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HOUSE COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

STATEMENT OF NEIL BAROFSKY

SPECIAL INSPECTOR GENERAL
TROUBLED ASSET RELIEF PROGRAM

BEFORE THE
HOUSE COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

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

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

TARP IN FOCUS, AND IN CONTEXT

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

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

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

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

OVERSIGHT ACTIVITIES OF SIGTARP

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

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

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

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

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

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

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

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

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

SIGTARP'S RECOMMENDATIONS ON THE OPERATION OF TARP

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

Transparency in TARP Programs

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

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

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

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

Imposition of Information Barriers, or "Walls," in PPIP

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

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

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

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

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

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