

January 2011

# TROUBLED ASSET RELIEF PROGRAM

## Status of Programs and Implementation of GAO Recommendations



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Highlights of [GAO-11-74](#), a report to congressional addressees

## Why GAO Did This Study

Since the Troubled Asset Relief Program (TARP) was implemented, GAO has issued more than 40 reports containing more than 60 recommendations to the Department of the Treasury (Treasury). This report assesses the status of Treasury's implementation of GAO's recommendations and current condition of TARP. Specifically, this 60-day report provides information on (1) the condition and status of active TARP programs; (2) Treasury's progress in implementing an effective management structure, including staffing for the Office of Financial Stability (OFS), overseeing contractors, and establishing a comprehensive system of internal control; and (3) trends in the status of key relevant economic indicators. GAO reviewed relevant documentation from various TARP programs and met with OFS officials and financial regulators. GAO also used information from existing reports and ongoing work.

## What GAO Recommends

As TARP enters its next phase and winds down, GAO recommends that OFS take action to further enhance its ongoing operations by finalizing a plan for addressing how it will manage its workforce, in particular term-appointed and key Senior Executive Service employees. While Treasury agreed with our recommendation, we have differing views on the status of prior recommendations. We will continue to update the status of recommendations as appropriate.

View [GAO-11-74](#) or [key components](#). For more information, contact Thomas J. McCool, (202) 512-2642 or [mccoolt@gao.gov](mailto:mccoolt@gao.gov).

# TROUBLED ASSET RELIEF PROGRAM

## Status of Programs and Implementation of GAO Recommendations

### What GAO Found

TARP programs implemented over the last 2 years covered a broad range of activities, including injecting capital into financial institutions; addressing issues in the securitization markets; providing assistance to the automobile industry and American International Group, Inc. (AIG); and offering incentives for modifying residential mortgages, among other things. While some programs have been terminated, others remain active, including those that focus on preserving homeownership and providing assistance to AIG, and require continued monitoring. Further, the Homeownership Preservation Office has not yet conducted a workforce assessment, despite the recent addition of several new programs. In prior work GAO has identified a number of weaknesses in Treasury's implementation of the Home Affordable Modification Program (HAMP), and a number of homeowner preservation initiatives have not yet reported activity. Other TARP programs have ended or are winding down. Table 1 provides an overview of selected outstanding programs, key GAO findings, and the status of the implementation of GAO recommendations. As of September 30, 2010, OFS reported \$179.2 billion in gross outstanding direct loans and equity investments with a subsidy cost allowance of \$36.7 billion resulting in a net balance of \$142.5 billion. The reported net cost of TARP transactions from inception through September 30, 2010, was \$18.5 billion; however, the ultimate cost of TARP will change as a result of (1) differences between the estimated values and the amounts that OFS will ultimately realize (as the assumptions and estimates underlying the valuation of direct loans and equity investments are inherently subject to substantial uncertainty); and (2) further disbursements, such as those relating to the housing programs which are not subject to repayment. For example, the proposed restructuring of AIG, if implemented, will likely affect TARP's ultimate cost.

Although OFS staffing has become more stable over the past year, with more than 200 employees, its stability remains fragile as it faces new challenges. For example, while it has filled key leadership positions, the Assistant Secretary of Financial Stability resigned in September 2010 and this key leadership position is temporarily filled. Staffing remains important as some programs are still being implemented, while others have closed or been terminated but have assets that must be managed, repaid, and divested. OFS has begun to take steps that will help to retain staff. But staff retention could be a challenge for OFS going forward, because more than half of OFS's employees, including key leaders, are term appointments (many with 4-year term limits). OFS has also begun to address succession planning for critical senior positions, but its workforce plan has not been updated since March 2009. Without a plan that considers various scenarios, OFS may find itself unprepared to adequately manage and oversee the remaining TARP investments and programs. OFS has strengthened its management and oversight of contractors and financial agents and its system of internal control for financial reporting and compliance with program requirements. Continued progress will depend on retaining qualified staff.

**Table 1: Status of Selected Programs and GAO Recommendations and Gross Outstanding Program Balance as of September 30, 2010**

Program	Gross outstanding balance
<p><i>Capital Purchase Program (CPP).</i> To provide capital to viable banks through the purchase of preferred shares and subordinated debentures. While many institutions have repaid Treasury, a growing number of institutions still participating have missed dividend payments or requested restructuring of CPP investments. Treasury has addressed many of GAO's concerns regarding transparency and accountability, but more needs to be done to monitor regulators' decisions on repayments and withdrawals. GAO previously recommended that to the extent future Treasury programs (e.g., Small Business Lending Fund) are modeled after CPP, Treasury should collect information on and monitor regulators' recommendations that applicants withdraw. Without this information, Treasury risks not having a basis for determining whether decisions involving similar institutions were being made consistently and thus whether participants were being treated equitably. Moreover, GAO recommended that OFS periodically collect and review certain information from the bank regulators supporting their decisions on CPP repayment requests and provide feedback for the regulators' consideration to help ensure that similar institutions are treated consistently. Treasury has not yet implemented these recommendations.</p>	\$49.8
<p><i>Automotive Industry Financing Program (AIFP).</i> To prevent a significant disruption of the American automotive industry. GM and, to a lesser extent, Chrysler have repaid some of their AIFP funding; however, the ability of the government to fully recoup its investments in these companies will depend on the companies' profitability and the success of future public stock offerings. GAO previously recommended that Treasury ensure it had adequate staff on board to monitor the government's investment in the auto companies and to report to Congress on how it planned to assess the companies' performance. Treasury has hired additional staff but has not yet provided information to Congress on its future monitoring plans.</p>	67.2
<p><i>AIG (formerly Systemically Significant Failing Institutions Program).</i> To provide stability in financial markets and avoid disruptions to the markets from the failure of a systemically significant institution. While AIG has announced plans to significantly restructure its outstanding assistance, several conditions will need to be met for the plan to work as intended. These include repaying the outstanding balance on the Federal Reserve Revolving Credit Facility, drawing down Treasury's equity capital facility, amending and creating new equity purchase agreements, and converting some preferred stock for common equity. However, whether Treasury will fully recoup its investment will not be known for some time and therefore, requires continued monitoring and oversight.</p>	47.6
<p><i>HAMP.</i> To offer assistance to homeowners through a cost-sharing arrangement with mortgage holders and investors to reduce the monthly mortgage payment amounts of those at risk of foreclosure to affordable levels. The program had a slow start and has not performed as anticipated. Further, the Homeownership Preservation Office has not yet conducted a workforce assessment, despite the recent addition of several new programs. Despite program changes that are intended to increase the number of mortgage loan modifications made under HAMP, more borrowers have had their trial modifications canceled than have received permanent modifications. Further, while Treasury has added TARP-funded housing program enhancements in an effort to reach more borrowers and address persistently high default and foreclosure levels, the newly announced programs have had very limited activity to date and Treasury continues to face challenges in expeditiously implementing a prudent design for these programs, as GAO recommended in a June 2010 report. Treasury has not yet fully implemented all of our prior recommendations to increase the transparency, accountability, and consistency of the program.</p>	n/a
<p><i>Public-Private Investment Program.</i> To address the challenge of "legacy assets" as part of Treasury's efforts to repair balance sheets throughout the financial system and increase the availability of credit to households and businesses. The program, though slow to start, has resulted in positive returns but continued monitoring is necessary because market prices can fluctuate, and Treasury still holds oversight responsibility for the fund managers.</p>	13.7
<p><i>Consumer and Business Lending Initiative.</i> Several programs designed to provide capital to certain financial institutions or liquidity to secondary markets for small business loans and other asset classes, and thereby improve access to credit for consumers and businesses. Although the purpose of the Community Development Capital Initiative was initially unclear to some participants, public communications about the dual purposes of the program—to assist small business lending and to support the mission of Community Development Financial Institutions—was clarified towards the end of the program. Treasury has addressed concerns that GAO raised about Treasury's role in the Term Asset-Backed Securities Loan Facility, including monitoring risks related to commercial mortgage-backed securities, formalizing the decision-making process with the Board of Governors of the Federal Reserve System, and conducting an assessment of how to track and report on assets that might be surrendered.</p>	0.9
<p><b>Total</b></p>	<p><b>\$179.2</b></p>

