the use of funds. The adoption of any one of these options would further the purposes of helping build and restore the confidence of taxpayers, investors, and policy makers.

**(2) Transparency and Asset Evaluation.** The need for transparency is closely related to the issue of accountability. The confidence that Treasury seeks can be restored only when information is completely transparent and reliable. Currently, Treasury's strategy appears to involve allocating the majority of the \$700 billion to "healthy banks," banks that have been assessed by their regulators as viable without federal assistance. Of course, whether a bank is "healthy" depends critically on the valuation of the bank's assets. If the banks have not yet recognized losses associated with over-valued assets, then their balance sheets – and Treasury's assessment of their health – may be suspect.

Many understood the purpose of EESA to be providing assistance to financial institutions that were "unhealthy" and at risk of failing. Such institutions were at risk, the public was told, due to so-called toxic assets that were impairing their balance sheets. EESA was designed to provide a mechanism to remove or otherwise provide clear value to those assets. The case of Citigroup illustrates this problem. Treasury provided Citigroup with a \$25 billion cash infusion as part of the "healthy banks" program whereby Treasury made nine initial investments in major banks. About two months later, Treasury provided Citigroup with \$20 billion in additional equity financing, apparently to avoid systemic failure, but it did not classify that investment as part of the Systemically Significant Failing Institution program (SSFI program). These events suggest that the marketplace assesses the assets of some banks well below Treasury's assessment. To date no such mechanism to provide more transparent asset valuation has been developed, meaning that the danger posed by those toxic assets remains unaddressed. The bubble that caused the economic crisis has its foundations in toxic mortgage assets. Until asset valuation is more transparent and until the market is confident that the banks have written down bad loans and accurately priced their assets, efforts to restore stability and confidence in the financial system may fail.

**(3) Foreclosures.** The crisis in the housing sector continues to affect any efforts at recovery. In enacting EESA, Congress called upon Treasury to

“implement a plan that seeks to maximize assistance for homeowners and use the authority of the Secretary to encourage the servicers of the underlying mortgages, considering net present value to the taxpayer, to take advantage of the HOPE for Homeowners Program under section 257 of the National Housing Act or other available programs to minimize foreclosures. In addition, the Secretary may use loan guarantees and credit enhancements to facilitate loan modifications to prevent avoidable foreclosures.”<sup>3</sup>

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<sup>3</sup> Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, at §109(a).

When Congress authorized the Panel, it specifically requested that the Panel evaluate “the effectiveness of foreclosure mitigation efforts.”<sup>4</sup> While the statute contemplates that foreclosure mitigation would be accomplished through the purchase of mortgage-related assets, many believe that Treasury has clear authority to use a portion of the \$700 billion to address mortgage foreclosures in other ways. For Treasury to take no steps to use any of this money to alleviate the foreclosure crisis raises questions about whether Treasury has complied with Congress’s intent that Treasury develop a “plan that seeks to maximize assistance for homeowners.”<sup>5</sup>

(4) **Strategy.** The Panel’s initial concerns about the TARP have only grown, exacerbated by the shifting explanations of its purposes and the tools used by Treasury. It is not enough to say that the goal is the stabilization of the financial markets and the broader economy. That goal is widely accepted. The question is *how* the infusion of billions of dollars to an insurance conglomerate or a credit card company advances both the goal of financial stability and the well-being of taxpayers, including homeowners threatened by foreclosure, people losing their jobs, and families unable to pay their credit cards. It would be constructive for Treasury to clearly identify the types of institutions it believes fall under the purview of EESA and which do not and the appropriate uses of TARP funds. The need for Treasury to address these fundamental issues of strategy has only intensified since our last report.

The issues related to strategy have wider implications as well. It appears that Treasury in its post-American International Group, Inc. (AIG) actions is using public dollars to support the value of equity in financial institutions. What strategy lies behind that decision? What about other alternatives? Would it be better and more cost effective to encourage private capital investors to assume control of such banks? Should those banks be required to maintain higher capital or liquidity positions or to pay higher Federal Deposit Insurance Corporation (FDIC) insurance premiums? Should we focus on ensuring that systemically significant institutions meet their fixed obligations and let the equity in such institutions be fully at risk, as we did in AIG? Should we simply let market forces work – letting sick banks fail and the healthy banks take the business? The Panel does not embrace any of these suggestions. Instead, it asks whether Treasury is involved in that re-thinking process.

The Panel recognizes that Treasury has many pressing obligations, and the Panel appreciates Treasury’s efforts to give timely responses. Ultimately, the Panel hopes that by posing these questions and offering these comments that it can be helpful to Treasury as it attempts to find more effective tools to deal with the current financial crisis.

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<sup>4</sup> *Id.*, at § 125(b)(1)(A)(iv).

<sup>5</sup> *Id.*, at § 109 (a).

## INTRODUCTION

Under Section 125(b) of EESA, the Congressional Oversight Panel is charged with making regular reports on:

- the use by the Secretary of the Treasury of authority under EESA, including his contracting authority and administration of the program;
- the impact of purchases made under EESA on the financial markets and financial institutions;
- the extent to which the information made available on transaction under the program has contributed to market transparency; and
- the effectiveness of foreclosure mitigation efforts, and the effectiveness of the program from the standpoint of minimizing long-term costs to the taxpayers and maximizing the benefits for taxpayers.

In its first report to Congress, the Panel posed ten basic questions and many subsidiary questions about Treasury's exercise of its authority under EESA. These questions set the framework for the related areas of inquiry that the Panel intends to pursue. The Panel is seeking information and advice from noted financial experts, academics, and the public. COP also invites public contributions through field hearings or through our website ([cop.senate.gov](http://cop.senate.gov)).

The highlighted area of this January Oversight report is an evaluation of Treasury's response to our December report. That section is titled, "Questions About the \$700 Billion: Discussion of Treasury's Responses."

In addition to monthly reporting, the Panel is charged with issuing a Special Report later this month on the topic of regulatory reform. The Panel also intends to issue other supplementary updates to Congress on a rolling basis, as recommendations or other findings are identified.

The Panel pledges to do its best to keep Congress and the public informed on the impact of Treasury's use of public funds and the effectiveness of the program in achieving the Congressional purposes, as stated in EESA, of (1) helping to "restore liquidity and stability to the financial system of the United States," and (2) ensuring that taxpayer funds are used "in a manner that protects home values, college funds, retirement accounts and life savings; preserves homeownership and promotes jobs and economic growth; maximizes overall returns to the taxpayers of the United States; and provides public accountability."<sup>6</sup>

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<sup>6</sup> *Id.*, at § 2.

## TREASURY DEPARTMENT UPDATES SINCE PRIOR REPORT

In the past weeks, Treasury has created new programs and expanded the scope of institutions eligible for TARP funding. The Panel will continue to evaluate the terms and conditions of the new programs and will provide updates on the effectiveness of these efforts.

- **Automotive Industry Financing Program (AIFP).** On December 19, 2008, Treasury announced a plan to make emergency TARP loans to General Motors Corporation and Chrysler LLC, to avoid bankruptcy and prevent further financial harm to the economy. In addition, on December 29, Treasury purchased \$5 billion in senior preferred equity with an 8% dividend from GMAC LLC. Under the agreement, GMAC issued warrants in the form of additional preferred equity in an amount equal to 5% of the preferred stock purchase. These warrants were exercised at the close of the transaction and pay a 9% dividend. Treasury has also agreed to lend up to \$1 billion to General Motors to facilitate their participation in a rights offering by GMAC, to support GMAC's reorganization as a bank holding company. These steps are part of the AIFP. The AIFP provides support both to automobile manufacturers and automobile finance companies and is a recognition by the administration of the critical importance of this key industry to economic stability. The Panel will be comparing and evaluating the appropriateness of the terms and conditions connected with the receipt of TARP funds across industries.
- **Asset Guarantee Program (AGP).** On December 31, 2008, Treasury submitted a report to Congress that outlined the AGP, which was established pursuant to Section 102 of EESA. The program will provide guarantees for assets held by systemically significant financial institutions. The previous guarantees made to Citigroup that were announced on November 23 may come under the umbrella of the AGP. The December 31 report contains an overview of Treasury's thought process in structuring guarantees, including the relative merits of various loss positions and eligibility standards for participating institutions. An evaluation of the AGP, including additional conversations with Treasury to consider specifics of the program, will be undertaken by the Panel.
- **Targeted Investment Program (TIP).** On January 2, 2009, Treasury formalized the TIP, a new program for financial institutions at risk of a loss of market confidence due to market volatility. Eligibility considerations include whether destabilization of the institution would cause systemic disruptions to the nation's financial markets, credit, payments and settlements systems, or would threaten asset prices or the broader economy. The terms and conditions of the TIP, a program that Treasury expects would only be used in exceptional cases, are still under development. The Panel intends to dialog with the Treasury to determine more specifically the conditions under which TIP, as opposed to the SSFI program, would be used. The Panel also intends to offer the new administration its input in the administration's effort to design the parameters of the TIP.



## **QUESTIONS ABOUT THE \$700 BILLION: DISCUSSION OF TREASURY'S RESPONSES**

On December 17, the Panel asked Treasury to respond to the ten questions set forth in the Panel's first report. On December 30, Treasury responded to the Panel's December 17 request. This section sets forth a summary and analysis of the Treasury's response, and the next section includes a grid with Treasury's answers and COP's response to those answers. (The full text of the Panel's letter and Treasury's response are included as Appendix I and II to this report.)

While Treasury's letter provided responses to some of the Panel's questions and shed some light on Treasury's decision-making process, it did not provide complete answers to several of the questions and failed to address some of the questions at all. The Panel is committed to making independent determinations of the answers to our questions. That work must begin, however, with an understanding of Treasury's thinking. The Panel is concerned that Treasury's initial response to our questions is not comprehensive and seems largely derived from earlier Treasury public statements.

- Treasury should provide an analysis of the origins of the credit crisis and the factors that exacerbated it. Only then will Congress be able to determine the appropriate legislative responses.
- Treasury should set forth the metrics by which success of the TARP in meeting the Congressional goals will be judged.
- The Panel believes that, to date, Treasury's actions to minimize avoidable foreclosures have not met Congress' expectations. An upcoming Panel report will make recommendations on the best ways to stem such foreclosures.
- Treasury should explain its basis for determining that all healthy banks are eligible to receive TARP funds, irrespective of whether they are in the lending business or are otherwise systemically significant.

**1. What Is Treasury's Strategy?** The Panel's first set of questions asked about Treasury's strategy in administering the TARP. There has been much public confusion over the purpose of the TARP, and whether it has had any effect on the credit markets, helped in price discovery for frozen assets, or increased lending. The name "Troubled Asset Relief Program" indicated that original purpose of buying troubled assets, but Treasury abruptly switched course and began making direct investments in banks.

Treasury's response regarding its strategy was not limited to its use of TARP funds:

Treasury's strategy is to work in coordination with all government agencies to use all the tools available to the government to achieve the following critical objectives:

- Stabilize financial markets and reduce systemic risk;
- Support the housing market by avoiding preventable foreclosures and supporting mortgage finance; and
- Protect taxpayers.

Treasury's response to our questions lists numerous initiatives that do not involve the use of TARP funds. While the Panel agrees with Treasury's goals, our Congressional mandate is to oversee the use of the TARP funds to determine if these goals are met. In particular, the Panel sees no evidence that Treasury has used TARP funds to support the housing market by avoiding preventable foreclosures. For Treasury to meet the stated intentions of EESA, Treasury must strengthen its efforts in this regard.

The Panel also asked Treasury for its conclusions about the nature and origins of the problem it is trying to address through TARP. Treasury did not provide any such analysis of the cause of the problem. The Panel believes, however, that it is important for Treasury and our financial services regulators to have an analysis of the causes and nature of the financial crisis to be able to craft a strategy for addressing the sources, and not solely the symptoms, of the problem or problems.

**2. Is the Strategy Working to Stabilize Markets?** The Panel's second set of questions dealt with whether Treasury's strategy was working to stabilize financial markets and our overall economy and to fulfill the other Congressional goals. The Panel continues to believe that Treasury needs to set forth the metrics by which these goals will be judged. Treasury's response designates an assertion and two metrics that purport to show that – in combination with other actions – Treasury's strategy has worked. Treasury claims that the TARP capital investments stemmed a series of financial institution failures and made the financial system fundamentally more stable than it was when Congress passed the legislation. It cites the "average credit default swap spread" for the eight largest U.S. banks, which Treasury notes has declined by about 240 basis points since before Congress passed EESA. Treasury does not state the dates of their measurements or note that credit spreads have been extremely volatile over the fourth quarter. The metric Treasury cites is the spread between the London Interbank Offered Rate (LIBOR) and the Overnight Index Swap rates (OIS). Treasury notes that 1-month and 3-month LIBOR-OIS spreads have declined about 220 and 145 basis points, respectively since the law was signed, and about 310 and 240 basis points, respectively, from their peak levels before the Capital Purchase Program (CPP) was announced. While it is true that the short-term spreads have contracted, they remain far above historic averages. Moreover, the long-term bank spreads remain extremely elevated. And, bank spreads represent a single indicator on the broader financial crisis. There is a need to have metrics that gauge the markets more broadly, as well as other economic measures, in order to form any firm view of the effectiveness of Treasury's strategy.

