



FOR OFFICIAL USE ONLY UNTIL RELEASED BY THE
SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

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

BEFORE THE
SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

September 24, 2009

Chairman Dodd, Ranking Member Shelby and Members of the Committee, I am honored to appear before you today to discuss the Troubled Asset Relief Program (“TARP”) as we approach the first anniversary of enactment of the Emergency Economic Stabilization Act of 2008 (“EESA”). I am particularly honored to appear with SIGTARP’s oversight partners, Acting Comptroller General Gene Dodaro of the Government Accountability Office and Elizabeth Warren, Chair of the Congressional Oversight Panel.

INTRODUCTION

Originally envisioned as a large but fairly straightforward program involving the purchase and management of “toxic” assets, TARP instead has evolved into 12 separate initiatives that are, collectively, of an unprecedented scope, scale, and complexity. From programs involving large capital infusions into hundreds of banks and other financial institutions, to a mortgage modification program designed to modify millions of mortgages, to significant infusions into the automobile industry, to public-private partnerships using tens of billions of taxpayer dollars to purchase “toxic” assets from banks, TARP affects significant portions of the financial system and the economy as a whole.

From a policy perspective, any assessment of whether such a complex enterprise is a success or failure, particularly in light of all of the other Government efforts to stabilize the economy during the worst economic downturn in decades, is a difficult task and depends greatly on one’s perspective. With respect to whether TARP has succeeded in restoring liquidity and stability to the financial system, for example, there are without question significant signs of improvement in the stability of the system. The causes for such improvement are no doubt many and complex, but there is little question that the dramatic steps taken by Treasury, the Federal Reserve and the FDIC through TARP and related programs, in the face of what can only be described as panic conditions, played a significant role in bringing the system back from the brink of collapse.

Whether the other policy goals of EESA are being met, on the other hand, is less clear. The progress on meeting the goal of “maximiz[ing] overall returns to the taxpayer” is unclear. While several TARP recipients have repaid funds for what has widely been reported as a 17% profit, it is extremely unlikely that the taxpayer will see a full return on its TARP investment. For example, certain TARP programs, such as the mortgage modification program which is scheduled to use \$50 billion of TARP funds, will yield no direct return, and for others, including the extraordinary assistance programs to AIG and the auto companies, full recovery is far from certain. Similarly, Treasury’s original stated goal of increasing lending has not yet occurred, although, as SIGTARP’s recently issued audit on TARP recipients’ use of funds indicates, it is likely that lending from TARP recipients would have decreased far more in the absence of TARP funding. Similarly, the goals of “preserving homeownership,” “promot[ing] jobs and economic growth” have not yet been met, and the ultimate success of meeting these policy goals will depend on programs that are just now reaching the implementation stage, such as the TARP’s mortgage modification program and the public-private investment funds. In the meantime, the risk of foreclosure continues to affect too many Americans; unemployment continues its rise to levels that Treasury has characterized as “unacceptable”; the so-called “toxic” assets that helped cause this crisis for the most part remain right where they were last fall – on the banks’ balance

sheets; and it is becoming more and more clear that the commercial real estate market might be the next proverbial shoe to drop, threatening to increase the pressure on banks and small business alike yet again.

Viewed from an oversight perspective, the success of the program is likewise mixed. With respect to imposing internal controls over TARP programs, Treasury has steadily improved over time. When SIGTARP first came into being in December 2008, Treasury was simply not equipped – from a resource perspective or in terms of its approach – to provide the kind of oversight and compliance functions that are necessary to manage such a large and complex program effectively. Treasury rolled out early programs with few meaningful conditions and little regard for internal controls: in the Capital Purchase Program (“CPP”) investments, for example, Treasury’s overriding oversight strategy was apparently to trust the banks to be responsible with the money. Over time, and in response to recommendations from the oversight bodies represented at this table, Treasury began to design programs with better internal controls and more effective anti-fraud provisions. Just eight days after I was sworn in, for example, we made a recommendation concerning basic internal controls that was adopted by Treasury and implemented into all subsequent programs. Today, in response to our repeated recommendations, the Office of Financial Stability has been devoting the necessary resources to develop a professionally run Compliance and Risk Management function, and while we do not always necessarily agree with them, it is fair to say that, with each program, Treasury actively engages with us with an eye to making the program better from a compliance perspective and less susceptible to waste, fraud and abuse.