Source: GAO analysis of Treasury's OFS information.

Some credit markets are beginning to show signs of a sustained recovery, even as other areas of the economy, particularly housing markets and job starts, remain fragile. Indicators that GAO monitors to assess the effectiveness of TARP showed that credit markets have largely held the gains they achieved since October 2008. While the degree of effectiveness has varied across programs, some programs have reportedly had the desired effects, especially if stabilizing and restoring confidence in the financial system are considered the principal goals of the government's

interventions. GAO noted in prior reports that while isolating the impact of TARP from various other significant federal efforts is impossible, many of the anticipated effects on credit markets and the economy had materialized. These effects included declines in perceptions of risks in various financial markets, including asset spreads in asset-backed securities; declines in interest rates in interbank, mortgage, and bond markets; a renewed ability by banks to access capital markets; increasing securitizations; and price recovery for some legacy or "troubled" assets.

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### Abbreviations

ABS	asset-backed securities
AGP	Asset Guarantee Program
AIA	American International Assurance Company, LTD
AIFP	Automotive Industry Financing Program
AIG	American International Group, LLC
ALICO	American Life Insurance Company
CAP	Capital Assistance Program
CDCI	Community Development Capital Initiative
CDFI	Community Development Financial Institution
Chrysler	Chrysler Group, LLC
CMBS	commercial mortgage-backed securities
CPP	Capital Purchase Program
Dodd-Frank Act	Dodd-Franck Wall Street Reform and Consumer Protection Act

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EESA	Emergency Economic Stabilization Act of 2008
FDIC	Federal Deposit Insurance Corporation
Federal Reserve	Board of Governors of the Federal Reserve System
FHA	Federal Housing Administration
FRBNY	Federal Reserve Bank of New York
GM	General Motors Company
GSE	government-sponsored enterprise
HAMP	Home Affordable Modification Program
MHA	Making Home Affordable
NCUA	National Credit Union Administration
NFIB	National Federation of Independent Business
OFS	Office of Financial Stability
OTS	Office of Thrift Supervision
PPIF	Public-Private Investment Fund
PPIP	Public-Private Investment Program
Recovery Act	American Recovery and Reinvestment Act of 2009
RMBS	residential mortgage-backed securities
SBA	Small Business Administration
SBLF	Small Business Lending Fund
SCAP	Supervisory Capital Assessment Program
SLOOS	Senior Loan Officer Opinion Survey on Bank Lending Practices
Special Master	Office of the Special Master for TARP Executive Compensation
SPV	special purpose vehicle
TARP	Troubled Asset Relief program
TALF	Term Asset-Backed Securities Loan Facility
Treasury	Department of the Treasury

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United States Government Accountability Office  
Washington, DC 20548

January 12, 2011

### Congressional Addressees

Just more than 2 years ago, the U.S. financial system and broader economy faced the most severe financial crisis since the Great Depression, and in 2011 the economy remains fragile. The crisis, which threatened the stability of the financial system and the solvency of many financial institutions, prompted the United States to initiate extraordinary interventions aimed at moderating any economic impact. Among these interventions was the Troubled Asset Relief Program (TARP), which was authorized by the Emergency Economic Stabilization Act of 2008 (EESA). EESA gave the Department of the Treasury (Treasury) the authority to purchase or guarantee “troubled assets,” such as mortgages and mortgage-backed securities, that were deemed to be at the heart of the crisis, along with any other financial instrument Treasury determined that it needed to purchase to help stabilize the financial system.<sup>1</sup> The Secretary of the Treasury exercised the authority provided under EESA to extend the sunset date for purchases of and commitments to purchase troubled assets through October 3, 2010; however, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)—signed into law on July 21, 2010—set a new spending ceiling for TARP, in effect prohibiting Treasury from incurring any additional obligations for programs that were not initiated prior to June 25, 2010.<sup>2</sup>

A broad range of activities have been initiated under TARP. Specific initiatives have injected capital into key financial institutions;

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<sup>1</sup>EESA, Pub. L. No. 110-343, 122 Stat. 3765 (2008) (codified at 12 U.S.C. §§ 5201 *et seq.*). EESA originally authorized Treasury to purchase or guarantee up to \$700 billion in troubled assets. The Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22, Div. A, 123 Stat. 1632 (2009), amended EESA to reduce the maximum allowable amount of outstanding troubled assets under EESA by almost \$1.3 billion, from \$700 billion to \$698.741 billion. EESA requires that the appropriate committees of Congress be notified in writing when the Secretary of the Treasury, after consultation with the Chairman of the Board of Governors of the Federal Reserve System, determines that it is necessary to purchase other financial instruments to promote financial market stability. Section 3(9) of EESA (codified at 12 U.S.C. § 5202(9)).