Although Treasury notes that it is also monitoring the effects of capital infusions on lending, it does not state what metrics it plans to use. While both tightened credit standards and the economic slowdown undoubtedly have depressed lending, these events do not justify the failure to measure whether the TARP capital investments are having a positive effect on lending. The

Panel therefore hopes to learn how Treasury plans to measure this important variable. The Panel stated in its first report that it believed Treasury should monitor lending at the individual TARP recipient level, and here the Panel again restates that recommendation.

**3. Is the Strategy Helping to Reduce Foreclosures?** One of Congress' stated goals was "foreclosure mitigation efforts." The Panel's third question was whether Treasury's strategy with respect to the TARP was reducing foreclosures. Treasury responded with a resounding yes, although none of the actions they credit with reducing foreclosures have a direct connection to TARP funding. This includes (1) preventing the failure of Fannie Mae and Freddie Mac, (2) Treasury and Fed programs to purchase Government Sponsored Enterprise (GSE) mortgage-backed securities, (3) attempts by the HOPE NOW Alliance, a coalition of mortgage servicers, investors and counselors, to help struggling homeowners by negotiating loan work-outs, (4) the development by HOPE NOW and the American Securitization Forum of a fast-track loan modification program to modify loans of subprime ARM borrowers facing unaffordable rate resets, and (5) the November 2008 industry announcement, along with HOPE NOW, the Federal Housing Finance Agency (FHFA) and the GSEs, of a streamlined loan modification program that builds on the mortgage modification protocol developed by the FDIC for IndyMac. A group of state attorneys general and banking departments have criticized many existing loan modification efforts, since many do nothing to reduce mortgage rates to affordable amounts.<sup>7</sup> More importantly, Treasury does not cite recent statistics on re-default rates. Only if homeowners have a realistic chance to remain current on their mortgages can a modification be deemed effective.

**4. What Have Financial Institutions Done With the Taxpayers' Money Received So Far?**

The Panel's fourth area of inquiry focused on what financial institutions have done with the taxpayer money they received. As indicated in question 1 above, Treasury appears to believe the question is beside the point because their goal for the CPP is to stabilize the financial system and to restore confidence in financial institutions. This, they believe, will eventually increase the flow of credit. Treasury argues that there are several reasons why the TARP investments will be slow to produce increased lending: (1) The CPP began only in October 2008, and the money must work its way into the system before it can have the desired effect. (2) Because confidence is low, banks will remain cautious about extending credit, and consumers and businesses will remain cautious about taking on new loans. (3) Credit quality at banks is deteriorating, which leads banks to build up their loan loss reserves. For example, Treasury notes that the level of loan loss provisioning by banks doubled in the third quarter from one year ago. Treasury seems to be suggesting these larger trends may be obscuring the effect of TARP funds. The Panel understands the reasons why measurement of banks' use of TARP funds may be difficult. Nevertheless, the Panel believes such direct measurements at the level of individual TARP recipient firms are important for determining the extent to which the funds are having a direct benefit to businesses and consumers.

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<sup>7</sup> Conference of State Bank Supervisors State Foreclosure Prevention Working Group, *Analysis of Subprime Mortgage Service Performance: Data Report No. 3* 9-10 (Sept. 2008) (online at [www.csbs.org/Content/NavigationMenu/Home/SFPWGReport3.pdf](http://www.csbs.org/Content/NavigationMenu/Home/SFPWGReport3.pdf)).

**5. Is the Public Receiving a Fair Deal?** The Panel’s fifth question dealt with whether the public is receiving a fair deal from the CPP and other investments. Treasury states that its investments are a good deal for the public for two reasons. First, the government will own shares which Treasury expects to yield a reasonable return and, second, the government will also receive warrants for common shares in participating institutions, which will allow the taxpayer to benefit from any appreciation in the market value of the institution. The Panel asked Treasury to compare the terms Treasury obtained for its investments and terms obtained by private parties investing in the same firms during the same period. Treasury did not believe this comparison was relevant and made no comparison. Treasury claims that, when measured on an accrual basis, the value of the preferred stock is at or near par. Treasury does not explain whether by “accrual basis” it means historical cost accounting, in which case its statement is a tautology, or whether it means some other method of accrual accounting. Treasury states that when measured on a mark-to-market basis, the value of some preferred stock may be judged lower than par, particularly if the valuation date is the purchase date rather than the announcement date, as equity markets have dropped since the program was first announced.

Finally, Treasury argues that it is not making the CPP investments for short-term gains. Rather, Treasury claims that, over time, the taxpayers will be protected by ensuring the stability of the financial system and by earning a return on these investments when they are eventually liquidated.

**6. What Is Treasury Doing to Help the American Family?** The Panel’s sixth question was whether Treasury was using its ownership position in banks to encourage them to take actions to help American families. In particular, the Panel asked whether Treasury’s actions preserved access to consumer credit, including student loans and auto loans at reasonable rates, and whether Treasury was taking action to ensure that public money could not be used to subsidize lending practices that are exploitive, predatory, or otherwise harmful to customers.

Treasury answered that its TARP programs to preserve access to consumer credit do not involve encouraging or mandating banks to take consumer-friendly actions with respect to credit cards or other consumer loans.

**7. Is Treasury Imposing Reforms on Financial Institutions that Are Taking Taxpayer Money?** The Panel’s seventh group of questions concerned whether Treasury was requiring recipients to undertake any particular reforms, including (1) the presentation of a viable business plan, (2) the replacement of failed executives and/or directors, (3) reforms designed to prevent future crises, to increase oversight, and to ensure better accounting and transparency, and (4) other appropriate operational reforms.

Treasury responded that it has required recipients of CPP funds to adhere to the executive compensation restrictions required by EESA. In addition, Treasury barred any increase in dividends for three years and restricted share repurchases. Both the dividend increase and share

buyback restrictions are designed to prevent banks from taking capital out of the financial system. Under the SSFI program, Treasury imposed additional terms and conditions on AIG. AIG must meet additional executive compensation, corporate expenses, and lobbying restrictions.

While some executives at some financial institutions have voluntarily reduced their compensation, there is no uniform program in place. Treasury has the power to set the “terms and conditions” of any purchase it makes using the TARP funds. The Panel continues to ask Treasury to explain why it has not required more of financial institutions, particularly in light of both the steps taken by the United Kingdom in similar circumstances and the extensive conditions imposed on auto companies, as a condition for receiving TARP funds.

**8. How Is Treasury Deciding Which Institutions Receive the Money?** The Panel’s eighth question concerned Treasury’s decisions about which institutions would receive TARP money. In response, Treasury referred the Panel to Treasury’s website, which showed the application form for TARP funds. The Panel was not seeking the information about the technical process for applying to participate in the program, but rather whether Treasury’s approach to advance taxpayer money to all healthy banks, regardless of the bank’s business profile, constitutes an effective use of funds. If the goal of the program was to stabilize financial markets, then Treasury should have standards for determining which banks are significant participants in the capital markets. If the goal of the program was to increase consumer and small business lending, then Treasury should have standards for determining which banks are active small business and consumer lenders or have committed to lend to small businesses and consumers.

The Panel was also interested in Treasury’s approach to the effect TARP transactions were having on the structure of the banking industry, and whether any such effects were the result of a deliberate strategy on Treasury’s part. Treasury did not address this aspect of the Panel’s question.

**9. What Is the Scope of Treasury’s Statutory Authority?** The Panel’s ninth area of inquiry sought Treasury’s opinion of the scope of its statutory authority. It also sought information about guarantees, credit insurance, joint stabilization efforts, and transparency of prices under the Term Asset-Backed Securities Loan Facility (TALF) program. In response, Treasury quoted the language of EESA and said it was working on the guaranty and credit insurance programs.

The Panel posed this question in order to understand Treasury’s interpretation of the statute in relation both to the actions Treasury has taken so far under EESA and to actions Treasury might take in the future. The pending arrangements with the automobile industry suggest that more thinking must go into this question than a mere rote recitation of the statute. COP is particularly interested in what limits, if any, Treasury sees to the definition of “financial institution” and “troubled asset” and hopes Treasury will provide its assessment of whether those terms cover other businesses, such as commercial real estate, manufacturers of consumer products, and other businesses not directly involved in financial services.

**10. Is Treasury Looking Ahead?** Finally, the Panel asked whether Treasury was looking ahead. In particular, it asked about likely challenges in implementing EESA and whether Treasury believed it had adequate contingency plans if the economy suffered further disruptions. Treasury responded that it is actively engaged in developing additional programs to strengthen our financial system so that credit flows to our communities, and that it is confident that it is pursuing the right strategy to stabilize the financial system and support the flow of credit to our economy. But it did not share any future plans or explain if any strategic planning for other financial reversals is in place.

## TREASURY DEPARTMENT RESPONSE GRID

|          | QUESTION   | TREASURY RESPONSE  | PANEL EVALUATION  |
|----------|--|--|---|
| <b>1</b> | <b>What Is Treasury's Strategy?</b>  |  |   |
| 1.1      | What is Treasury's vision of the problem?  | No response.   | Defining the problem to be addressed is essential to designing an effective strategy. If Treasury sees the core problem as inadequate bank capital in relation to bank obligations, certain strategies to address that problem will follow. On the other hand, if Treasury sees the problem as unclear asset valuation, consumer caution, or accounting failures, other strategies would follow. Treasury has still not explained precisely what it sees as the problem.  |
| 1.2      | What is Treasury's overall strategy?   | Throughout the crisis, Treasury's strategy has been to work in coordination with all government agencies to use all the tools available to the government to achieve the following critical objectives:<br><ul style="list-style-type: none"> <li>- Stabilize financial markets and reduce systemic risk</li> <li>- Support the housing market by avoiding preventable foreclosures and supporting mortgage finance</li> <li>- Protect taxpayers.</li> </ul> | Although Treasury's clear identification of its goals, operations, and the operations of other federal agencies is welcome, Treasury has not yet explained its strategy. A strategy is a plan or method that is designed to achieve a goal. Treasury has identified its goals and announced its programs, but it has not yet explained how the programs chosen constitute a coherent plan to achieve those goals. There are a number of different possible approaches on how to support the housing market or to stabilize financial markets. COP asks Treasury to explain the theory behind its approach. The question remains unanswered. |
| 1.3      | What does Treasury think the central causes of the financial crisis are and how does its | No response.   |   |

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|     | overall strategy for using its authority and taxpayer funds address those causes?  |   |  |
| 1.4 | What specific facts caused Treasury to change its strategy in the last two months? | <p>In the weeks after Secretary Paulson and Chairman Bernanke first went to the Congress, market conditions deteriorated at an unprecedented and accelerating rate. One key measure Treasury assessed was the LIBOR-OIS spread – a key gauge of funding pressures and perceived counterparty credit risk. Typically between 5-10 basis points, on September 1, the one month spread was 47 basis points. By September 18<sup>th</sup>, when Treasury first went to Congress, the spread had climbed 88 basis points to 135 basis points. By the time the bill passed, just two week later on October 3, the spread had climbed another 128 basis points to 263 basis points. By October 10, LIBOR-OIS spread rose another 75 basis points to 338 basis points. During this period, credit markets effectively froze. The commercial paper market shut down, 3-month Treasuries dipped below zero, and a money market mutual fund “broke the buck” for only the second time in history, precipitating a \$200 billion net outflow of funds from that market.</p> <p>Given such market conditions, Secretary Paulson and Chairman Bernanke recognized that Treasury needed to use the authority and</p> | <p>Treasury has provided a helpful response as to how the decision was made to pursue the Capital Purchase Program instead of the purchase of illiquid assets. This response does not, however, explain why capital infusion, which Treasury points out elsewhere in the letter is a several-month process, was “faster” than other approaches.</p> <p>Nor does this response explain why the capital infusion approach was “more effective.” Indeed, with no specific metrics in place to gauge changes in lending, it is unclear how any conclusions can be drawn about the program’s effectiveness.</p> <p>To evaluate whether Treasury’s capital infusion program was less expensive than other approaches or provided “more bang for the buck,” once again it is necessary to develop metrics to determine the effects of the program.</p> <p>Treasury’s explanation of how it made the decision to abandon the purchase of troubled assets in favor of capital infusion in the first days of the TARP program does not account for its decision a few weeks later to pursue other strategies, such as the purchase of GSE mortgage backed securities.</p> <p>Treasury’s response focuses on two alternatives, but it raises questions about other options that</p> |



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|  |  | <p>flexibility granted under EESA as aggressively as possible to help stabilize the financial system. They determined the fastest, most direct way was to increase capital in the system by buying equity in healthy banks of all sizes. Illiquid asset purchases, in contrast, require much longer to execute.</p> <p>As Treasury continued very serious preparations and exploration of purchasing illiquid assets, scale became a factor; for an asset purchase program to be effective, it must be done in very large scale. With \$250 billion allocated for the CPP, Treasury considered whether there was sufficient capacity in the TARP for an asset purchase program to be effective. In addition, each dollar invested in capital can have a bigger impact on the financial system than a dollar of asset purchase; capital injections provide better “bang for the buck.”</p> <p>...</p> <p>Like other forms of credit, the availability of affordable consumer credit depends on ready access to a liquid and affordable secondary market – in this case, the asset backed credit market. Recent credit market stresses essentially brought this market to a halt in October 2008. As a result, millions of Americans cannot find affordable financing for their basic credit needs. And</p> | <p>might have been considered. For example, an alternative would have been to force troubled institutions to reorganize quickly (and continue to operate) while acting to ensure no systemically dangerous defaults on fixed obligations, thereby allowing recapitalization without transfers to existing equity holders – and also, perhaps, speeding the return of confidence to the markets by reducing doubts about the value of the assets held by large firms.</p> |
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|     |  | credit card rates are climbing, making it more expensive for families to finance everyday purchases. The Federal Reserve and the Treasury announced an aggressive program [the TALF] to support the normalization of credit markets and the availability of affordable consumer credit to support economic recovery. (From p. 9) |  |
| 1.5 | What specific facts changed that made purchase of mortgage-backed assets a bad idea within days of the request and what specific facts changed again to make guaranteeing such assets a good idea a few weeks later?   | See 1.4 for a response to the first part of the question. Treasury did not respond to the second part of the question (what specific facts changed again to make guaranteeing such assets a good idea a few weeks later?).   |  |
| 1.6 | What is Treasury's explanation of its understanding of the role played by each of the following factors and by their interaction:<br>(1) capital inadequacy in financial institutions;<br>(2) lack of reliable information in credit markets with respect to counterparty risk;<br>(3) temporary liquidity shortfalls in particular financial markets;<br>(4) falling real estate prices and rising foreclosure rates;<br>(5) stagnant family incomes and rising unemployment; | No response.   |  |