Treasury’s basic attitude towards transparency and Congress’ stated goal in enacting the TARP of providing “public accountability” for the exercise of authority under EESA, on the other hand, remains a significant frustration. Although SIGTARP understands Treasury’s need to balance the public’s transparency interests, on one hand, with the interests of the participants and the desire to have wide participation in the programs, on the other, Treasury’s default position should always be to require more disclosure rather than less and to provide the investors in TARP — the American taxpayers — as much information about what is being done with their money as possible. While Treasury has taken some steps in the right direction on this front, its continued refusal to accept SIGTARP’s basic transparency recommendations on such issues as how TARP recipients are using TARP funds and the disclosure of trading of toxic assets of banks in the PPIP means that TARP largely remains a program in which taxpayers are not being told what most of the TARP recipients are doing with their money and will not be told the full details of how their money is being invested.

TARP IN FOCUS, AND IN CONTEXT

TARP, as originally envisioned in the fall of 2008, would have involved the purchase, management, and sale of up to \$700 billion of “toxic” assets, primarily troubled mortgages and mortgage-backed securities (“MBS”). Very quickly, however, that framework was discarded in favor of direct investments in financial institutions, and TARP funds have subsequently been used, are being used, or have been announced to be used, in connection with 12 separate programs that involve a total (including TARP funds, loans and guarantees from other agencies, and private money) that could reach more than \$2 trillion, as set forth in first column of Table 1 below. Treasury has announced the parameters how the \$700 billion may be spent for the 12 programs, as set forth in the second column;

of this amount, Treasury has legally committed to expend or expended approximately \$445 billion, as set forth in the third column.

TOTAL POTENTIAL FUNDS SUBJECT TO SIGTARP OVERSIGHT, AS OF 6/30/2009 (\$ BILLIONS)				
Program	Brief Description or Participant	Total Projected Funding at Risk (\$)	Projected TARP Funding (\$)	Committed to Expend or Expended (\$)
Capital Purchase Program	Investments in 649 banks as of 6/30/09; 8 institutions total \$134 billion; received \$70.6 billion in capital repayments through 9/11/09	\$218.0 (\$70.6)	\$218.0 (\$70.6)	204.5
Automotive Industry Financing Program	GM, Chrysler, GMAC, Chrysler Financial; received \$2.14 billion in loan repayments (Chrysler Financial)	79.3 (1.5)	79.3 (1.5)	79.3
Auto Supplier Support Program	Government-backed protection for auto parts suppliers	3.5	3.5	3.5
Auto Warranty Commitment Program	Government-backed protection for warranties of cars sold during the GM and Chrysler bankruptcy restructuring proceedings.	0.6 (0.6)	0.6 (0.6)	0.6
Systemically Significant Failing Institutions	AIG investment	69.8	69.8	69.8
Targeted Investment Program	Citigroup, Bank of America investments	40.0	40.0	40.0
Asset Guarantee Program	Citigroup, ring-fence asset guarantee	301.0	5.0	5.0
Term Asset-Backed Securities Loan Facility	FRBNY non-recourse loans for purchase of asset-backed securities	1,000.0	80.0	20.0
Making Home Affordable Program	Modification of mortgage loans	75.0	50.0	22.3
Public-Private Investment Program	Disposition of legacy assets; Legacy Loans Program, Legacy Securities Program (expansion of TALF)	500.0 – 1,000.0	75.0	0.0
Capital Assistance Program	Capital to qualified financial institutions; includes stress test	TBD	TBD	0.0
Unlocking Credit for Small Businesses	Purchase of securities backed by SBA loans.	15	15	0.0
New Programs, or Funds Remaining for Existing Programs	Potential additional funding related to CAP; other programs	135.5	134.5	0.0
Total		\$2,365.0 – \$2,865.0	\$699.0	\$445

As noted in the chart, approximately \$70.56 billion has been repaid to the TARP by more than a dozen financial institutions, under the CPP. Through September 11, 2009, the Treasury Department granted permission to 41 financial institutions to repay \$70.56 billion in government-bailout funds. Of the 19 largest bank holding companies selected for stress testing under the Supervisory Capital Assessment Program, 9 institutions were approved to repay \$66.6 billion. Several smaller financial institutions also repaid the TARP investments both before and after the 9 large institutions' repayments.

OVERSIGHT ACTIVITIES OF SIGTARP

Since it began operations in December 2008, SIGTARP has been actively engaged in fulfilling its vital investigative and audit functions as well as in building its staff and organization. To date, SIGTARP has hired 86 employees and plans to grow to 160 employees.