<sup>2</sup>The Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (1) reduced Treasury’s authority to purchase or insure troubled assets to a maximum of \$475 billion and (2) prohibited Treasury, under EESA, from incurring any additional obligations for a program or initiative unless the program or initiative had already been initiated prior to June 25, 2010.



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implemented programs to address problems in the securitization markets; provided assistance to the automobile industry and American International Group, Inc. (AIG); and offered incentives for modifying residential mortgages, among other things. As TARP passes the 2-year mark, U.S. financial markets are less volatile than they were in 2008; however, questions about a sustained economic recovery continue, and certain areas of the economy still face significant challenges. For example, foreclosures and mortgage delinquencies continue to linger and small businesses still face tight credit conditions. As a result, TARP has been transformed to a program focused primarily on preserving homeownership and improving financial conditions for small financial institutions and businesses. While many other programs have ended or begun winding down and some participating institutions have repaid part or all of their TARP funds, the prospect of repayment from some other institutions, both large and small, is less certain.

EESA provided us with broad oversight authorities for actions taken under TARP and requires that we report at least every 60 days on TARP activities and performance.<sup>3</sup> Our reports have focused on

- findings resulting from our oversight of TARP's performance in meeting the purposes of EESA;
- the financial condition and internal controls of TARP, its representatives, and agents;
- the characteristics of both asset purchases and the disposition of assets acquired, including any related commitments that were entered into;
- TARP's efficiency in using the funds appropriated for the program's operation;
- TARP's compliance with applicable laws and regulations;
- efforts to prevent, identify, and minimize conflicts of interest among those involved in TARP's operations;

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<sup>3</sup>Section 116 of EESA, 12 U.S.C. § 5226 (codified at 12 U.S.C. § 5226).

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- the efficacy of contracting procedures; and
  - the process for making decisions related to unwinding TARP programs.

This report assesses the status of Treasury's implementation of our recommendations and the current condition of TARP. Specifically, this 60-day report provides information on (1) the condition and status of active TARP programs; (2) Treasury's progress in implementing an effective management structure, including staffing for the Office of Financial Stability (OFS), overseeing contractors, and establishing a comprehensive system of internal control; and (3) trends in the status of key relevant economic indicators.

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## Scope and Methodology

To determine the status of active TARP programs that are still being implemented or utilized, we obtained information from OFS, including disbursements, dividend payments, repurchases, and warrant liquidations as of September 30, 2010 (unless otherwise noted). In addition, we also obtained information on the status of actions Treasury has taken in response to recommendations from our previous TARP reports, including

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its progress in developing a comprehensive system of internal control.<sup>4</sup> We also reviewed documents provided by OFS and conducted interviews with officials from its Office of the Chief Financial Officer. In addition, we obtained and reviewed relevant program documents from OFS and leveraged our previous reports and reports by the Special Inspector General for TARP and the Congressional Oversight Panel, as appropriate.

For the Capital Purchase Program (CPP), we leveraged work completed as part of our detailed review of the program. We used OFS's reports to identify the participants that had repurchased their preferred shares and paid dividends when due, among other things. To update the status of the Targeted Investment Program (TIP), we reviewed relevant documents related to its termination, including repayments by the participants.

To update the status of the Automotive Industry Financing Program (AIFP) and obtain information on the current financial condition of General Motors Company (GM), Chrysler Group LLC (Chrysler), and Ally Financial, Inc. (formerly GMAC, Inc.) and Treasury's plans for managing

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<sup>4</sup>GAO, *Financial Audit: Office of Financial Stability (Troubled Asset Relief Program) Fiscal Year 2010 and 2009 Financial Statements*, [GAO-11-174](#) (Washington, D.C.: Nov. 15, 2010); *Troubled Asset Relief Program: Opportunities Exist to Apply Lessons Learned from the Capital Purchase Program to Similarly Designed Programs and to Improve the Repayment Process*, [GAO-11-47](#) (Washington, D.C.: Oct. 4, 2010); *Troubled Asset Relief Program: Bank Stress Test Offers Lessons as Regulators Take Further Actions to Strengthen Supervisory Oversight*, [GAO-10-861](#) (Washington, D.C.: Sept. 23, 2010); *Financial Assistance: Ongoing Challenges and Guiding Principles Related to Government Assistance For Private Sector Companies*, [GAO-10-719](#) (Washington, D.C.: Aug. 3, 2010); *Troubled Asset Relief Program: Treasury's Framework for Deciding to Extend TARP Was Sufficient, but Could be Strengthened for Future Decisions*, [GAO-10-531](#) (Washington, D.C.: June 30, 2010); *Management Report: Improvements Are Needed in Internal Control Over Financial Reporting for the Troubled Asset Relief Program*, [GAO-10-743R](#) (Washington, D.C.: June 30, 2010); *Troubled Asset Relief Program: Further Actions Needed to Fully and Equitably Implement Foreclosure Mitigation Programs*, [GAO-10-634](#) (Washington, D.C.: June 24, 2010); *Troubled Asset Relief Program: Update of Government Assistance Provided to AIG*, [GAO-10-475](#) (Washington D.C.: Apr. 27, 2010); *Troubled Asset Relief Program: Automaker Pension Funding and Multiple Federal Roles Pose Challenges for the Future*, [GAO-10-492](#) (Washington D.C.: Apr. 6, 2010); *Troubled Asset Relief Program: Home Affordable Modification Program Continues to Face Implementation Challenges*, [GAO-10-556T](#) (Washington, D.C.: Mar. 25, 2010); *Troubled Asset Relief Program: Treasury Needs to Strengthen Its Decision-Making Process on the Term Asset-Backed Securities Loan Facility*, [GAO-10-25](#) (Washington, D.C.: Feb. 5, 2010); *Financial Audit: Office of Financial Stability (Troubled Asset Relief Program) Fiscal Year 2009 Financial Statements*, [GAO-10-301](#) (Washington, D.C.: Dec. 9, 2009); and *Troubled Asset Relief Program: Continued Stewardship Needed as Treasury Develops Strategies for Monitoring and Divesting Financial Interests in Chrysler and GM*, [GAO-10-151](#) (Washington, D.C.: Nov. 2, 2009).