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|          | <p>(6) changes in consumer borrowing capacity;</p> <p>(7) business and financial focus on short-term gains to the detriment of long-term growth;</p> <p>(8) effectiveness of regulatory oversight;</p> <p>(9) CPP participants' involvement in and exposure to off balance sheet vehicles and unregulated markets;</p> <p>and</p> <p>(10) broader long-term macroeconomic imbalances.</p> |  |  |
| <b>2</b> | <b>Is the Strategy Working to Stabilize Markets?</b>  |  |  |
| 2.1      | <p>What specific metrics can Treasury cite to show the effects of the \$350 billion allocated thus far on the financial markets, on credit availability, or, most importantly, on the economy?</p>  | <p>The most important evidence that our strategy is working is that Treasury's actions, in combination with other actions, stemmed a series of financial institution failures. The financial system is fundamentally more stable than it was when Congress passed the legislation. ... While it is difficult to isolate one program's effects given policymakers' numerous actions, one indicator that points to reduced risk of default among financial institutions is the average credit default swap spread for the eight largest U.S. banks, which has declined by about 240 basis points since before Congress passed EESA. Another key indicator of</p> | <p>Before EESA, various short-term spreads had risen to levels that indicated extremely serious disruptions in the money market and those spreads have declined considerably, particularly for very short horizons (e.g., 1-month LIBOR does not reflect a large risk premium). COP understands that short-term spreads reflected enormous concern about counterparty risk, and with the infusion of capital into some of the most important counterparties (as well as the signal that if further capital were required it would be forthcoming), these risks were necessarily diminished. Nonetheless, these spreads remain at several times their historic levels.</p> <p>It is not surprising that a</p> |

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|     |  | <p>perceived risk is the spread between LIBOR and OIS: 1-month and 3-month LIBOR-OIS spreads have declined about 220 and 145 basis points, respectively, since the law was signed and about 310 and 240 basis points, respectively, from their peak levels before the CPP was announced.</p>  | <p>substantial government investment in the top U.S. banks reduced the perceived risk that those banks would collapse. Treasury clearly signaled that these firms were too big to fail. The market now expects taxpayer money to continue to be used to support them. The continued high levels of short term spreads compared to their very stable levels of the past suggest that the infusion of billions of dollars into the banks forestalled immediate collapse, as it necessarily would, but has not affected liquidity in credit markets or reassured the capital markets that large financial institutions are strong credits.</p> <p>There is no response to the question of the impact on the economy or credit availability.</p> |
| 2.2 | <p>Have Treasury's actions increased lending and unfrozen the credit markets or simply bolstered the banks' books?</p> | <p>Treasury is also monitoring the effects our strategy is having on lending, although it is important to note that nearly half the money allocated to the Capital Purchase Program has yet to be received by the banks. Treasury is executing at a rapid speed, but it will take some time to review and fund all the remaining applications. Clearly this capital needs to get into the system before it can have the desired effect. In addition, we are still at a point of low confidence – both due to the financial crisis and the economic downturn. As long as confidence remains low, banks will remain cautious about extending credit, and consumers and businesses will remain cautious about taking</p> | <p>COP appreciates Treasury's recognition of the low confidence in the market and the current caution about extending and taking credit. Although half the money has not yet been received by the banks, hundreds of billions of dollars have been injected into the marketplace with no demonstrable effects on lending. Once again, the Panel asks Treasury what metrics or mechanisms it has in place to monitor whether the banks that have received money are using funds for credit availability or for other purposes.</p> <p>The TARP funds increased the capital base of recipient banks, but whether that would lead to increased lending depends on two facts: that the increase in the capital base is adequate to support</p>   |

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|     |   | <p>on new loans. As confidence returns, Treasury expects to see more credit extended.</p> | <p>more lending, and that good lending opportunities exist. On the first issue, without clearer information on the true value of banks' assets (including their toxic assets), it is not clear how much those assets must be written down and therefore whether the TARP funds are adequate to bring the banks' balance sheets into the positive range to support new lending.</p> <p>On the issue of lending opportunities, Treasury seems to be addressing the underlying vital public interest in reviving economic activity by a model of giving money to banks and assuming they will lend the money out. Until the basic financial problems at the household level are addressed, however, banks may not have good opportunities to extend credit either to those households or the businesses that depend on them. Retail flows from equity and bond funds to money market funds have been dramatic, suggesting that all investors are having trouble finding good lending opportunities. The Panel continues to ask whether Treasury has evidence that this top-down model is working.</p> |
| 2.3 | <p>How does Treasury expect to achieve the goal of price discovery for impaired assets?</p> | <p>No response.</p>   | <p>Treasury has not yet demonstrated an interest in price discovery for impaired assets. Under the initial purpose of EESA, to purchase mortgage-backed assets, Treasury would have had the power to determine the value of its newly purchased assets. But when</p>   |

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|          |  |  | Treasury shifted to capital infusions, a program in which those assets remain with the financial institutions, Treasury did not set up a new mechanism to determine asset values. Treasury needs to explain how it believes price discovery will be achieved and, if they have no plans to do so, why price discovery is no longer important.  |
| <b>3</b> | <b>Is the Strategy Helping to Reduce Foreclosures?</b> |  |  |
| 3.1      | What steps has Treasury taken to reduce foreclosures?  | <p>1. To support the housing and mortgage market, Treasury acted earlier this year to prevent the failure of Fannie Mae and Freddie Mac, the housing GSEs that affect over 70% of mortgage originations. ... In addition, Treasury and the Federal Reserve have both announced programs to purchase GSE mortgage-backed securities.</p> <p>2. October 2007, Treasury helped establish the HOPE NOW Alliance, a coalition of mortgage servicers, investors and counselors, to help struggling homeowners avoid preventable foreclosures. ... In addition, Treasury worked with HOPE NOW and the ASF to develop a fast-track loan modification program to modify loans of subprime ARM borrowers facing unaffordable rate resets.</p> <p>3. Treasury worked with</p> | The three areas that Treasury identifies are discussed below, but an initial point is critical: none of these programs deal with implementation of EESA, and almost all pre-date EESA. The statute is clear: “To the extent that the Secretary acquires mortgages, mortgage backed securities, and other assets secured by residential real estate, including multifamily housing, the Secretary shall implement a plan that seeks to maximize assistance for homeowners and use the authority of the Secretary to encourage the servicers of the underlying mortgages, considering net present value to the taxpayer, to take advantage of the HOPE for Homeowners Program under section 257 of the National Housing Act or other available programs to minimize foreclosures. In addition, the Secretary may use loan guarantees and credit enhancements to facilitate loan modifications to prevent avoidable foreclosures.” <sup>8</sup> |

<sup>8</sup> EESA, *supra* note 3, at § 109(a).

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|  |  | <p>HOPE NOW, FHFA and the GSEs to achieve a major industry breakthrough in November 2008 with the announcement of a streamlined loan modification program that builds on the mortgage modification protocol developed by the FDIC for IndyMac. By targeting a benchmark ratio of housing payments to gross monthly household income, HOPE NOW servicers and the GSEs will have greater ability to quickly and efficiently create sustainable monthly mortgage payments for troubled borrowers.</p> | <p>The intent of the COP question was to explore how the authorization under EESA has been used to provide mortgage relief. Treasury has not answered the question of how, if at all, it has used the authority granted in EESA to address the mortgage crisis.</p> <ol style="list-style-type: none"> <li>1. Treasury put the GSE's into conservatorship prior to the passage of EESA. In any case, putting GSEs into conservatorship is not foreclosure prevention. The GSEs encourage mortgage origination by providing liquidity. For families facing foreclosures on mortgages that exceed the value of the property, financing devices to support new purchases offer no relief.</li> <li>2. HOPE Now is not a government agency, and it has no governmental authority. The program's operators may have been glad to receive Treasury's approval, but Treasury has not provided any evidence that Treasury made any financial or other tangible contributions to it from funds granted by EESA.</li> <li>3. The Streamlined Loan Modification Program (SMP) is an entirely voluntary program, and Treasury's encouragement of this program appears to be independent of the powers and funds granted to Treasury under EESA. Its key feature is a 38% front-end debt-to-income (DTI) target for modifications. The 38% DTI target had already been set by Congress for the Hope for</li> </ol> |
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|  |  | <p>Homeowners Program in July 2008, adopted by the FDIC for IndyMac Federal Bank, FSB loan modifications in August, 2008, and adopted on November 5, 2008 by the State of California for the Keeping Californians In Their Homes Program,<sup>9</sup> and was already the industry standard weeks before the SMP was announced.<sup>10</sup> Interim Assistant Secretary Kashkari stated, “FHFA, the GSEs and HOPE NOW relied heavily on the IndyMac model in developing this new protocol.”<sup>11</sup> Rather than a “major industry breakthrough,” it appears that the November 11, 2008 announcement referred to by Treasury involved the adoption by the GSE’s under Treasury’s control of a standard that leading elements of the mortgage servicing industry have already abandoned as resulting in unsustainable modifications. Litton Loan Servicing, a Goldman Sachs affiliate, uses 31% DTI as its initial target,<sup>12</sup> FDIC has proposed a general modification program using a 31% DTI target,<sup>13</sup> and</p> |
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<sup>9</sup> State of California Office of the Governor, *Special Session 2008: Keeping Californians in Their Homes* (Nov. 5, 2008) (online at [gov.ca.gov/index.php?/fact-sheet/10961](http://gov.ca.gov/index.php?/fact-sheet/10961)).

<sup>10</sup> Senate Committee on Banking, Housing, and Urban Affairs, Testimony of Martin D. Eakes and Gregory Palm, *Oversight of the Emergency Economic Stabilization Act: Examining Financial Institution Use of Funding Under the Capital Purchase Program*, 110th Cong. (Nov. 13, 2008) (online at [banking.senate.gov/public/index.cfm?FuseAction=Hearings.LiveStream&Hearing\\_id=1d38de7d-67db-4614-965b-edf5749f1fa3](http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.LiveStream&Hearing_id=1d38de7d-67db-4614-965b-edf5749f1fa3), at minutes 142-144).

<sup>11</sup> U.S. Department of the Treasury, *Treasury Interim Assistant Secretary for Financial Stability Neel Kashkari Remarks on GSE, HOPE NOW Streamlined Loan Modification Program* (Nov. 11, 2008) (online at [www.treas.gov/press/releases/hp1264.htm](http://www.treas.gov/press/releases/hp1264.htm)).

<sup>12</sup> Testimony of Gregory Palm, *supra* note 12.

<sup>13</sup> Federal Deposit Insurance Corporation, *FDIC Loss Sharing Proposal to Promote Affordable Loan Modifications* (online at [www.fdic.gov/consumers/loans/loanmod/index.html](http://www.fdic.gov/consumers/loans/loanmod/index.html)) (proposed Nov. 14, 2008).



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|     |                                      |   | <p>Bank of America/Countrywide’s settlement with the state Attorneys General requires use of a 25%-34% DTI standard.<sup>14</sup> Indeed, the GSEs’ own initial underwriting guidelines suggest a maximum 25%-28% front-end DTI.<sup>15</sup> Moreover, most loans already have a front-end DTI of less than 38%.<sup>16</sup> Only around 10-15% of prime and alt-A and 25-30% of subprime are already above this threshold.<sup>17</sup> For most loans, Treasury’s “breakthrough” standard is of no value. However helpful Treasury might have been in working out GSE adoption of this protocol, it appears again to have no connection to the mandate to use the powers and funds granted under EESA to ease the mortgage crisis.</p> |
| 3.2 | How effective have those steps been? | 1. [Fannie Mae and Freddie Mac] are systemically critical to financial and housing markets, and their failure would have materially exacerbated the recent market turmoil and profoundly impacted household wealth. Mortgage finance is available today on attractive terms because of Treasury’s actions | 1. Maintaining mortgage credit markets may be valuable to new buyers with good credit ratings, down payments, and appropriate collateral, but it provides no help to families facing foreclosure. Treasury has provided no refinancing initiative, no help for borrowers whose credit has been damaged, and no effort to address the problem of mortgages that   |

<sup>14</sup> *California v. Countrywide Financial Corporation*, No. LC083076, Slip Op., 14 (Cal. Sup. Ct., L.A. County, N.W. District, Oct. 20, 2008) (online at [ag.ca.gov/cms\\_attachments/press/pdfs/n1618\\_cw\\_judgment.pdf](http://ag.ca.gov/cms_attachments/press/pdfs/n1618_cw_judgment.pdf)) (Stipulated Judgment & Injunction).