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

- **TBW and Colonial Search Warrants:** On August 3, 2009, SIGTARP, with the FBI, HUD OIG, and FDIC OIG, executed search warrants at the offices of Taylor, Bean and Whitaker, formerly the nation's 12th-largest loan originator and servicer, and Colonial Bank, which applied for assistance under the CPP. Prior to the execution of these warrants, SIGTARP had served subpoenas on Colonial after it had announced that it had received preliminary contingent approval from the Treasury to receive \$553 million in TARP funding. The funding was never made and this investigation, which is being conducted with both the Department of Justice and the SEC, is ongoing.
- **Federal Felony Charges Against Gordon Grigg:** On April 23, 2009, Federal felony charges were filed against Gordon B. Grigg in the U.S. District Court for the Middle District of Tennessee, charging him with four counts of mail fraud and four counts of wire fraud. The charges are based on Grigg's role in embezzling approximately \$11 million in client investment funds that he garnered through false claims, including that he had invested \$5 million in pooled client funds toward the purchase of the TARP-guaranteed debt. Grigg pleaded guilty to all charges and was sentenced to 10 years imprisonment.
- **FTC Action Against Misleading Use of "MakingHomeAffordable.gov":** On May 15, 2009, based upon an action brought by the Federal Trade Commission ("FTC"), a Federal district court issued an order to stop an Internet-based operation that pretended to operate "MakingHomeAffordable.gov," the official website of the Federal Making Home Affordable program. The FTC's action, which was developed with the investigative assistance of SIGTARP, alleges that the defendants purchased sponsored links as advertising on the results pages of Internet search engines, and, when consumers searched for "making home affordable" or similar search terms, the defendants' ads prominently and conspicuously displayed "MakingHomeAffordable.gov." Consumers who clicked on this link were not

directed to the official website, but were diverted to sites that solicit applicants for paid loan modification services. The operators of these websites either purport to offer loan modification services themselves or sold the victims' personally identifying information to others.

- National Housing Modification Center: On September 16, 2009, the FTC filed a complaint against the Nations Housing Modification Center ("NHMC") and its principals in the U.S. District Court for the District of Columbia. With investigative support from SIGTARP and other federal, state and local enforcement partners, the FTC alleged violations of the FTC Act and Telemarketing Sales Rules by NHMC by misrepresenting itself as a Federal government agency or affiliate and falsely claiming that they would obtain mortgage modifications for consumers for a \$3,000 fee. SIGTARP's joint investigation is continuing.
- Bank of America: SIGTARP continues to play a significant role in the investigations by the New York State Attorney General's Office, the SEC and the Department of Justice into the circumstances of Bank of America's merger with Merrill Lynch and its receipt of additional TARP funds under the Targeted Investment Program.

More than 50% of SIGTARP's ongoing investigations were developed in whole or in part through tips or leads provided on SIGTARP's Hotline (877-SIG-2009, which is also accessible at www.SIGTARP.gov). Since the SIGTARP Hotline commenced operations, it has received and analyzed more than 6,572 tips, running the gamut from expressions of concern over the economy to serious allegations of fraud.

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

SIGTARP's Audit Division has completed its first round of audits. SIGTARP issued its first formal audit report concerning how recipients of CPP funds reported their use of such funds based upon a February 2009 survey SIGTARP sent to more than 360 financial and other institutions that had completed TARP funding agreements through January 2009. Although most banks reported they did not segregate or track TARP fund usage on a dollar-for-dollar basis, they were able to provide insights into their actual or planned future use of TARP funds. For some respondents the infusion of TARP funds helped to avoid a "managed" reduction of their activities; others reported that their lending activities would have come to a standstill without TARP funds; and others explained that they used TARP funds to acquire other institutions, invest in securities, pay off debts, or that they retained the funds to serve as a cushion against future losses. Many survey responses also highlighted the importance of the TARP funds to the bank's capital base, and by extension, the impact of the

funds on lending. As I previously noted, Treasury has failed to adopt the audit's recommendation that it require TARP recipients to report on their use of funds.