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its investment in the companies, we leveraged our past work; reviewed information on the companies' finances and operations, including financial statements, selected documents from their bankruptcy proceedings, and company-provided data; and interviewed representatives of the companies. To determine how Treasury was managing its investment in GM and Chrysler, we reviewed information on Treasury's plans for overseeing its ownership interests in the companies, including congressional testimonies and White House and Treasury press releases. In addition, we interviewed OFS officials about their plans to monitor the government's financial interests in the auto companies and Treasury's plans to divest its interest in GM, including their preparation for GM's initial public offering (IPO). We also updated key information about Ally Financial, Inc., and the status of additional assistance provided under AIFP. For this information, we primarily relied on our recently issued report on the bank holding company stress tests.<sup>5</sup>

To update the status of the AIG Investment Program (formerly the Systemically Significant Failing Institutions Program) and the Public-Private Investment Program (PPIP), we reviewed relevant documents from Treasury and other parties. For the AIG Investment Program, these documents included periodic reports provided to Congress by Treasury, the Board of Governors of the Federal Reserve System (Federal Reserve), and the Federal Reserve Bank of New York (FRBNY), and other relevant documentation such as AIG's financial disclosures, among other things. We also interviewed officials from each agency and AIG. For PPIP, we reviewed and analyzed Treasury's announcements concerning the program and its reports on PPIP allocations, expenditures, and fund performance, along with program operation and design documents published by Treasury and the Federal Deposit Insurance Corporation (FDIC).

To determine the status of the Home Affordable Modification Program (HAMP) and our previous recommendations to the program, we obtained and reviewed Treasury's published reports on HAMP and servicer performance, documentation on cost estimates for and guidelines issued to each TARP-funded housing program, and written responses to our July 2009 recommendations. In addition, we interviewed Treasury officials about the status of TARP-funded housing programs, including anticipated implementation dates, numbers of borrowers to be helped, and the actions Treasury had taken to address our July 2009 recommendations. We also

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<sup>5</sup>[GAO-10-861](#).

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analyzed data on changes in default and foreclosure activity before and during HAMP's implementation.

For the programs aimed at assisting small businesses, we analyzed OFS transaction and budget documents and reviewed program terms for the Community Development Capital Initiative (CDCI), the Term Asset-Backed Securities Loan Facility (TALF), and the Small Business Administration (SBA) 7(a) Securities Purchase Program. We interviewed officials and collected data, when available, on the credit problems of small businesses and the impact of TARP programs from Treasury (OFS and Community Development Financial Institutions (CDFI) Fund), the Federal Reserve, SBA, small business trade groups, industry associations for banks and credit unions, and federal regulators for depository institutions.

- For CDCI, we interviewed federal depository institution supervisors—FDIC, the Federal Reserve, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision (OTS)—about their processes for reviewing CDCI applications. We also analyzed bank, thrift, and credit union regulatory data to compare CDFIs to other depository institutions. We analyzed OTS and National Credit Union Administration data on CDCI applicants' intended use of capital. Finally, we spoke with advocacy groups for CDFIs to obtain their views on CDCI.
- For the SBA 7(a) Securities Purchase Program, we reviewed documents on OFS's internal processes.

To understand the types of depository institutions that lend to small businesses, we collected bank, thrift, and credit union regulatory financial data using SNL Financial and discussed this data with experts from federal regulators for depository institutions.<sup>6</sup> We determined that SNL Financial was sufficiently reliable for the purposes of our review.

For TALF, we reviewed program announcements and loan volume data to determine the amount of loans issued and the proportions that were related to SBA-related securities. We also reviewed TALF impact analyses from FRBNY. In addition, we obtained information from Treasury officials in OFS about their progress in addressing recommendations related to

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<sup>6</sup>SNL Financial is a database that collects, standardizes, and disseminates corporate, financial, market, and mergers and acquisitions data.

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TALF. To determine the status of the Capital Assistance Program (CAP) and the Asset Guarantee Program (AGP), we reviewed relevant information from OFS and leveraged our past work.

To determine OFS's mix of permanent and detailee staff and the number of vacancies, we reviewed the totals for each type of staff over time and within each OFS office. To examine changes in composition of OFS's organizational structure since the office was established, we reviewed past GAO reports on TARP and various documents OFS provided to us, including an updated organizational chart. To assess Treasury's workforce planning effort, we met with officials from its Office of the Deputy Assistant Secretary for Human Resources and Chief Human Capital Officer and OFS to discuss workforce planning, including staff retention efforts and plans for managing its workforce as TARP winds down. In these interviews, we obtained information from officials on the various actions for retaining individuals with the skill sets and competencies needed to administer TARP, including succession planning for filling management and leadership positions and staff development efforts. We reviewed various documents that OFS provided to us, including its human capital strategy and workforce plan. We also reviewed GAO reports related to workforce planning.

To assess OFS's use of financial agents and contractors since TARP was established in October 2008, we reviewed information from a Treasury database of financial agents and contractors and interviewed Treasury contract officials about financial agency agreements, contracts, and blanket purchase agreements as of September 30, 2010, that support OFS administration and operation of TARP. We analyzed information from the database to update key details on the status of TARP financial agents and contractors, such as total number of agreements and contracts, type of services being performed, potential dollar amount, periods of performance, and share of work by small businesses. To assess OFS's progress in maintaining the appropriate infrastructure to manage and oversee the performance of TARP financial agents and contractors and address conflicts of interest that could arise with the use of private sector sources, we reviewed various documents and interviewed OFS officials regarding recent changes in organizational roles and responsibilities within OFS and its policies and procedures regarding (1) management and oversight of TARP financial agents and contractors and (2) monitoring and oversight activities by the OFS team responsible for financial agent and contractor compliance with TARP conflicts-of-interest requirements.

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As noted in our initial TARP report under the mandate, we identified a preliminary set of indicators on the state of credit and financial markets that might be suggestive of the performance and effectiveness of TARP.<sup>7</sup> We consulted Treasury officials and other experts and analyzed available data sources and academic literature. We selected a set of indicators that offered perspectives on different facets of credit and financial markets, including perceptions of risk, cost of credit, and flows of credit to businesses and consumers.<sup>8</sup> To update the indicators in this report, we used data from Thomson Reuters, the Federal Reserve, the National Federation of Independent Business, and a broker-dealer to assess the state of the economy and financial markets. We believe that despite certain limitations, these data considered as a whole, are sufficiently reliable for the purpose of presenting and analyzing trends in the economy and financial markets.