<sup>15</sup> Freddie Mac, *Single-Family Seller/Service Guide* § 37.15 (online at <http://www.freddiemac.com/sell/guide>).

<sup>16</sup> Admittedly, DTI reporting is of questionable accuracy.

<sup>17</sup> Merrill Lynch MBS / ABS Special Report, *Loan Modifications: What Investors Need to Know* 7 (Nov. 21, 2008). Reliance on DTI is itself questionable; loan performance seems to correlate better to loan-to-value ratio than front-end DTI. *Id.*

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|  |  | <p>with the Federal Reserve and the Federal Housing Finance Agency to stabilize Fannie Mae and Freddie Mac. ... [Programs to purchase GSE mortgage-backed securities] are lowering borrowing rates for homeowners, to both purchase homes and to refinance into more affordable mortgages.</p> <p>2. HOPE NOW estimates that roughly 2.9 million homeowners have been helped by the industry since July 2007; the industry is now helping more than 200,000 homeowners a month avoid foreclosure.</p> <p>3. Potentially hundreds of thousands more struggling borrowers will be enabled to stay in their homes at an affordable monthly mortgage payment. Many private-label mortgage-backed securities pooling and servicing agreements reference the GSE servicing standards, giving this new program reach far beyond GSE loans.</p> | <p>exceed the market value of the homes.</p> <p>2. Again, COP asked what Treasury has done, and received a response referring to what “industry” has done. HOPE NOW is not an EESA program and involves no expenditure of EESA resources or use of EESA powers. Treasury’s response does not explain what “help” means. Many of those “helped” by HOPE NOW have been put into repayment plans that increase monthly payments.<sup>18</sup> A recent study of loan modifications found that 23% result in higher monthly payments and another 23% result in no change in the monthly payment, while most of those that decreased payments did so by less than \$100/month.<sup>19</sup> Not surprisingly, failure rates on modified loans are high.<sup>20</sup> Treasury needs to be clear as to what, if anything, it has done, and if it insists on taking credit for private sector efforts, it must explain what “help” means – <i>i.e.</i> what exactly has happened to the 2.9 million people who have been through one of these programs.</p> <p>3. The operative word is “potentially.” Hope for Homeowners was initially predicted to help 400,000 families, but it has received only 357</p> |
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<sup>18</sup> Testimony of Martin D. Eakes, *supra* note 12.

<sup>19</sup> Alan M. White, *Rewriting Contracts, Wholesale: Data on Voluntary Mortgage Modifications from 2007 and 2008 Remittance Reports*, Fordham Urban Law Journal (2009) (online at [ssm.com/abstract=125953](http://ssm.com/abstract=125953)).

<sup>20</sup> See Office of the Comptroller of the Currency, *Comptroller Dugan Highlights Re-default Rates on Modified Loans* (Dec. 8, 2008) (online at [www.occ.treas.gov/ftp/release/2008-142.htm](http://www.occ.treas.gov/ftp/release/2008-142.htm)).

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|     |  |              | applications, none of which have been processed. <sup>21</sup> FHA Secure was predicted to help 240,000 homeowners, but it was shut down at the end of 2008 after helping only 4,100 delinquent borrowers. <sup>22</sup> |
| 3.3 | Why has Treasury not generally required financial institutions to engage in specific mortgage foreclosure mitigation plans as a condition of receiving taxpayer funds? | No response. |  |
| 3.4 | Why has Treasury required Citigroup to enact the FDIC mortgage modification program, but not required any other bank receiving TARP funds to do so?                    | No response. | Treasury's refusal to answer this question is one of the most troubling aspects of their letter. The Panel intends to do further fact finding on this matter.  |
| 3.5 | Is there a need for additional industry reporting on delinquency data, foreclosures, and loss mitigations efforts in a standard format, with appropriate analysis?     | No response. |  |
| 3.6 | Should Treasury be considering others models and more innovative uses of its new authority under the Act to avoid unnecessary  | No response. |  |

<sup>21</sup> Michael Corkery, *Mortgage 'Cram-Downs' Loom as Foreclosures Mount*, Wall Street Journal (Dec. 31, 2008) (online at [online.wsj.com/article/SB123068005350543971.html](http://online.wsj.com/article/SB123068005350543971.html)).

<sup>22</sup> *Id.* See also, U.S. Department of Housing and Urban Development, *Bush Administration to Help Nearly One-Quarter of a Million Homeowners Refinance, Keep their Homes: FHA to Implement New "FHA Secure" Refinancing Product* (Aug. 31, 2007) (online at [www.hud.gov/news/release.cfm?content=pr07-123.cfm](http://www.hud.gov/news/release.cfm?content=pr07-123.cfm)).

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|      | foreclosures?  |              |  |
| 3.7  | Is there a substantial body of potential homeowners who could take advantage of proposed 4.5% rates, but who did not purchase homes on easy credit during the mortgage bubble?   | No response. |  |
| 3.8  | Will lower rates create a large enough pool of new home buyers to lead to a general increase in home prices?   | No response. |  |
| 3.9  | Are the assumptions underlying Treasury's plan 4.5% plan still valid in a time of great economic uncertainty for the households that would be expected to take advantage of the lower mortgage rates?  | No response. |  |
| 3.10 | Will lower interest rates induce demand for home ownership in the face of falling housing prices, consumer uncertainty about the future of the economy and employment, and the reasonable expectation that an even better deal might be available in the future? | No response. |  |
| 3.11 | What steps is Treasury taking to encourage mortgage servicers, including affiliates of financial institutions that have received CPP or TALF funding, to engage in loan  | No response. |  |

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|          | modifications, participate in the HOPE for Homeowners Program (in which none of the institutions receiving CPP funds have participated), or take other steps to minimize foreclosures? |  |   |
| 3.12     | What is Treasury's objection to the FDIC proposal and why is its objection to the FDIC proposal is not also relevant to Citigroup?   | No response.   |   |
| <b>4</b> | <b>What Have Financial Institutions Done with the Taxpayers' Money Received So Far?</b>  |  |   |
| 4.1      | What have the companies who received money from Treasury done with the money?  | As the GAO noted in its report, given the number and variety of financial stability actions being put in place by multiple entities, it will be challenging to view the impact of the Capital Purchase Program in isolation and at the institutional level. Moreover, each individual financial institution's circumstances are different, making comparisons challenging at best, and it is difficult to track where individual dollars flow through an organization. Nonetheless, Treasury is working with the banking regulators to develop appropriate measurements and Treasury is focused on determining the extent to which the CPP is having its desired effect. | COP is pleased that Treasury has committed to developing measurements of how the banks are using taxpayer dollars. It may be difficult to view the impact of the funds at the institutional level and difficult to make comparisons among institutions, but it is possible for the institutions to provide an accounting of where dollars flowed within their organizations and when they first left those organizations through loans, dividend repayments, executive compensation, purchase of other assets, etc. |
| 4.2      | Have the companies   | No response.   |   |

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|     | used the funds in the way Treasury intended when it disbursed them?   |  |   |
| 4.3 | Have companies receiving CPP funds leveraged the capital support to increase lending activity?                                  | <p>The level of loan loss provisioning by banks doubled in the third quarter from one year ago, putting pressure on bank earnings and capital. By injecting new capital into healthy banks, the CPP has helped banks maintain strong balance sheets and eased the pressure on them to scale back their lending and investment activities.</p> <p>As a direct result of Treasury’s actions through TARP, all participating financial institutions in the CPP have stronger capital positions, and with higher capital levels and restored confidence, banks can continue to play their role as financial lenders in our communities. While difficult to achieve during times like this, this lending is essential to economic recovery.</p> | <p>There is little doubt that injecting cash into financial institutions will improve their balance sheets, but COP’s question focuses on what effect this money has had on lending activity. To determine the effects of stronger capital positions, it is necessary to document the level of lending. Treasury should require institutions receiving CPP funds to report their lending activities to Treasury.</p> <p>Moreover, Treasury has no clear sense of whether CPP has had an effect on lending. In its response to Question 2.2, Treasury noted that confidence was low and that lending levels would rise when confidence rises. Here, Treasury suggests that confidence has already been restored because of CPP, and that banks are now lending in their communities. Treasury needs to provide some evidence on the level of lending to determine which of these assertions is accurate.</p> <p>Pending Treasury’s providing responsive data, the question remains unanswered.</p> |
| 4.4 | How have funds been used by institutions who received funds pursuant to the Systemically Significant Failing Institutions plan? | In the case of the SSFI program, Treasury did not provide funds to a financial institution directly. The \$40 billion in Treasury funds was paid directly to the FRBNY to restructure AIG’s balance sheet. AIG did not receive those funds. The FRBNY  | Treasury appears to be saying that TARP money was given through the SSFI program to the Federal Reserve Bank of New York, which passed it on to AIG’s creditors to make good AIG’s debts. This raises the question: In what sense is a bank healthy if it is relying on federal support for its   |

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|          |  | credit facility has helped minimize the disorderly collateral effects on healthy banks, which were counterparties that bought insurance from AIG. Treasury's investment in AIG was necessary to preserve stability in the financial system and to give AIG time to sell assets in an orderly manner to pay back taxpayers.  | counterparties? Which banks received these payments and in what amounts? Were the AIG funds used to protect the equity holders in certain other financial institutions? COP intends to conduct additional fact finding in this area and looks forward to a more detailed explanation from Treasury as to the use of SSFI funds. |
| 4.5      | Is Treasury seeking to use TARP money to shape the future of the American financial system, and if so, how?  | No response.  |   |
| 4.6      | Why does Treasury believe that using "general economic metrics" will be effective for ensuring (1) that the funds are used for their intended purposes, or (2) that the funds have an effect on the economy? | No response.  |   |
| <b>5</b> | <b>Is the Public Receiving a Fair Deal?</b>  |   |   |
| 5.1      | What is the value of the preferred stock Treasury has received in exchange for cash infusions to financial institutions?   | When measured on an accrual basis, the value of the preferred stock is at or near par. Furthermore, Treasury has already started receiving required dividend payments. On a mark-to-market basis, the value of some preferred stock may be judged lower when compared to the date of purchase as equity markets have experienced pressure since the program began. In | The use of "accrual basis" raises some concerns about Treasury's answer and how the value of the assets has been calculated. No one doubts that either the preferred stock or the warrants have "positive value." Instead, the question is the value of the warrants. COP will pursue this issue further.                       |

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|          |  | addition to preferred stock, Treasury also received warrants in the institutions it has invested in to provide further value and protection to taxpayers (other than community development organizations which are exempt from warrant requirements). These warrants also have positive value.   |   |
| 5.2      | Are the terms comparable to those received in recent private transactions, such as those with Warren Buffett and the Abu Dhabi Investment Authority?                                     | Treasury has designed its programs, consistent with EESA, to protect the taxpayer and to provide positive return on investments to the maximum extent possible. For example, under the CPP, Treasury will purchase up to \$250 billion of senior preferred shares on standardized terms, including a 5% dividend for 5 years, which then increases to 9%. The government will not only own shares which we expect to yield a reasonable return, but will also receive warrants for common shares in participating institutions. These warrants allow the taxpayer to benefit from any appreciation in the market value of the institution. | COP asked how the terms of purchase for the government through CCP and for other major investors compare. From a policy perspective, there is room for debate about whether the government should insist on terms as favorable as third parties or whether it should offer a better deal as a public good. But that policy debate cannot begin until there is a reasonably direct assessment of the difference, if any, so that the relative costs are clear.<br><br>The question remains unanswered. |
| 5.3      | Has Treasury set up a Section 102 premium requirement for the \$306 Billion guarantee of Citigroup? If not, why not? If so, what is the amount of the premium and how was it determined? | No response.   |   |
| <b>6</b> | <b>What Is Treasury Doing to Help the American Family?</b>   |  |   |



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| 6.1 | Does Treasury believe American families need to borrow more money?   | No response.   |   |
| 6.2 | Does Treasury believe American families can safely borrow more money, given uncertainty as to employment and other household economic factors? | No response.   |   |
| 6.3 | Have Treasury's actions preserved access to consumer credit, including student loans and auto loans at reasonable rates?                       | Term Asset Backed Securities Lending Facility. Consumer credit is critical for many households as they consider purchasing a car, new appliances, or other big ticket items. Like other forms of credit, the availability of affordable consumer credit depends on ready access to a liquid and affordable secondary market – in this case, the asset backed credit market. Recent credit market stresses essentially brought this market to a halt in October 2008. As a result, millions of Americans cannot find affordable financing for their basic credit needs. And credit card rates are climbing, making it more expensive for families to finance everyday purchases. The Federal Reserve and the Treasury announced an aggressive program to support the normalization of credit markets and the availability of affordable consumer credit to support economic recovery. Treasury will invest \$20 billion in a Federal Reserve facility that will provide | Treasury's plan to invest \$20 billion in a facility to improve liquidity raises the same issues as its injection of capital into banks: without metrics in place to track this money and without effective plans to measure the effects of this \$20 billion, it will remain impossible to evaluate the effectiveness of Treasury's plans. Treasury's statement is a list of its intentions. The question asked was what have been the consequences of Treasury's actions to date. That question remains unanswered. |