SIGTARP has also completed an audit examining undue external influences over the CPP decision-making process. This audit addressed the extent to which Treasury and the banking regulators have controls to safeguard against external influences over the CPP decision-making process and whether there were any indications of external parties having unduly influenced CPP decision-making. SIGTARP found no information indicating that external inquiries on CPP applications had affected the decision-making process, but gaps in the internal controls by the government agencies conducting the CPP application process makes it impossible to determine if all attempts to influence TARP decisions were captured by the audit. Of the 56 institutions SIGTARP identified that were the subjects of external inquiries, three institutions did not meet all the CPP quantitative criteria but were approved based on mitigating factors considered by Treasury and banking agency officials. Among these three, one institution stood out. SIGTARP's analysis indicated that discretion afforded this applicant in its approval was greater than that afforded other applicants. In connection with the audit, SIGTARP made recommendations regarding the improvement of internal controls and record keeping, which Treasury has adopted.

SIGTARP also issued an audit examining executive compensation restriction compliance. This audit examined the efforts of TARP recipients' to comply with executive compensation restrictions in place at the time of SIGTARP's survey of banks use of funds. The audit was set against a background of the evolving rules on executive compensation for TARP recipients. Although recipients expressed frustration with changing compensation guidance, they were able to report the actions that they have been taking.

SIGTARP also has audits nearing completion examining the selection of the first nine participants for funds under CPP (with a particular emphasis on Bank of America), AIG bonuses, AIG counterparty payments and an update on SIGTARP's use of funds survey. In addition, SIGTARP is undertaking a series of new audits, as follows:

- **CPP Warrant Valuation and Disposition Process:** The audit will seek to determine (i) the extent to which financial institutions have repaid Treasury's investment under CPP and the extent to which the warrants associated with that process were repurchased or sold; and (ii) what process and procedures Treasury has established to ensure the Government receives fair market value for the warrants and the extent to which Treasury follows a clear, consistent, and objective process in reaching decisions where differing valuations of warrants exist. This audit complements a July 10, 2009, report by the Congressional Oversight Panel examining the warrant valuation process.
- **Governance Issues Where U.S. Holds Large Ownership Interests:** The audit will examine governance issues when the U.S. Government has obtained a large ownership interest in a particular institution, including: (i) what is the extent of Government involvement in management of companies in which it has made sizeable investments, including direction and control over such elements as governance, compensation, spending, and other corporate decision-making; (ii) to what extent are effective risk management, monitoring, and internal controls in place to protect and balance the Government's interests and corporate needs; (iii)

are there performance measures in place that can be used to track progress against long-term goals and timeframes affecting the Government's ability to wind down its investments and disengage from these companies; and (iv) is there adequate transparency to support decision making and to provide full disclosure to the Congress and the public.

- **Status of the Government's Asset Guarantee Program with Citigroup:** The audit will examine the Government's Asset Guarantee Program with Citigroup. Specifically, the audit will address: (i) how was the program for Citigroup developed; (ii) what are the current cash flows from the affected assets; and (iii) what are the potential for losses to Treasury, the Federal Deposit Insurance Corporation, and the Federal Reserve.
- **Making Home Affordable Mortgage Modification Program:** The audit will examine the Making Home Affordable mortgage modification program to assess the status of the program, the effectiveness of outreach efforts, capabilities of loan servicers to provide services to eligible recipients, and challenges confronting the program as it goes forward.
- **Auto dealership terminations:** The audit will examine the process used by General Motors ("GM") and Chrysler to identify which automotive dealerships should be maintained or terminated. GM and Chrysler reportedly have announced plans to terminate more than two thousand automotive dealerships as part of their restructuring process.

SIGTARP'S RECOMMENDATIONS ON THE OPERATION OF TARP

One of SIGTARP's responsibilities is to provide recommendations to Treasury so that TARP programs can be designed or modified to facilitate effective transparency and to deter fraud, waste, and abuse. SIGTARP has now made dozens of such recommendations, and the reader is referred to SIGTARP's July Quarterly Report starting on page 188 for a full listing of the recommendations and Treasury's responses to them. Four recommendations concerning transparency are detailed here.

Transparency in TARP Programs

Although Treasury has taken some steps towards improving transparency in TARP programs, it has repeatedly failed to adopt recommendations that SIGTARP believes are essential to providing basic transparency and fulfill Treasury's stated commitment to implement TARP "with the highest degree of accountability and transparency possible."