We conducted this performance audit from March 2010 to January 2011 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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## Background

When EESA was signed on October 3, 2008, the U.S. financial system and the broader economy faced the most severe crisis since the Great Depression. The dramatic correction in the U.S. housing market had precipitated a decline in the price of financial assets associated with housing, in particular mortgage assets based on subprime loans that lost value as the housing boom ended and the market underwent a dramatic correction. Some institutions found themselves so exposed that they were threatened with failure—and some failed—because they were unable to

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<sup>7</sup>See GAO, *Troubled Asset Relief Program: Additional Actions Needed to Better Ensure Integrity, Accountability, and Transparency*, [GAO-09-161](#) (Washington, D.C.: Dec. 2, 2008).

<sup>8</sup>No indicator on its own provides a definitive perspective on the state of markets; collectively, the indicators should provide a broad sense of the stability and liquidity of the financial system and could be suggestive of the program's impact. However, it is difficult to draw conclusions about causality, because a variety of actions have been taken to address the economic downturn, and determining what would have happened in the absence of TARP is difficult.

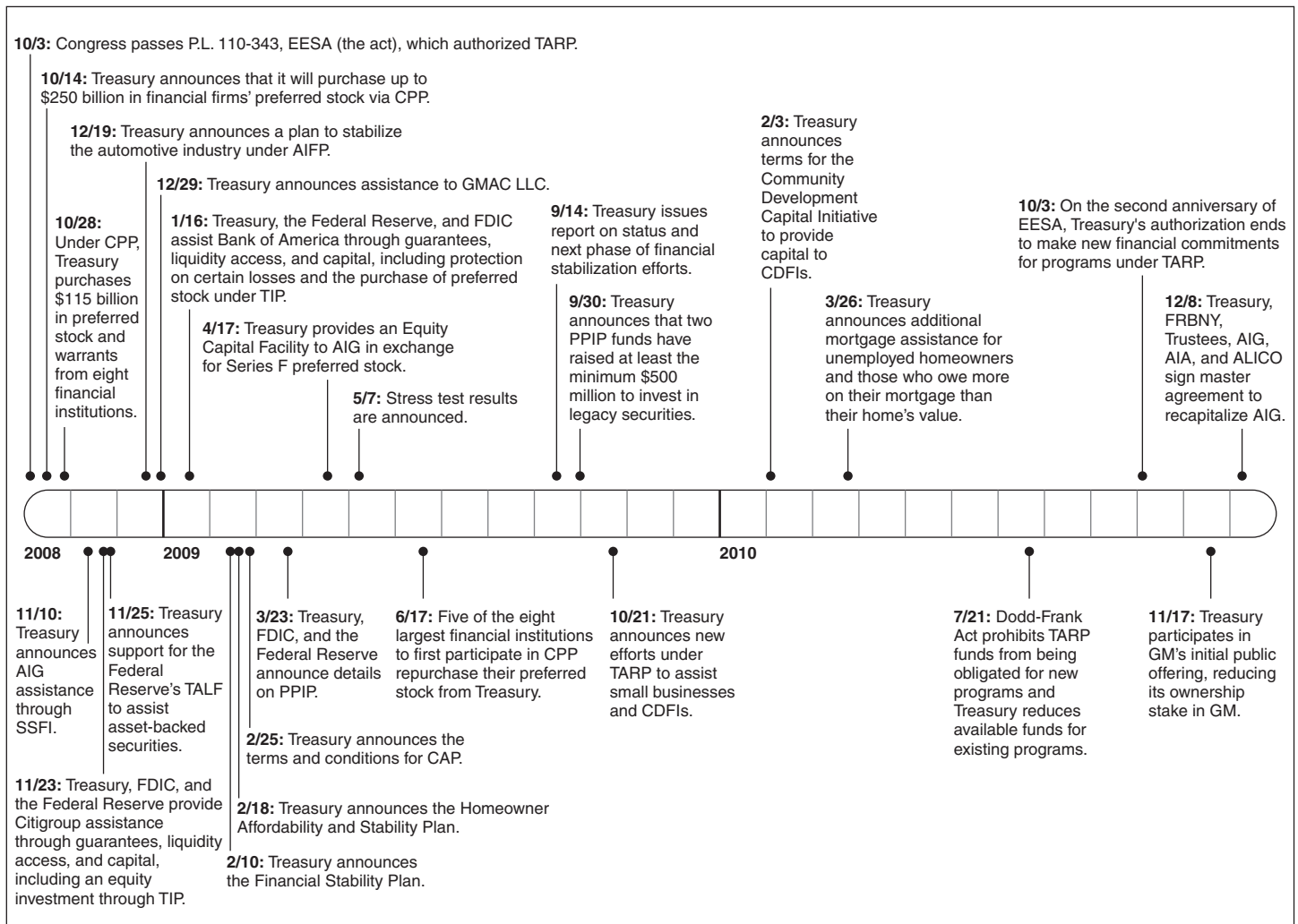
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raise the necessary capital as the value of their portfolios declined. Other institutions, ranging from government-sponsored enterprises (GSE)—such as Fannie Mae and Freddie Mac—to Wall Street firms, were left holding “toxic” or “legacy” assets that became increasingly difficult to value, were illiquid, and potentially had little worth. Moreover, investors not only stopped buying mortgage-backed securities but also became reluctant to buy securities backed by many other types of assets. Because of uncertainty about the financial condition and solvency of financial entities, the prices banks charged each other for funds rose dramatically, and interbank lending effectively came to a halt. The resulting credit crunch made the financing on which businesses and individuals depend increasingly difficult to obtain as cash-strapped banks held on to their assets. By late summer of 2008, the potential ramifications of the financial crisis ranged from the continued failure of financial institutions to increased losses of individual savings and corporate investments, and further tightening of credit would exacerbate the emerging global economic slowdown that was beginning to take shape.

The passage of EESA and its authorization of TARP provided Treasury with a framework to implement a course of action that ultimately resulted in the development of a variety of new programs. Soon after EESA was enacted in October 2008, Treasury decided to change its strategy from purchasing mortgage-backed securities to recapitalizing financial institutions. This tactical shift raised questions about TARP’s transparency and the direction of the program. Amid these concerns, Treasury attempted to provide a more strategic direction for using the remaining funds and created a number of programs aimed at stabilizing the securitization markets, among other things. The extension of TARP, announced by the Treasury on December 9, 2009, has allowed Treasury to reallocate existing commitments and make additional funds available for programs focused primarily on preserving homeownership and providing assistance to community banks and small businesses. The Dodd-Frank Act reduced the amount of available TARP funds, and in response, Treasury has reduced allocations for a number of programs. Figure 1 provides an overview of key dates for TARP implementation.