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|     |   | liquidity to issuers of consumer asset backed paper, enabling a broad range of institutions to step up their lending, and enabling borrowers to have access to lower-cost consumer finance (auto loans, credit cards, student loans) and small business loans. The facility may be expanded over time and eligible asset classes may be expanded later to include other assets, such as commercial mortgage-backed securities, non-agency residential mortgage-backed securities or other asset classes.               |   |
| 6.4 | What restrictions will Treasury put on credit issuers to assure that taxpayer dollars are not used to subsidize lending practices that are exploitive, predatory or otherwise harmful to customers? | No response.   |   |
| 6.5 | What is Treasury doing to ensure that its spending is directed in ways that maximize the impact on the American economy?  | Every aspect of the implementation of the financial rescue package has a single purpose – to stabilize the financial system so it can support the financing needs of the American people, as consumers and as owners and employees of businesses. American families rely on the services provided by a wide array of sound financial institutions and financial markets, such as savings and investment for retirement (e.g., 401k accounts), and access to affordable credit for education, business development, and | Treasury may be “confident” that it is “pursuing the right strategy to stabilize the financial system and support the flow of credit to our economy,” but the function of oversight is to evaluate that claim. Once again, COP asks for metrics and data, not for general claims. COP understands that it is difficult to disaggregate the impact of various efforts to influence the economy, but it is possible to collect data on the use of the money, changes in lending levels, and other specific indicia of change. |

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|  |  | <p>even daily necessities.</p> <p>...</p> <p>All of the steps that Treasury has taken, alone and in coordination with the regulators, are benefiting Americans because they have prevented a further deterioration of the financial system. The problems facing the financial sectors here and abroad arose over a number of years and it will take time for the restoration of normal financial markets. There is no single action the federal government can take to end the financial market turmoil and the economic downturn, but Treasury is confident that we are pursuing the right strategy to stabilize the financial system and support the flow of credit to our economy. The TARP is just one of many policy measures that Treasury has taken to restore the liquidity and capital necessary to support economic growth, protect the savings of millions of individuals and restore the flow of credit to consumers and businesses. In addition, the measures we are taking are allowing the process of financial intermediation to continue- which means that banks and financial institutions can play their vital role in the economy, including providing savings, retirement and lending services.</p> |  |
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| 7   | <b>Is Treasury Imposing Reforms on Financial Institutions that Are Taking Taxpayer Money?</b>   |   |  |
| 7.1 | Has Treasury required banks receiving aid to<br>(1) Present a viable business plan;<br>(2) Replace failed executives and/or directors;<br>(3) Undertake internal reforms to prevent future crises, to increase oversight, and to ensure better accounting and transparency;<br>(4) Undertake any other operational reforms? | Treasury established strict executive compensation requirements on all participating institutions, as per the requirements set out in EESA. Treasury barred any increase in dividends for 3 years and restricted share repurchases. Increasing dividends or buying back shares would undermine our policy objective by taking capital out of the financial system.<br>...<br>Under the Systemically Significant Failing Institution program, additional terms and conditions were established for AIG. As a condition of extending an \$85 billion line of credit to AIG, the Fed required a change in management at AIG. Also as a condition for Treasury assistance under TARP, AIG must meet stringent executive compensation, corporate expenses and lobbying restrictions. | Aside from the legally mandated executive compensation limits, Treasury appears not to have required a viable business plan, internal reforms related to transparency, oversight, or accounting, the replacement of leadership, or other operational reforms by institutions receiving funds under CPP.<br><br>The SSFI program has required greater reforms, including management changes, but it also has not required internal reforms related to transparency, oversight, or accounting or a viable business plan.<br><br>Treasury has the power to set the “terms and conditions” of any purchase it makes using the TARP funds. Treasury should therefore explain why it has not required more of financial institutions, particularly in light of the extensive conditions imposed on auto companies as a condition of receiving TARP funds. The question remains unanswered. |
| 8   | <b>How Is Treasury Deciding Which Institutions Receive the Money?</b>   |   |  |
| 8.1 | What factors is Treasury using to determine which institutions receive equity infusions, purchase of portfolio  | No response.  | Although Treasury has provided a helpful discussion of its process for determining which institutions have access to funds under the CPP, COP hopes to learn how Treasury determines whether   |

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|          | assets, or insurance of portfolio assets?   |  | equity infusions, purchase of assets, or insurance of assets is the best approach to strengthening a particular institution or the financial system overall. The COP question is broader than the administrative processes of CPP. For example, one might wonder why an institution receiving equity infusions did not instead receive insurance for portfolio assets. COP looks forward to learning more about Treasury’s thinking on this broader question. The question remains unanswered.  |
| 8.2      | Why does Treasury believe that providing capital to all viable banks, regardless of business profile, is the most efficient use of funds? | The Capital Purchase Program is available to a broad array of private and publically held-financial institutions of all sizes- including qualifying U.S. controlled banks, savings associations, and certain bank and savings and loan holding companies. The program is designed for healthy banks – banks that are considered viable without government investment. It is designed to have attractive terms to encourage healthy banks to participate; they are best positioned to increase the flow of credit in their communities. | COP understands the rationale advanced for capital infusions in healthy banks rather than in failing banks. The COP question was directed, however, toward whether it is an effective use of funds to offer money on a voluntary basis to all healthy banks, regardless of the bank’s business profile, or alternatively, would it have made sense to require all healthy banks to accept government capital to avoid some of the strategic dilemmas that were described by the banking industry in the Panel’s Nevada hearing. If, as Treasury has stated, the goal of capital infusions was to increase consumer and small business lending, why were funds not concentrated among businesses with substantial small business and consumer lending or authorized only when a financial institution presented a business plan to use the funds for small business or consumer lending? |
| <b>9</b> | <b>What Is the Scope of Treasury’s Statutory Authority?</b>   |  |   |

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| 9.1 | What is Treasury’s understanding of the statutory limits on its use of funds? | <p>Recognizing the severity of the economic challenges facing the U.S. financial system, Congress incorporated a broad definition of financial institutions which covers any institution established and regulated in the United States or its territories and which has significant operations in the Unites [sic] States; the definition of financial institutions includes, but by its express terms is not limited to, banks, savings associations, credit unions, security broker or dealers and insurance companies. The definition of “troubled asset” provides authority to the Secretary, in consultation with the Chairman of the Board of Governors of the Federal Reserve System, to define a “troubled asset” as any financial instrument the purchase of which is necessary to promote financial market stability.”</p> <p>In exercising this authority, Treasury is limited by a series of requirements and directions set out in EESA. These requirements, which are found in a variety of sections of EESA including sections 101, 103, 104, 105, 107, 108, 109, 110, 111, 113, 115, 121, and 125, encompass, among other things, requirements related to transactions, conflicts of interest, executive compensation, maximizing taxpayers returns, reporting, oversight, and coordination.</p> | <p>The pending arrangements with the automobile industry suggest that more thinking must go into this question than a mere repetition of the statute. COP is particularly interested in what limits, if any, Treasury sees to the definition of “financial institution” and “troubled asset” and hopes Treasury will provide its assessment of whether those terms cover other businesses, such as commercial real estate, manufacturers of consumer products, and other businesses not directly involved in financial services. The question remains unanswered.</p> |
| 9.2 | How is Treasury   | As required by section 102(a),  | Treasury did not respond to this  |

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|  | <p>carrying out its statutory mandate regarding credit insurance?</p> | <p>Treasury established the Asset Guarantee Program (AGP). This program provides guarantees for assets held by systemically significant financial institutions that face a high risk of losing market confidence due in large part to a portfolio of distressed or illiquid assets. This program will be applied with extreme discretion in order to improve market confidence in the systemically significant institution and in financial markets broadly. It is not anticipated that the program will be made widely available.</p> <p>Under the AGP, Treasury would assume a loss position with specified attachment and detachment points on certain assets held by the qualifying financial institution; the set of insured assets would be selected by the Treasury and its agents in consultation with the financial institution receiving the guarantee. In accordance with section 102(a), assets to be guaranteed must have been originated before March 14, 2008.</p> <p>Treasury would collect a premium, deliverable in a form deemed appropriate by the Treasury Secretary. As required by the statute, an actuarial analysis would be used to ensure that the expected value of the premium is no less than the expected value of the losses to TARP from the guarantee. The</p> | <p>question in its December 30 response to the Panel. The sections included here are taken from Treasury's Report to Congress Pursuant to Section 102 of EESA, dated December 31, 2008.</p> |
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|           |   | <p>United States government would also provide a set of portfolio management guidelines to which the institution must adhere for the guaranteed portfolio.</p> <p>Treasury would determine the eligibility of participants and the allocation of resources on a case-by-case basis. The program would be used for systemically significant institutions, and could be used in coordination with other programs. Treasury may, on a case-by-case basis, use this program in coordination with a broader guarantee involving one or more other agencies of the United States government.</p> |  |
| 9.3       | What does Treasury believe its limits are, if any, in working with other regulators and government bodies to jointly finance stabilization efforts?         | No response.   |  |
| 9.4       | How does Treasury intend to fulfill its obligation under Section 114 of the Act to ensure transparency when FRBNY is responsible for implementing the TALF? | No response.   |  |
| <b>10</b> | <b>Is Treasury Looking Ahead?</b>   |  |  |
| 10.1      | What are the likely challenges the implementation of the Emergency Economic Stabilization Act will face in the weeks and                                    | No response.   |  |



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|      | months ahead?  |  |  |
| 10.2 | Can Treasury offer some assurance that it has worked out contingency plans if the economy suffers further disruptions? | Treasury is actively engaged in developing additional programs to strengthen our financial system so that credit flows to our communities. Treasury believes that the new authorities Congress provided in October dramatically expanded the tools available to address the needs of our system. We have made significant progress, but there is no single action the federal government can take to end the financial market turmoil and the economic downturn. We are confident that we are pursuing the right strategy to stabilize the financial system and support the flow of credit to our economy. | Treasury may be “confident” that it is “pursuing the right strategy to stabilize the financial system and support the flow of credit to our economy,” but, once again, the function of oversight is to evaluate that claim. In this case, COP asks if any strategic planning for other financial reversals is in place. The question remains unanswered. |

## OVERSIGHT ACTIVITIES

COP was established as part of EESA. It was formed on November 26, 2008, and it issued its first report on December 10, 2008. That report posed ten questions that identified central issues regarding the use of taxpayers' funds through the TARP.

Since the first report, the following developments pertaining to COP's oversight of the TARP took place:

- On December 16, 2008, COP held a Field Hearing in Clark County, Nevada to examine the roots of the financial crisis and its impact on everyday Americans. At the hearing, scores of local residents turned out to personally voice their skepticism and concern over the TARP's lack of transparency.
- On December 17, 2008, Elizabeth Warren, Chair of the Panel, sent a letter to Treasury Secretary Henry Paulson on behalf of the Panel requesting that Treasury answer the questions posed in the first report.
- On December 30, Treasury responded to the Panel's December 17 request. Both the full text of Professor Warren's letter and Treasury's response are included in the Appendices to this report.
- COP has engaged consultants to help us determine if Treasury's investments in preferred stock of various banking organizations under its Capital Purchase Program were made on terms that minimize long-term costs and maximize benefits to the taxpayers.
- COP has received and reviewed more than 2,500 messages with stories, comments, or suggestions through [cop.senate.gov](http://cop.senate.gov).

### **Report on Field Hearing in Clark County, Nevada**

On December 16, 2008, COP held its first field hearing, in Clark County, Nevada. Clark County suffered from over 30,000 foreclosures in 2008, an increase of nearly 300% from 2007. Overall, Nevada has had the highest foreclosure rate in the nation for 23 months.

The hearing took place at the Thomas and Mack Moot Court at the University of Nevada-Las Vegas Law School. Three Panel members attended the hearing: Elizabeth Warren, Richard H. Neiman, and Damon Silvers.

At the hearing, the Panel sought information from a broad spectrum of sources about the nature and cause of the current financial situation, the impact of federal government actions to date to address the economic crisis, and local initiatives to address the crisis.

The Panel heard testimony from the following witnesses:

- George Burns, Commissioner, Nevada Financial Institutions Division
- R. Keith Schwer, Director, Center for Business and Economic Research, UNLV
- Bill Uffelman, President and Chief Executive Officer, Nevada Bankers Association

- Gail Burks, President and Chief Executive Officer, Nevada Fair Housing Center
- Julie Murray, Chief Executive Officer, Three Square Food Bank
- Danny Thompson, Executive Secretary-Treasurer, Nevada State AFL-CIO
- Alfred Estrada, Resident of Clark County

The Panel also heard from the following elected officials:

- Harry Reid, United States Senate Majority Leader (D-NV)
- Shelley Berkley, Congresswoman (D-NV)
- Dina Titus, Congresswoman-elect (D-NV)

Senator Harry Reid, Representative Shelley Berkley and Representative-elect Dina Titus emphasized the importance of ensuring that the use of TARP funds benefit American working families. George Burns, Keith Schwer, and Bill Uffelman discussed the collapse of the housing bubble and the current state of the Nevadan economy. The witnesses on the second panel – Gail Burks, Julie Murray, Danny Thompson, and Alfred Estrada – testified about the human consequences of the economic downturn.

Video, a transcript and testimony from the Clark County Field Hearing are available at [cop.senate.gov](http://cop.senate.gov).

The Panel owes a special thanks to UNLV President David Ashley, UNLV Law School Dean John White and the Boyd School of Law staff for their hospitality in hosting this event. The Panel also owes thanks to Kenneth LoBene, the local Field Office Director for the U.S Department of Housing and Urban Development, for providing them with a tour of local neighborhoods severely impacted by foreclosures following the hearing.