- **Use of Funds Generally:** One of SIGTARP's first recommendations was that Treasury require all TARP recipients to report on the actual use of TARP funds. Other than in a few agreements (with Citigroup, Bank of America, and AIG), Treasury declined to adopt this recommendation, calling any such reporting "meaningless" in light of the inherent fungibility of money. SIGTARP, nonetheless, continues to believe that banks can provide meaningful information about what they are doing with TARP funds — in particular what activities they would not have been able to do but for the infusion of TARP funds. That belief has been supported by SIGTARP's first audit, in which nearly all banks were able to provide such information. SIGTARP's report noted that most firms reported multiple and sometimes interrelated uses of the funds. For example:

- More than 80 percent of the respondents cited the use of funds for lending or how it helped them avoid reduced lending. Many banks reported that lending would have been lower without TARP funds or would have come to a standstill.
- More than 40 percent of the respondents reported that they used some TARP funds to help maintain the capital cushions and reserves required by their banking regulators to be able to absorb unanticipated losses.
- Nearly a third of the respondents reported that they used some TARP funds to invest in agency-mortgage backed securities. These actions, they claimed, provided immediate support of the lending and borrowing activities of other banks and positioned the banks for increased lending later.
- A smaller number reported using some TARP funds to repay outstanding loans—some because the TARP funds were a more cost-effective source of funds than their outstanding debt, and some because of pressure from a creditor to use the funds for that purpose.
- Several banks reported using some TARP funds to buy other banks. One reported that this was a cost-effective way to acquire additional deposits that, in turn, would facilitate an even greater amount of lending.
- Some banks reported that they had not yet allocated funds for lending and other activities due to the short time elapsed since the receipt of funds, the weak demand for credit, and the uncertain economic environment.

In response to SIGTARP's recommendation, on September 16, 2009, Treasury informed SIGTARP that it was expanding its Quarterly CPP Report to include two additional categories of information that the TARP recipients indicated in the SIGTARP survey responses as a way that they used TARP funds. Treasury said this expansion will begin with the next Quarterly CPP Report, scheduled to be released during October 2009. Although this expansion should provide some additional information on an aggregate basis, it falls short of meeting the goal of basic transparency regarding the use of TARP funds. For example, it will only include aggregate data and will not report on each institution. It will not capture the broader range of use of funds depicted in SIGTARP's report, nor will it reflect how they may be changing over time. It also will not reflect the financial institution's view of what steps it was able to take that it otherwise would not have been able to take absent its receipt of TARP funds. While SIGTARP is encouraged that Treasury has apparently abandoned its prior position that it is impossible to measure and report on TARP recipients' use of funds, we remain puzzled as to why Treasury refuses to adopt our recommendation to report on each TARP recipient's use of TARP funds.

- Valuation of the TARP Portfolio: SIGTARP has recommended that Treasury begin reporting on the values of its TARP portfolio so that taxpayers can get regular updates on the financial

performance of their TARP investments. Notwithstanding that Treasury has now retained asset managers and is receiving such valuation data on a monthly basis, Treasury has not committed to providing such information except on the statutorily required annual basis.

- **Disclosure of TALF Borrowers Upon Surrender of Collateral:** In TALF, the loans are non-recourse, that is, the lender (Federal Reserve Bank of New York) will have no recourse against the borrower beyond taking possession of the posted collateral (consisting of asset-backed securities (“ABS”)). Under the program, should such a collateral surrender occur, TARP funds will be used to purchase the surrendered collateral. In light of this use of TARP funds, SIGTARP has recommended that Treasury and the Federal Reserve disclose the identity of any TALF borrowers that fail to repay the TALF loan and must surrender the ABS collateral. To date, Treasury has refused to implement the disclosure.
- **Regular Disclosure of PPIF Activity, Holdings, and Valuation:** In the PPIF Legacy Securities Program, the taxpayer will be providing a substantial portion of the funds (contributing both equity and lending) that will be used to purchase toxic assets in the Public-Private Investment Funds (“PPIFs”). SIGTARP has recommended that all trading activity, holdings, and valuations of assets of the PPIFs be disclosed on a timely basis. Not only should this disclosure be required as a matter of basic transparency in light of the billions of taxpayer dollars at stake, but such disclosure would also serve well one of Treasury’s stated reasons for the program in the first instance: the promotion of “price discovery” in the illiquid market for MBS. Treasury has indicated that it will not require such disclosure.

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

If you are aware of fraud, waste, abuse, mismanagement or misrepresentations affiliated with the troubled asset relief program, please contact the SIGTARP Hotline.

Via Online: WWW.SIGTARP.GOV
Via Toll Free Phone: 877-SIG-2009
Via Fax: 202-622-4559

Via Mail: Hotline, Office of the SIGTARP
1500 Pennsylvania Ave., N.W. Suite 1064
Washington, D.C., 20220