**Figure 1: Timeline for the Implementation of TARP, October 3, 2008 through December 30, 2010**



Source: GAO.

In response to EESA's mandate that we report at least every 60 days on TARP programs, we have issued more than 40 reports and testimonies related to TARP and made more than 60 recommendations to Treasury and the Federal Reserve to improve the transparency and accountability of

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TARP operations.<sup>9</sup> Some of our recommendations applied to OFS in general, while others involved specific programs, such as CPP, HAMP, and TALF. Our recommendations to Treasury generally fell into three broad categories: (1) transparency, reporting, and accountability; (2) management infrastructure; and (3) communication. Other TARP oversight entities, such as Special Inspector General for TARP and Congressional Oversight Panel, have also made numerous recommendations aimed at improving TARP.

**Transparency, reporting, and accountability.** Initially, we made a series of recommendations aimed at improving the transparency of several programs and related processes, including CPP and the warrant repurchase process. We also made a number of recommendations addressing the basis for and design of HAMP. Treasury has taken a variety of steps to implement our recommendations. We also made recommendations aimed at strengthening the process for making decisions about the use of TARP funds for TALF. We also recommended that Treasury improve the transparency of and analytical basis for its decisions to wind down the remaining programs and liquidate investments. And we recommended that Treasury implement metrics to measure the performance of HAMP's first-lien modification program and small business lending programs. Treasury has started to address many of these recommendations.

**Management infrastructure.** To ensure that OFS established a robust management structure, comprehensive system of internal control, and risk assessment process, we initially made a series of recommendations aimed at addressing challenges associated with establishing a federal program in a short period of time, including staffing, contractor oversight, and internal controls. More recently, we recommended that Treasury finalize a comprehensive system of internal control over HAMP, ensure that it had the expertise needed to adequately monitor and divest the government's investment in Chrysler and GM, and develop criteria for evaluating the optimal method and timing for divesting the government's ownership stake in these two automakers. Treasury has taken steps to address most of these recommendations.

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<sup>9</sup>Appendix I provides a list of the recommendations by report and their status as of December 30, 2010. The list does not include 20 recommendations from the TARP Management Report ([GAO-10-743R](#)) that was issued in connection with the audit of TARP's fiscal year 2009 financial statements.

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**Communication.** We have made a number of recommendations for improving communication with stakeholders, including the public, about TARP. These recommendations are designed to help ensure that Treasury develops a comprehensive communication strategy and clearly articulated vision for TARP that goes beyond simply providing information. Treasury continues to take steps to address these recommendations, including hiring a communications officer, integrating communications into TARP operations, maintaining regular contact with congressional committees and members, and attempting to leverage technology. In the second year of TARP, we continued to identify opportunities for better communication. For instance, we recommended that Treasury more clearly inform borrowers that they could use the HOPE Hotline if they were having difficulty with their HAMP application or servicers, among other things, and that Treasury report to Congress on its plans to assess and monitor the auto companies' performance and ability to repay their loans.

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## Only TARP Programs Focused on Housing Foreclosures, AIG, Securitizations, and Legacy Assets Remain Active

Treasury has managed TARP programs at every stage of development, from implementation to termination. In the last 2 years Treasury disbursed about \$387 billion under the various TARP programs, and about \$179 billion remained outstanding as of September 30, 2010 (see table 1). Some TARP programs have repaid their balances and have been terminated, while others that closed in the last year have outstanding balances that expose Treasury to risk. Furthermore, these outstanding balances require ongoing attention and monitoring to help ensure that participating institutions comply with the terms of the agreements and that Treasury stays abreast of any issues that would impact participants' ability to repurchase their assets or repay their debts. Specifically:

- CPP, which closed in December 2009, had \$49.8 billion outstanding as of September 30, 2010.
- AIFP had an outstanding balance of just more than \$67.2 billion as of September 30, 2010.
- AIG has continued to receive assistance over the last year via an equity capital line established in 2009 and as of September 30, 2010, Treasury's assistance to AIG had a balance of \$47.6 billion.
- While HAMP remains Treasury's primary program to assist homeowners facing foreclosure, Treasury announced several new programs in 2010. As of September 30, 2010, \$543 million had been disbursed for TARP housing programs, which is not recoverable.

- PPIP continues to be an active program with \$14.1 billion disbursed as of September 30, 2010, and \$13.7 billion outstanding.
- Small business programs like CDCI and the SBA 7(a) Securities Purchase Program account for a small portion of TARP funding and Treasury has shifted the focus of its small business efforts outside of TARP.
- Funding of TALF loans by FRBNY closed in June 2010, and no TARP funds had been expended as of September 30, 2010 to purchase collateral from the FRBNY because no collateral had been surrendered to TALF LLC. TALF will continue to pose potential risks to Treasury until all loans are repaid to FRBNY and the program is terminated.

Three programs were terminated—CAP, AGP, and TIP. Treasury sold the Citigroup trust preferred securities it received as a guarantee fee for AGP.<sup>10</sup> TIP was terminated and its \$40 billion outstanding balance was repaid in December 2009.

**Table 1: Status of TARP Programs, as of September 30, 2010**

Dollars in billions

Program <sup>a</sup>	Asset purchase price <sup>b</sup>	Total cash disbursed	Repayments <sup>c</sup>	Additional proceeds <sup>c</sup>	Outstanding balance <sup>d</sup>
CPP provides capital to viable banks through the purchase of preferred shares and subordinated debentures.	\$204.9	\$204.9	\$152.2	\$19.7	\$49.8
TIP fosters market stability and thereby strengthens the economy by making case-by-case investments in institutions that Treasury deems are critical to the functioning of the financial system.	40.0	40.0	40.0	4.2	0.0
AIFP prevents a significant disruption of the American automotive industry. <sup>e</sup>	81.8	79.7	11.2	2.9	67.2

<sup>10</sup>Treasury, the Federal Reserve, FDIC, FRBNY, and Citigroup agreed to terminate Treasury's guarantee commitment. In consideration for early termination of the guarantee, FDIC and Treasury would keep \$3 billion and \$2.2 billion respectively of the \$7 billion of Citigroup preferred securities issued as a premium for the guarantee and the Federal Reserve Bank of New York would receive a \$50 million termination fee. On September 30, 2010, Treasury agreed to sell the \$2.2 billion of Citigroup preferred securities and received the proceeds of the sale in October 2010. FDIC may transfer \$800 million in Citigroup trust preferred securities to Treasury at the close of Citigroup's participation in FDIC's Temporary Liquidity Guarantee Program.