## **FUTURE OVERSIGHT ACTIVITIES**

### **Public Hearings**

Given its successful public hearing in Clark County, Nevada, COP will continue to hold field hearings to shine light on the causes of the financial crisis, the administration of TARP, and the anxieties and challenges of ordinary Americans. The next hearing will be on January 14, 2009 in Washington, DC.

### **Upcoming Reports**

In January 2009, COP will release a report providing recommendations for reforms to the financial regulatory structure. The report will provide a roadmap for a regulatory system that will revitalize Wall Street, protect consumers, and ensure future stability in the financial markets. In early February, COP will release its third oversight report.

### **Public Participation and Comment Process**

The Panel encourages members of the public to visit its website at [cop.senate.gov](http://cop.senate.gov). The website provides information about COP and the text of COP's reports. In addition, concerned citizens can share their stories, concerns, and suggestions with the Panel through the website's comment feature. To date, COP has received more than 2,500 comments, and COP looks forward to hearing more from the American people. By engaging in this dialogue, COP aims to enhance the quality of its ideas and advocacy.

## **ABOUT THE CONGRESSIONAL OVERSIGHT PANEL**

In response to the escalating crisis, on October 3, 2008, Congress provided the U.S. Department of the Treasury with the authority to spend \$700 billion to stabilize the U.S. economy, preserve home ownership, and promote economic growth. Congress created the Office of Financial Stabilization (OFS) within Treasury to implement a Troubled Asset Relief Program (TARP). At the same time, Congress created COP to “review the current state of financial markets and the regulatory system.” The Panel is empowered to hold hearings, review official data, and write reports on actions taken by Treasury and financial institutions and their effect on the economy. Through regular reports, COP must oversee Treasury’s actions, assess the impact of spending to stabilize the economy, evaluate market transparency, ensure effective foreclosure mitigation efforts, and guarantee that Treasury’s actions are in the best interests of the American people. In addition, Congress has instructed COP to produce a special report on regulatory reform that will analyze “the current state of the regulatory system and its effectiveness at overseeing the participants in the financial system and protecting consumers.”

On November 14, 2008, Senate Majority Leader Harry Reid and the Speaker of the House Nancy Pelosi appointed Richard H. Neiman, Superintendent of Banks for the State of New York, Damon Silvers, Associate General Counsel of the American Federation of Labor and Congress of Industrial Organizations (AFL-CIO), and Elizabeth Warren, Leo Gottlieb Professor of Law at Harvard Law School to the Panel. With the appointment on November 19 of Congressman Jeb Hensarling to the Panel by House Minority Leader John Boehner, the Panel had a quorum and met for the first time on November 26, 2008, electing Professor Warren as its chair. On December 16, 2008, Senate Minority Leader Mitch McConnell named Senator John E. Sununu to the Panel, completing the Panel’s membership.

In the production of this report, COP owes special thanks to Adam Blumenthal for his help in interpreting financial statistics and to Professor Adam Levitin for his assistance in working through the foreclosure data. Ganesh Sitaraman provided important drafting help and also deserves COP’s special thanks.

## ALTERNATIVE VIEWS

### Sen. John E. Sununu

The central portion of this report presents Treasury's response to questions posed in the Panel's first report, released on December 10, 2009, as well as an evaluation of those responses. In many cases, the report highlights areas where additional information may or should be provided to better understand Treasury's motives in choosing specific features of the TARP, measuring its performance, and monitoring compliance. In these and other areas, the public is better served by a process that is as clear and transparent as possible.

Compiling this evaluation, and creating a panel report, is a consensus process. As a result, its tone and emphasis cannot perfectly reflect the priorities and language of every member. Taken as a whole, I believe that the material presented in the January Report will help increase the public's understanding of the process to date, and, as such, I have supported its release. In two areas, however, the approach taken is of particular concern and deserves additional clarification.

First, in several places within the report text, language is used which can easily be interpreted as suggesting that the purpose of the TARP is to increase lending to the levels that existed before the current financial crisis. (See, e.g., page 8: "... or increased lending"; page 10: "... why the TARP investments will be slow to produce increased lending"; page 13: "... the goal of the program was to increase consumer or small business lending ...."). But the current crisis was caused, in large part, by the extension of *too much* credit to institutions and individuals that were not creditworthy. This, in turn, has resulted in a broad and dramatic de-leveraging of the global economy. When, and as, the economy begins to recover, it will do so in an environment of lower leverage, and, thus, lower levels of aggregate borrowing than existed in 2007. This fact should not be ignored.

With regard to lending, the TARP is intended to help ensure the *availability* of credit to individuals and businesses that are creditworthy and that credit is made available at sustainable levels over time. Language to this effect is used on page 11 ("... the Panel asked whether Treasury's action preserved access to consumer credit ..."), but by omitting it elsewhere, readers might easily, and incorrectly, conclude that the TARP is intended to bring total borrowing back to pre-crisis levels.

Second, while Treasury can and should provide additional information to the public regarding the TARP's design, its performance, and the compliance of firms receiving capital, there are several questions posed in the Panel's December 10 report that are enormously difficult, if not impossible, to answer with any certainty. Moreover, there are a few that are best left unanswered.

Questions such as: "3.8 Will lower rates lead to a large enough pool of buyers to lead to a general increase in home prices?" and "3.10 Will lower interest rates induce demand for home ownership in the face of falling housing prices, consumer uncertainty about the future of the

economy and unemployment, and the reasonable expectation that an even better deal might be available in the future?” require gross assumptions about multiple economic indicators and human behavior. In the current environment it is not practical to attempt to accurately forecast such behavior.

Questions such as “4.5 Is Treasury seeking to use TARP to shape the future of the American financial system?” and “6.1 Does Treasury believe American families need to borrow more money?” contain vague and sweeping generalizations. No Treasury Secretary should be asked to assert that “American families should borrow more” or “should borrow less” as part of the TARP oversight process. Families and consumers face situations and circumstances that are unique, and those situations and circumstances should be recognized as such.

The work of the Panel is important, and it should help provide the public and Congress with useful information regarding the design, operation, and performance of the TARP. Thus, it is essential that every effort be made to use unambiguous language and to ask direct and practical questions. We must redouble efforts to do so in future reports.

**APPENDIX I:  
LETTER FROM CONGRESSIONAL OVERSIGHT PANEL CHAIR  
ELIZABETH WARREN TO TREASURY SECRETARY MR. HENRY M.  
PAULSON, JR., DATED DECEMBER 17, 2008**



# Congressional Oversight Panel

732 North Capitol Street, NW

Rooms: C-320 and C-617

Mailstop: BOC

Washington, DC 20401

December 17, 2008

Mr. Henry M. Paulson, Jr.  
Secretary of the Treasury  
U. S. Department of the Treasury  
1500 Pennsylvania Avenue, N.W.  
Washington, DC 20220

Dear Mr. Paulson:

I write as chair of the Congressional Oversight Panel established as part of the Emergency Economic Stabilization Act of 2008. On behalf of the Panel, I want to thank you for making it possible for us to meet with the staff of the Treasury in November just as we were getting underway. We appreciate the cooperation and care your staff took in helping us understand the general outlines of the TARP program.

Our panel, which was established on November 26, 2008, issued its first report on December 10. A copy of that report is attached. As mandated by statute, that report will be followed by a report from the panel every thirty days. As we prepare for our January 9, 2009, report, we request your assistance in two ways. First, we ask that you help us answer the ten questions that we posed in our December 10 report. Second, we ask that you appear at a hearing called by the Panel on January 13, 2009. You will receive a formal request, of course, but we wanted you to have an opportunity to put this on your calendar now.

Each of the ten questions we posed has multiple parts. So that there will be no misunderstanding, we have tried in our report to give some of the context and factual background that prompt the questions. We look forward to answers in writing so that we can carefully follow the details.

We request that you send us the answers to these questions within two weeks, that is, by December 30. We know that you and your staff have many pressing duties, but we hope that many of the answers are readily available to you. We must ask for a prompt response because we cannot exercise our 30-day oversight functions in a responsible manner without pressing for timely responses.

Thank you for your attention to this matter. If I can be helpful in any way as you prepare this report, please call on me.

Secretary Henry Paulson

December 17, 2008

Page 2

Yours truly,

A handwritten signature in black ink, appearing to read "E. Warren", written in a cursive style.

Elizabeth Warren  
Chairperson  
Congressional Oversight Panel

Enclosure

cc: Rep. Jeb Hensarling  
Richard H. Neiman  
Damon A. Silvers  
Sen. John E. Sununu

**APPENDIX II: TREASURY DEPARTMENT RESPONSES TO  
QUESTIONS OF THE FIRST REPORT OF THE CONGRESSIONAL  
OVERSIGHT PANEL, DATED DECEMBER 30, 2008**

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RESPONSES TO QUESTIONS  
OF THE FIRST REPORT OF THE CONGRESSIONAL OVERSIGHT PANEL  
FOR ECONOMIC STABILIZATION

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Department of the Treasury

December 30, 2008

## Question 1: What is Treasury's strategy?

### Answer:

The Nation has been experiencing an unprecedented period of financial market turmoil with market events occurring rapidly and unpredictably. The Treasury Department has responded and adapted quickly to these events. Throughout the crisis, Treasury's strategy has been to work in coordination with all government agencies to use all the tools available to the government to achieve the following critical objectives:

- Stabilize financial markets and reduce systemic risk
- Support the housing market by avoiding preventable foreclosures and supporting mortgage finance
- Protect taxpayers.

The measures taken by Treasury under the Emergency Economic Stabilization Act (EESA) are part of a comprehensive strategy by Treasury and the federal regulators since the onset of the crisis to stabilize the financial system and housing markets, and strengthen our financial institutions. Treasury has acted quickly and creatively in coordination with the Federal Reserve, the FDIC, OTS, and the OCC to help stabilize the financial system. In addition, because the crisis is global in nature, Treasury and the Federal Reserve have also worked in close coordination with Finance Ministries and major Central Banks around the world, which have taken similar measures to stabilize their financial systems. It is clear that our coordinated actions have made an impact. Our coordinated effort to strengthen our financial institutions so they can support our economy is critical to working through the current economic downturn.

The following is a list of many of the actions taken by Treasury and other federal agencies as part of our comprehensive approach. Detailed information on all of these programs is available on websites of the respective federal agencies.

### a) Actions to Stabilize Financial Markets

- **Term Asset-Backed Securities Loan Facility (TALF):** Treasury is providing TARP support for this program, which was created by the Federal Reserve, to support consumer lending. The TALF will help market participants meet the credit needs of households and small businesses by supporting the issuance of asset-backed securities (ABS) collateralized by student loans, auto loans, credit card loans, and loans guaranteed by the Small Business Administration.
- **Term Auction Facility (TAF):** Under the TAF, the Federal Reserve auctions term funds to depository institutions. All depository institutions that are eligible to borrow under the primary credit program are eligible to participate in TAF auctions. All advances must be fully collateralized.
- **Term Securities Lending Facility (TSLF):** Under the TSLF, the Federal Reserve lends Treasury securities to primary dealers secured by a pledge of other securities, including federal agency debt, federal agency residential mortgage-backed securities, and non-agency AAA/Aaa-rated private-label residential MBS.
- **Primary Dealer Credit Facility (PDCF):** The PDCF is an overnight loan facility that provides funding to primary dealers in exchange for a specified range of eligible

collateral. On September 14, 2008, the Federal Reserve announced that collateral eligible to be pledged at the PDCF had been broadened. The program is intended to foster the functioning of financial markets more generally.

- **Money Market Investor Funding Facility (MMIFF):** The MMIFF supports a private-sector initiative designed to provide liquidity to U.S. money market investors. Under the MMIFF, the Federal Reserve Bank of New York (FRBNY) provides senior secured funding to a series of special purpose vehicles to facilitate an industry-supported private-sector initiative to finance the purchase of eligible assets from eligible investors.
- **Temporary Guarantee Program for Money Market Mutual Funds:** This program offers unprecedented government insurance in order to address concerns about the safety and accessibility of these investments and enhance market confidence. Treasury quickly set this program up after a mutual fund “broke the buck” for the second time in history.
- **Commercial Paper Funding Facility (CPFF):** The Federal Reserve created the CPFF to provide a liquidity backstop to U.S. issuers of commercial paper. The CPFF is intended to improve liquidity in short-term funding markets and thereby contribute to greater availability of credit for businesses and households. Under the CPFF, FRBNY finances the purchase of highly-rated unsecured and asset-backed commercial paper from eligible issuers via eligible primary dealers.
- **Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility:** The Federal Reserve established this lending facility to provide funding to U.S. depository institutions and bank holding companies to finance their purchases of high-quality asset-backed commercial paper (ABCP) from money market mutual funds under certain conditions. The program is intended to assist money funds that hold such paper in meeting demands for redemptions by investors and to foster liquidity in the ABCP market and money markets more generally.
- **Swap Lines with Foreign Central Banks:** On September 29, 2008 the Federal Reserve authorized a \$330 billion expansion of its temporary reciprocal currency arrangements (swap lines). The Federal Reserve enacted this program to improve the distribution of dollar liquidity around the globe and it is available to other central banks through April 30, 2009. The program was enacted because, at the time, dollar funding rates abroad had been elevated relative to dollar funding rates available in the U.S., reflecting a structural dollar funding shortfall outside of the U.S. The increase in the amount of foreign exchange swap authorization limits enabled many foreign central banks to increase the amount of dollar funding that they can provide in their home markets.