Dollars in billions						
Program <sup>a</sup>	Asset purchase price <sup>b</sup>	Total cash disbursed	Repayments <sup>c</sup>	Additional proceeds <sup>c</sup>	Outstanding balance <sup>d</sup>	
AIG provides stability in financial markets and avoids disruptions to the markets from the failure of a systemically significant institution.	69.8	47.6	0.0	0.0	47.6	
HAMP offers assistance to homeowners through a cost-sharing arrangement with mortgage holders and investors to reduce the monthly mortgage payment amounts of those at risk of foreclosure to affordable levels.	45.6	0.5	n/a	n/a	n/a	
PPIP addresses the challenge of “legacy assets” as part of Treasury’s efforts to repair balance sheets throughout the financial system and increase the availability of credit to households and businesses.	22.4	14.1	0.4	0.2	13.7	
SBA 7(a) Securities Purchase Program provides liquidity to secondary markets for government-guaranteed small business loans in SBA’s 7(a) loan program.	0.4	0.2	less than 0.1	less than 0.1	0.2	
CDCI provides capital to Community Development Financial Institutions by purchasing preferred stock.	0.6	0.2	0.0	0.0	0.6	
TALF provides liquidity in securitization markets for various asset classes to thereby improve access to credit for consumers and businesses.	4.3	0.1	0.0	0.0	0.1	
AGP provides federal government assurances for assets held by financial institutions that are viewed as critical to the functioning of the nation’s financial system.	5.0	0.0	0.0	0.7	0.0	
<b>Total</b>	<b>\$474.8</b>	<b>\$387.3</b>	<b>203.8</b>	<b>\$27.8</b>	<b>\$179.2</b>	

Source: GAO analysis of Treasury (OFS) data.

<sup>a</sup>CAP was terminated in November 2009. No funds were disbursed under this program.

<sup>b</sup>“Asset purchase price” reflects the aggregate amount Treasury agreed to pay to purchase outstanding troubled assets subject to the \$475 billion limit in section 115 of EESA, as amended by Section 1302 of the Dodd-Frank Act. This amount includes signed contract amounts not yet disbursed.

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<sup>c</sup>“Additional proceeds” include dividends from equity securities, interest income from loans and securities, proceeds from repurchases of warrants and warrant preferred stock, and proceeds from warrant auctions. Treasury also received \$16.1 billion in proceeds from sales of 4 billion shares of Citigroup common stock, of which \$13.1 billion is included at cost in “repayments,” and \$3.0 billion of net proceeds in excess of cost is included in “additional proceeds.” As of September 30, 2010, Treasury still held approximately 3.7 billion shares of Citigroup common stock.

<sup>d</sup>During fiscal year 2010 OFS wrote-off \$2.3 billion in CPP investments (primarily relating to CIT Group) and wrote-off \$1.6 billion in loans to Chrysler pursuant to a settlement agreement. The “outstanding balance” has been reduced for these write-offs. In addition, the outstanding balance is affected by other noncash events.

<sup>e</sup>As of December 15, 2010, approximately \$51.6 billion of the \$79.7 billion for AIFP is outstanding after considering the proceeds from GM’s IPO in November 2010 and payment for Treasury’s preferred stock in December 2010, which is discussed later in this report.

As shown in table 1, participants have repaid more than \$200 billion. This amount includes repurchases of preferred stock and repayments of loans. Treasury also received additional proceeds totaling more than \$27 billion as of September 30, 2010, which includes dividends from equity securities, interest income from loans and securities, and net proceeds in excess of cost on the sale or repurchase of common stock and warrants.<sup>11</sup>

As of September 30, 2010, Treasury had received approximately \$16.7 billion in dividend payments, interest payments and fees relating primarily to assets acquired through CPP, TIP, AIFP, PPIP, and AGP (see table 2).<sup>12</sup> Treasury’s agreements under these programs entitled it to receive dividend payments on varying terms and at varying rates. The dividend payments to Treasury are contingent on each institution declaring dividends. As we discuss later in the report, dozens of institutions have not paid dividends, primarily institutions participating in CPP. Treasury has also entered into certain loan agreements and invested in subordinate debentures which generate interest. Further, Treasury auctioned its first securities in December 2009 and has been selling its Citigroup common stock throughout 2010.

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<sup>11</sup>In addition to preferred stock, Treasury also received from privately held institutions warrants to purchase a specified number of shares of preferred stock—called warrant preferred stock—that pay quarterly dividends at a rate of 9 percent per year. A warrant is an option to buy shares of common stock or preferred stock at a predetermined price on or before a specified date. The exercise price for the warrant preferred stock is \$0.01 per share unless the financial institution’s charter requires otherwise. Treasury exercised these warrants immediately for privately held institutions.

<sup>12</sup>Under the CPP terms, institutions pay cumulative dividends on their preferred shares except for banks that are not subsidiaries of holding companies, which pay noncumulative dividends. Some of the other types of institutions, such as S-corporations, received their CPP investment in the form of subordinated debt and pay Treasury interest rather than dividends.

**Table 2: TARP Additional Cash Proceeds Received from inception through September 30, 2010**

<b>Program</b>	<b>Warrant proceeds/ gain on sale of common stock<sup>a</sup></b>	<b>Dividend, interest and fees</b>	<b>Total additional proceeds</b>
CPP	\$9,818	\$9,921	<b>\$19,739</b>
TIP	1,237	3,005	<b>4,242</b>
AIFP	114	2,800	<b>2,916</b>
AGP	n/a	716	<b>716</b>
PPIP	1	228	<b>229</b>
<b>Total</b>	<b>\$11,170</b>	<b>\$16,670</b>	<b>\$27,842</b>

Source: GAO analysis of Treasury (OFS) data.

<sup>a</sup>Warrant proceeds includes cash received from Treasury's auction of warrants, TARP participants' repurchase of warrants, and warrant preferred stock issued to Treasury.