#### **b) Actions to Strengthen U.S. Financial Institutions**

- **Temporary Increase in Deposit Insurance:** On October 3, as part of the EESA, the FDIC temporarily raised the deposit insurance limit from \$100,000 to \$250,000 for all deposit categories until December 31, 2009.
- **Temporary Liquidity Guarantee Program (TLGP):** On October 14, 2008, the FDIC established the TLGP in the following two parts:
  - **Debt Guarantee Program (DGP):** The DGP temporarily guarantees all senior unsecured debt newly issued by FDIC-insured institutions and certain holding companies on or after October 14, 2008, through June 30, 2009.

- Transaction Account Guarantee Program: the FDIC also temporarily provides full deposit insurance coverage to deposits in non-interest bearing transaction accounts (mainly payment processing accounts) until December 31, 2009.
- **Capital Purchase Program (CPP):** The CPP is a key component of the TARP. Treasury established this voluntary program to stabilize financial markets by providing capital to healthy institutions, increasing the flow of credit to businesses and consumers and supporting the U.S. economy. Under the CPP, Treasury will purchase up to \$250 billion of senior preferred shares on standardized terms as described in the program's term sheet. The program is available to qualifying U.S. controlled banks, savings associations, and certain bank and savings and loan holding companies engaged only in financial activities. Institutions participating in the program must adopt the Treasury Department's standards for executive compensation and corporate governance for the period during which Treasury holds equity issued under this program.
- **Systemically Significant Failing Institutions Program (SSFI):** The SSFI program is another key component of the TARP. Treasury will provide capital on a case-by-case basis to systemically significant institutions that are at substantial risk of failure. In determining eligibility, Treasury may consider the following, among other factors: the extent to which the failure of an institution could threaten the viability of its creditors and counterparties; the number and size of financial institutions that are seen by investors or counterparties as similarly situated to the failing institution, or that would otherwise be likely to experience indirect contagion effects from the failure of the institution; whether the institution is sufficiently important to the nation's financial and economic system; or the extent and probability of the institution's ability to access alternative sources of capital and liquidity.

### c) Initiatives to Support the U.S. Housing Market

- **FHASecure:** Announced by HUD in August 2007, the *FHASecure* program offers homeowners who have missed payments an opportunity to refinance into affordable FHA-insured loans. More than 450,000 homeowners have refinanced through *FHASecure* since the launch of the program.
- **HOPE NOW:** In October 2007, Treasury actively helped facilitate the creation of the HOPE NOW Alliance, a private sector coalition of mortgage market participants and non-profit housing counselors. HOPE NOW servicers represent more than 90 percent of the subprime mortgage market and 70 percent of the prime mortgage market. Since inception, HOPE NOW has kept roughly 2.9 million homeowners in their homes through modifications and repayment plans, and it is currently helping more than 200,000 borrowers per month.
- **Stabilizing Fannie Mae and Freddie Mac:** Treasury took aggressive actions in 2008 to stabilize and strengthen Fannie Mae and Freddie Mac, and prevent the collapse of two institutions with \$5.4 trillion in debt and mortgage-backed securities held by investors and financial institutions throughout the United States and the world. The systemic importance of these two enterprises, and the systemic impact of a collapse of either, cannot be overstated. Treasury's efforts to stabilize them by effectively guaranteeing their debt has increased the flow of mortgage credit and insulated mortgage rates from the rapid increases and fluctuations in the cost of other credit.

- **Hope for Homeowners:** On October 1, 2008, HUD implemented Hope for Homeowners, a new FHA program, available to lenders and borrowers on a voluntary basis, that insures refinanced affordable mortgage loans for distressed borrowers to support long-term sustainable homeownership.
- **Streamlined Loan Modification Program:** On November 11, 2008, Treasury joined with the FHFA, the GSEs, and HOPE NOW to announce a major streamlined loan modification program to move struggling homeowners into affordable mortgages. The program, implemented on December 15, 2008, creates sustainable monthly mortgage payments by targeting a benchmark ratio of housing payments to monthly gross household income (38%). Additionally, on November 20, 2008, Fannie Mae and Freddie Mac announced that they would suspend foreclosure sales and cease evictions of owner-occupied homes to allow time for implementation of the modification program.
- **Subprime Fast-Track Loan Modification Framework:** Treasury worked with the American Securitization Forum to develop a loan modification framework to allow servicers to modify or refinance loans more quickly and systematically. Subprime ARM borrowers who are current but ineligible to refinance may be offered a loan modification freezing the loan at the introductory rate for five years.

Treasury, working with the Federal Reserve, the FDIC and other regulators, has taken the necessary steps to prevent a financial collapse. The authorities and flexibility granted to the Treasury Department by Congress have been essential to developing the programs necessary to meet these objectives. Strong financial institutions and a stable financial system will smooth the path to economic recovery and an eventual return to prosperity.

**Question 1b: What specific facts changed that led to your change in strategy?**

**Answer:**

In the discussions with the Congress in mid-September during consideration of the financial rescue package legislation, Treasury focused on an initial plan to purchase illiquid mortgage assets in order to remove the uncertainty regarding banks' capital strength. At the same time, Treasury worked hard with the Congress to build maximum flexibility into the law to enable Treasury to adapt our policies and strategies to address market challenges that may arise.

In the weeks after Secretary Paulson and Chairman Bernanke first went to the Congress, market conditions deteriorated at an unprecedented and accelerating rate. One key measure Treasury assessed was the LIBOR-OIS spread – a key gauge of funding pressures and perceived counterparty credit risk. Typically between 5 – 10 basis points, on September 1, the one month spread was 47 basis points. By September 18<sup>th</sup>, when Treasury first went to Congress, the spread had climbed 88 basis points to 135 basis points. By the time the bill passed, just two week later on October 3, the spread had climbed another 128 basis points to 263 basis points. By October 10, LIBOR-OIS spread rose another 75 basis points to 338 basis points. During this period, credit markets effectively froze. The commercial paper market shut down, 3-month Treasuries dipped below zero, and a money market mutual fund “broke the buck” for only the second time in history, precipitating a \$200 billion net outflow of funds from that market.



Given such market conditions, Secretary Paulson and Chairman Bernanke recognized that Treasury needed to use the authority and flexibility granted under the EESA as aggressively as possible to help stabilize the financial system. They determined the fastest, most direct way was to increase capital in the system by buying equity in healthy banks of all sizes. Illiquid asset purchases, in contrast, require much longer to execute.

Treasury then began immediately designing a capital program to complement the asset purchase programs under development. Since launching the program on October 14, 2008, we have invested \$162 billion in 208 institutions of all sizes across the country.

As Treasury continued very serious preparations and exploration of purchasing illiquid assets, scale became a factor; for an asset purchase program to be effective, it must be done in very large scale. With \$250 billion allocated for the CPP, Treasury considered whether there was sufficient capacity in the TARP for an asset purchase program to be effective. In addition, each dollar invested in capital can have a bigger impact on the financial system than a dollar of asset purchase; capital injections provide better “bang for the buck.”

As markets continued to deteriorate through October, it became clear that the preservation of market stability would require that Treasury support non-bank financial institutions and the securitization market, both of which are crucial sources of lending for consumers and business of all sizes.

## **Question 2: Is the strategy working to stabilize markets?**

### **Answer:**

Yes. The most important evidence that our strategy is working is that Treasury’s actions, in combination with other actions, stemmed a series of financial institution failures. The financial system is fundamentally more stable than it was when Congress passed the legislation. While it is difficult to isolate one program's effects given policymakers' numerous actions, one indicator that points to reduced risk of default among financial institutions is the average credit default swap spread for the eight largest U.S. banks, which has declined by about 240 basis points since before Congress passed the EESA. Another key indicator of perceived risk is the spread between LIBOR and OIS: 1 month and 3-month LIBOR-OIS spreads have declined about 220 and 145 basis points, respectively, since the law was signed and about 310 and 240 basis points, respectively, from their peak levels before the CPP was announced.

Treasury is also monitoring the effects our strategy is having on lending, although it is important to note that nearly half the money allocated to the Capital Purchase Program has yet to be received by the banks. Treasury is executing at a rapid speed, but it will take some time to review and fund all the remaining applications. Clearly this capital needs to get into the system before it can have the desired effect. In addition, we are still at a point of low confidence – both due to the financial crisis and the economic downturn. As long as confidence remains low, banks will remain cautious about extending credit, and consumers and businesses will remain cautious about taking on new loans. As confidence returns, Treasury expects to see more credit extended.

The increased lending that is vital to our economy will not materialize as fast as anyone would like, but it will happen much faster as a result of deploying resources from the TARP to stabilize the system and increase capital in our banks.

**Question 3: Is the strategy helping to reduce foreclosures?**

**Answer:**

Yes. Treasury has moved aggressively to keep mortgage financing available and develop new tools to help homeowners. Specifically, Treasury has achieved the following three key accomplishments:

1. To support the housing and mortgage market, Treasury acted earlier this year to prevent the failure of Fannie Mae and Freddie Mac, the housing GSEs that affect over 70 percent of mortgage originations. These institutions are systemically critical to financial and housing markets, and their failure would have materially exacerbated the recent market turmoil and profoundly impacted household wealth. Mortgage finance is available today on attractive terms because of Treasury's actions with the Federal Reserve and the Federal Housing Finance Agency to stabilize Fannie Mae and Freddie Mac. In addition, Treasury and the Federal Reserve have both announced programs to purchase GSE mortgage-backed securities. These programs are lowering borrowing rates for homeowners, to both purchase homes and to refinance into more affordable mortgages.

2. October 2007, Treasury helped establish the HOPE NOW Alliance, a coalition of mortgage servicers, investors and counselors, to help struggling homeowners avoid preventable foreclosures. HOPE NOW estimates that roughly 2.9 million homeowners have been helped by the industry since July 2007; the industry is now helping more than 200,000 homeowners a month avoid foreclosure. In addition, Treasury worked with HOPE NOW and the ASF to develop a fast-track loan modification program to modify loans of subprime ARM borrowers facing unaffordable rate resets.

3. Treasury worked with HOPE NOW, FHFA and the GSEs to achieve a major industry breakthrough in November 2008 with the announcement of a streamlined loan modification program that builds on the mortgage modification protocol developed by the FDIC for IndyMac. By targeting a benchmark ratio of housing payments to gross monthly household income, HOPE NOW servicers and the GSEs will have greater ability to quickly and efficiently create sustainable monthly mortgage payments for troubled borrowers. Potentially hundreds of thousands more struggling borrowers will be enabled to stay in their homes at an affordable monthly mortgage payment. Many private-label mortgage-backed securities pooling and servicing agreements reference the GSE servicing standards, giving this new program reach far beyond GSE loans.

An important complement to those guidelines was the GSEs' announcement on November 20, 2008 that they will suspend all foreclosures for 90 days. The foreclosure suspension will give homeowners and servicers time to utilize the new streamlined loan

modification program and make it possible for more families to work out terms to stay in their homes.

**Question 4: What have financial institutions done with the taxpayers' money received so far?**

**Answer:**

The goal of the Capital Purchase Program is to stabilize the financial system and restore confidence in financial institutions, which will increase the flow of credit. To date, 208 financial institutions of all sizes have received investments through the CPP. These institutions include regional, small and community banks, as well as Community Development Finance Institutions, all of which play a vital role in their communities. We expect communities of all sizes to benefit from the investments into these institutions, which now have an enhanced capacity to perform their vital functions, including lending to U.S. consumers and businesses and promoting economic growth.

As the GAO noted in its report, given the number and variety of financial stability actions being put in place by multiple entities, it will be challenging to view the impact of the Capital Purchase Program in isolation and at the institutional level. Moreover, each individual financial institution's circumstances are different, making comparisons challenging at best, and it is difficult to track where individual dollars flow through an organization. Nonetheless, Treasury is working with the banking regulators to develop appropriate measurements and Treasury is focused on determining the extent to which the CPP is having its desired effect.

The CPP began in October 2008 and the money must work its way into the system before it can have the desired effect. Moreover, we are still at a point of low confidence – both due to the credit crisis and due to the economic downturn, during which lending and borrowing levels normally drop. While confidence is low, banks will remain cautious about extending credit, and consumers and businesses will remain cautious about taking on new loans. As confidence returns, we expect to see more credit extended. This lending won't materialize as fast as anyone would like, but it will happen much faster as a result of having used the TARP to stabilize the system and to increase the capital in our banks.

We also know that credit quality at banks is deteriorating. This has led banks to build up their loan loss reserves and to work with troubled borrowers to restructure loans. The level of loan loss provisioning by banks doubled in the third quarter from one year ago, putting pressure on bank earnings and capital. By injecting new capital into healthy banks, the CPP has helped banks maintain strong balance sheets and eased the pressure on them to scale back their lending and investment activities.

As a direct result of Treasury's actions through TARP, all participating financial institutions in the CPP have stronger capital positions, and with higher capital levels and restored confidence, banks can continue to play their role as financial lenders in our communities. While difficult to achieve during times like this, this lending is essential to economic recovery.

In the case of the SSFI program, Treasury did not provide funds to a financial institution directly. The \$40 billion in Treasury funds was paid directly to the FRBNY to restructure AIG's balance sheet. AIG did not receive those funds. The FRBNY credit facility has helped minimize the disorderly collateral effects on healthy banks, which were counterparties that bought insurance from AIG. Treasury's investment in AIG was necessary to preserve stability in the financial system and to give AIG time to sell assets in an orderly manner to pay back taxpayers.

#### **Question 5: Is the public receiving a fair deal?**

##### **Answer:**

Yes. The American people have benefited from the financial rescue package. The financial crisis, and the ensuing economic downturn, would have been far worse without this legislation and our implementation of it. In addition, Treasury has designed its programs, consistent with EESA, to protect the taxpayer and to provide positive return on investments to the maximum extent possible. For example, under the CPP, Treasury will purchase up to \$250 billion of senior preferred shares on standardized terms, including a 5 percent dividend for 5 years, which then increases to 9 percent. The government will not only own shares which we expect to yield a reasonable return, but will also receive warrants for common shares in participating institutions. These warrants allow the taxpayer to benefit from any appreciation in the market value of the institution.

When measured on an accrual basis, the value of the preferred stock is at or near par. Furthermore, Treasury has already started receiving required dividend payments. On a mark-to-market basis, the value of some preferred stock may be judged lower when compared to the date of purchase as equity markets have experienced pressure since the program began. In addition to preferred stock, Treasury also received warrants in the institutions it has invested in to provide further value and protection to taxpayers (other than community development organizations which are exempt from warrant requirements). These warrants also have positive value.

Treasury is investing in banks of all sizes around the country to help stabilize the financial system and get credit flowing to our communities. Treasury is not making these investments for short-term gains – we are not day traders. Over time, Treasury believes the taxpayers will be protected by ensuring the stability of the financial system and by earning a return on these investments when they are eventually liquidated.

#### **Question 6: What is Treasury doing to help the American family?**

##### **Answer:**

Every aspect of the implementation of the financial rescue package has a single purpose – to stabilize the financial system so it can support the financing needs of the American people, as consumers and as owners and employees of businesses. American families rely on the services provided by a wide array of sound financial institutions and financial markets, such as savings and investment for retirement (e.g., 401k accounts), and access to affordable credit for education, business development, and even daily necessities. For example, when financial institutions fail and when various credit markets don't function, every American household is impacted. A bank failure can suspend or end access to basic financial services in a community, and create

enormous anxiety among individuals. As the commercial paper market came under pressure, small and large businesses had difficulty raising money to meet basic needs such as making payroll or purchasing inventory. Consumer credit relies on the securitization market, which froze this year, increasing the costs of credit cards, car loans, and student loans.

All of the steps that Treasury has taken, alone and in coordination with the regulators, are benefiting Americans because they have prevented a further deterioration of the financial system. The problems facing the financial sectors here and abroad arose over a number of years and it will take time for the restoration of normal financial markets. There is no single action the federal government can take to end the financial market turmoil and the economic downturn, but Treasury is confident that we are pursuing the right strategy to stabilize the financial system and support the flow of credit to our economy. The TARP is just one of many policy measures that Treasury has taken to restore the liquidity and capital necessary to support economic growth, protect the savings of millions of individuals and restore the flow of credit to consumers and businesses. In addition, the measures we are taking are allowing the process of financial intermediation to continue- which means that banks and financial institutions can play their vital role in the economy, including providing savings, retirement and lending services. Some of the specific programs we have established to directly help American families are:

- **Term Asset Backed Securities Lending Facility:** Consumer credit is critical for many households as they consider purchasing a car, new appliances, or other big ticket items. Like other forms of credit, the availability of affordable consumer credit depends on ready access to a liquid and affordable secondary market – in this case, the asset backed credit market. Recent credit market stresses essentially brought this market to a halt in October 2008. As a result, millions of Americans cannot find affordable financing for their basic credit needs. And credit card rates are climbing, making it more expensive for families to finance everyday purchases. The Federal Reserve and the Treasury announced an aggressive program to support the normalization of credit markets and the availability of affordable consumer credit to support economic recovery. Treasury will invest \$20 billion in a Federal Reserve facility that will provide liquidity to issuers of consumer asset backed paper, enabling a broad range of institutions to step up their lending, and enabling borrowers to have access to lower-cost consumer finance (auto loans, credit cards, student loans) and small business loans. The facility may be expanded over time and eligible asset classes may be expanded later to include other assets, such as commercial mortgage-backed securities, non-agency residential mortgage-backed securities or other asset classes.
- **Guarantee for Money Market Mutual Funds:** In September 2008, after a money market mutual fund “broke the buck” for only the second time in history, Treasury established a temporary Guarantee Program for Money Market Mutual Funds. The program will help protect the savings and pensions of individuals, as well as institutional investors.
- **Fannie Mae and Freddie Mac:** The housing correction has been at the root of the crisis. One of the most important things Treasury can do to mitigate foreclosures and progress through the housing correction is to reduce the cost of mortgage finance, so more families

can afford to buy a home, and so homeowners can refinance into more affordable mortgages. Treasury took strong actions in 2008 to stabilize and strengthen Fannie Mae and Freddie Mac, and prevent the collapse of two institutions with \$5.4 trillion in debt and mortgage-backed securities held by investors and financial institutions throughout the United States and the world. The systemic importance of these two enterprises, and the systemic impact of a collapse of either, cannot be overstated. Treasury's efforts to stabilize them by effectively guaranteeing their debt has increased the flow of mortgage credit and insulated mortgage rates from the rapid increases and fluctuations in the cost of other credit. Recently, the Federal Reserve announced that it will purchase \$100 billion in GSE debt and half a trillion dollars in GSE mortgage backed securities, which should have a strongly positive impact on the cost of mortgage finance. Treasury continues to look for additional ways to make mortgage credit more affordable, which will stimulate home purchases, help to stabilize prices and end this housing correction.

- **HOPE NOW:** October 2007, Treasury helped establish the HOPE NOW Alliance, a coalition of mortgage servicers, investors and counselors, to help struggling homeowners avoid preventable foreclosures. HOPE NOW estimates that roughly 2.9 million homeowners have been helped by the industry since July 2007; the industry is now helping more than 200,000 homeowners a month avoid foreclosure. In addition, Treasury worked with HOPE NOW and the ASF to develop a fast-track loan modification program to modify loans of subprime ARM borrowers facing unaffordable rate resets.
- **Streamlined Loan Modification Program:** On November 11, 2008, Treasury joined with the FHFA, the GSEs, and HOPE NOW to announce a major streamlined loan modification program to move struggling homeowners into affordable mortgages. The program, implemented on December 15, creates sustainable monthly mortgage payments by targeting a benchmark ratio of housing payments to monthly gross household income (38%). Additionally, on November 20, 2008, Fannie Mae and Freddie Mac announced that they would suspend foreclosure sales and cease evictions of owner-occupied homes to allow time for implementation of the modification program.

**Question 7: Is Treasury imposing reforms on financial institutions that are taking taxpayer money?**

**Answer:**

The CPP is a voluntary program for viable institutions. The program was designed to be attractive to financial institutions of all sizes as a mechanism to increase capital in the financial system while also protecting the taxpayer. Treasury established strict executive compensation requirements on all participating institutions, as per the requirements set out in the EESA. Treasury barred any increase in dividends for 3 years and restricted share repurchases. Increasing dividends or buying back shares would undermine our policy objective by taking capital out of the financial system. In addition, Treasury is taking warrants in participating institutions so that taxpayers benefit from any appreciation in the value of these firms' stock.

Under the Systemically Significant Failing Institution program, additional terms and conditions were established for AIG. As a condition of extending an \$85 billion line of credit to AIG, the Fed required a change in management at AIG. Also as a condition for Treasury assistance under TARP, AIG must meet stringent executive compensation, corporate expenses and lobbying restrictions.

Treasury is committed to rigorous oversight of the restrictions pertaining to executive compensation and is continuing to develop a comprehensive compliance program to ensure that institutions adhere to executive compensation provisions.

### **Question 8: How is Treasury deciding which institutions receive the money?**

#### **Answer:**

All information about the terms and conditions of the CPP, including the formal application process and forms, is publically available on the Treasury website, as well as on the websites of all the primary federal regulators.

- *Institutions:* The Capital Purchase Program is available to a broad array of private and publically held- financial institutions of all sizes- including qualifying U.S. controlled banks, savings associations, and certain bank and savings and loan holding companies. The program is designed for healthy banks – banks that are considered viable without government investment. It is designed to have attractive terms to encourage healthy banks to participate; they are best positioned to increase the flow of credit in their communities.
- *Terms:* The terms for this program are the same for all institutions. Treasury issued a term sheet for publically held banks and followed with term sheet for private depositories. The minimum subscription amount available to a participating institution is 1 percent of risk-weighted assets. The maximum subscription amount in this program is the lesser of \$25 billion or 3 percent of risk-weighted assets. Treasury also created a standard investment agreement for all banks, regardless of size.
- *Application Process:* There is one common application form that all qualified and interested financial institutions used to submit to their primary regulator – the Federal Reserve, the FDIC, the OCC or the OTS. This common application form is available on the websites of all the regulatory agencies.
- *Evaluation Process:* Treasury worked closely with the banking regulators to establish a standardized evaluation process; this means that all regulators use the same standards to review all applications to ensure consistency. Once a Federal regulator has reviewed an application, it will take one of the following three actions:
  1. For applications the regulator does not recommend, it may encourage the institution to withdraw the application.
  2. For applications the regulator strongly believes should be included in the program, it directly sends the application and its recommendation to the TARP Investment Committee at the Treasury Department.

3. For cases that are less clear, the regulator will forward the application to a Regulatory Council, made up of senior representatives of the four banking regulators for a joint review and recommendation. Treasury is an observer on the Council. The Regulatory Council will make a joint recommendation of either withdrawal or approval.

The Treasury TARP Investment Committee reviews all recommendations from the regulators and recommendations for CPP investment are made based on all of the information received from the above process. The Investment Committee gives considerable weight to the recommendations of the banking regulators. In some cases, the Committee will send the application back to the primary regulator for additional information, or even remand it to the Regulatory Council for further review. At the end of the evaluation process, Treasury notifies all approved institutions.

Institutions then have 30 days to complete the required documents before Treasury funds the transaction. All completed transactions will be publicly announced within 2 business days of execution, as required by the law. Treasury will not, however, announce any applications that are withdrawn or denied.

Treasury's investment committee includes senior officials on financial markets, economic policy, financial institutions, and financial stability, as well as the Chief Investment Officer for the TARP. For SSFI and other programs, Treasury makes the decision on a case-by-case basis.

The goal of TARP is to stabilize the financial system and restore confidence in and of financial institutions, enabling credit to flow to consumers and businesses. In March of 2008, Treasury published an extensive Blueprint for a Modernized Regulatory Structure that proposes a framework and many specific recommendations for reforming our financial regulatory system. Our current system is a patchwork quilt that developed over many decades and is not optimal for our complex financial system today. Treasury is using TARP to stabilize the financial system today, while regulatory modernization will likely take several years to complete.

### **Question 9: What is the scope of Treasury's statutory authority?**

#### **Answer:**

The Emergency Economic Stabilization Act of 2008 ("EESA") was enacted by Congress and signed by the President with the stated purposes "*(1) to immediately provide authority and facilities that the Secretary of the Treasury can use to restore liquidity and stability to the financial system of the United States; and (2) to ensure that such authority and such facilities are used in a manner that (A) protects home values, college funds, retirement accounts, and life savings; (B) preserves homeownership and promotes jobs and economic growth; (C) maximizes overall returns to the taxpayers of the United States; and, (D) provides public accountability for the exercise of such authority.*"<sup>1</sup> In order to achieve these purposes, Congress provided broad authority to the Secretary of the Treasury to establish the Troubled Asset Relief Program to purchase, and to make and fund commitments to purchase, troubled assets from any financial

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<sup>1</sup> Emergency Economic Stabilization Act of 2008 ("EESA"), Sec. 2.



institution, on terms and conditions determined by the Secretary in accordance with EESA and applicable policies and procedures.

Recognizing the severity of the economic challenges facing the U.S. financial system, Congress incorporated a broad definition of financial institutions which covers any institution established and regulated in the United States or its territories and which has significant operations in the United States; the definition of financial institutions includes, but by its express terms is not limited to, banks, savings associations, credit unions, security broker or dealers and insurance companies.<sup>2</sup> The definition of “troubled asset” provides authority to the Secretary, in consultation with the Chairman of the Board of Governors of the Federal Reserve System, to define a “troubled asset” as any financial instrument the purchase of which is necessary to promote financial market stability.”<sup>3</sup>

In exercising this authority, Treasury is limited by a series of requirements and directions set out in EESA. These requirements, which are found in a variety of sections of EESA including sections 101, 103, 104, 105, 107, 108, 109, 110, 111, 113, 115, 121, and 125, encompass, among other things, requirements related to transactions, conflicts of interest, executive compensation, maximizing taxpayers returns, reporting, oversight, and coordination.

Treasury is working on developing an insurance program under section 102. Treasury will submit a report on Dec. 31, 2008 regarding the status of that program.

**Question 10: Is Treasury looking ahead?**

**Answer:**

Yes. Treasury is actively engaged in developing additional programs to strengthen our financial system so that credit flows to our communities. Treasury believes that the new authorities Congress provided in October dramatically expanded the tools available to address the needs of our system. We have made significant progress, but there is no single action the federal government can take to end the financial market turmoil and the economic downturn. We are confident that we are pursuing the right strategy to stabilize the financial system and support the flow of credit to our economy.

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<sup>2</sup> EESA Sec. 3(5).

<sup>3</sup> EESA Sec. 3(9).