As of September 30, 2010, OFS had valued these TARP direct loans and equity investments at \$142.5 billion and the asset guarantee program at \$3 billion for a total of \$145.5 billion based on estimates using economic and financial credit subsidy models. The estimates used entity-specific as well as relevant market data as the basis for assumptions about future performance and incorporate an adjustment for market risk to reflect the variability around any unexpected losses. In valuing the direct loans, equity investments, and asset guarantee program, OFS management considered and selected assumptions and data that it believed provided a reasonable basis for the estimated subsidy allowance and related subsidy costs reported in the financial statements. However, there are a large number of factors that affect these assumptions and estimates, which are inherently subject to substantial uncertainty arising from the likelihood of future changes in general economic, regulatory, and market conditions. The estimates have an added uncertainty resulting from the unique nature of transactions associated with the multiple initiatives undertaken for TARP and the lack of historical program experience upon which to base the estimates. These differences will also affect the ultimate cost of TARP. The estimated value of TARP's \$142.5 billion in direct loans and equity investments is net of a \$36.7 billion subsidy cost allowance—primarily the difference between the amounts paid by OFS for the direct loans and equity investments and the reported value of such assets. The reported net cost of TARP transactions from inception through September 30, 2010, was \$18.5 billion. However, the ultimate cost will change as OFS continues to purchase troubled assets and incur related subsidy costs as well as incur costs under other TARP initiatives relating to Treasury housing programs under TARP.

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## Treasury Faces Oversight Challenges in Managing CPP Investments

Under CPP, Treasury provided capital to qualifying financial institutions by purchasing preferred shares or subordinated debentures.<sup>13</sup> In return for its investment, Treasury received preferred stock or debentures, which provided for dividend payments (if declared by the issuer) or interest payments as well as warrants. As we recently reported, Treasury disbursed about \$205 billion to 707 financial institutions nationwide from October 2008 through December 2009.<sup>14</sup> Increasing numbers of CPP participants have missed scheduled dividend or interest payments resulting in Treasury developing a plan for exercising its right to appoint directors as it deems appropriate. Over the last 2 years, Treasury has restructured the assistance provided to 12 CPP participants by swapping cumulative preferred stock for other forms of equity securities or selling the preferred stock to an institution involved in a merger or capital restructuring with a CPP institution. Through September 2010, Treasury had received about \$152 billion in full and partial repayments from 89 institutions, and 28 institutions exchanged \$363 million of their CPP investments for investments under Treasury's CDCI program. However, questions about the health of smaller banks continue, and small institutions participating in CPP may face challenges in fulfilling the terms needed to exit the program.

## The Growing Number of CPP Participants with Missed Dividend or Interest Payments Creates Oversight Challenges for Treasury

As the number of institutions that have missed scheduled dividend or interest payments increases, Treasury faces various oversight and management challenges (see fig. 2). As of September 30, 2010, 144 institutions had not made at least one scheduled dividend or interest payment by the end of the reporting month in which the payments were due, for a total of 413 missed payments.<sup>15</sup> The total amount of missed dividend and interest payments was \$235 million, although some of these payments were later made prior to the end of the reporting month. From February 2009 through August 2010, the number of institutions missing dividend or interest payments due on their CPP investments increased steadily from 8 to 123, or about 20 percent of existing CPP participants. Institutions can elect whether to pay dividends and may choose not to pay

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<sup>13</sup>For the purposes of CPP, financial institutions generally include qualifying U.S.-controlled banks, savings associations, and both bank and savings and loan holding companies.

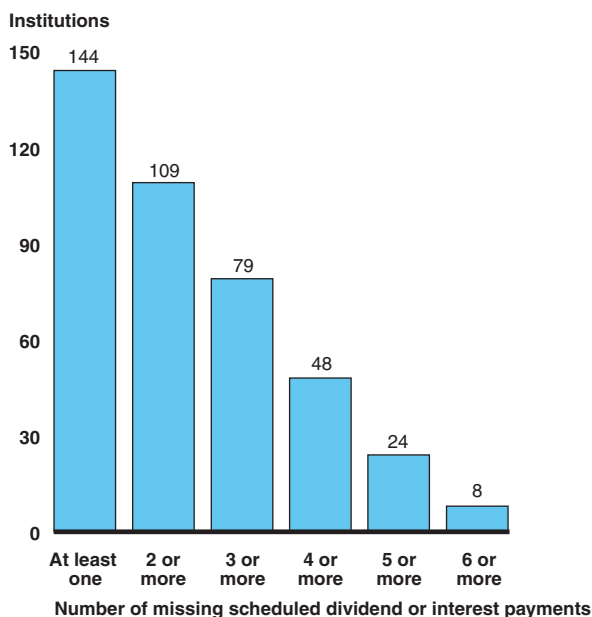
<sup>14</sup>[GAO-11-47](#).

<sup>15</sup>These figures differ from the number of dividend or interest payments outstanding because some institutions made their payments after the end of the reporting month. CPP dividend and interest payments are due on February 15, May 15, August 15, and November 15 of each year, or the first business day subsequent to those dates. The reporting period ends on the last day of the calendar month in which the dividend or interest payment is due.



for a variety of reasons, including decisions that they or their federal and state regulators make to conserve cash and maintain (or increase) capital levels. Institutions are required to pay dividends only if they declare dividends, although unpaid cumulative dividends generally accrue and the institution must pay them before making payments to other types of shareholders, such as holders of common stock.

**Figure 2: Number of Institutions Missing Scheduled Dividend or Interest Payments, as of September 30, 2010**



Source: GAO analysis of Treasury data.

Generally, if an institution has not paid in full a total of six dividend or interest payments, Treasury has the right to elect two members to the institution’s board of directors. As of September 30, 2010, eight institutions had missed at least six payments, and these payments remained unpaid for seven of the institutions. For these seven institutions, Treasury had not yet exercised its right to nominate directors. However, it has elected two members to AIG’s board of directors under the AIG Investment program. As more institutions miss scheduled dividend payments, Treasury faces a significant challenge of determining the extent to which it plans to exercise its right to nominate board members. In August 2010, Treasury began addressing this challenge by publicly releasing a “fact sheet” and “frequently asked questions” regarding the nomination of board members to these institutions. In nominating directors, Treasury said that it would

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proceed in two steps. First, after an institution misses five dividend or interest payments, Treasury plans, with the institutions' approval, to send qualified members of OFS staff to observe board meetings. The information gleaned will not only help Treasury understand any special conditions and challenges that the institution is facing, but will also support Treasury's ongoing monitoring of its investment. The observers' activities generally will be limited to listening and asking clarifying questions regarding materials presented at the board meetings. Second, once an institution has missed six dividend payments, Treasury will decide whether to nominate a board member based on a variety of considerations, including what it learns from the board meetings, the institution's financial condition, and the function of its board of directors. Further, Treasury will prioritize the institutions it is monitoring for possible appointments to the board, in part based on the size of its investment, with institutions with investments of more than \$25 million receiving priority.

Treasury reported that it may not nominate directors immediately after an institution misses six payments but plans to develop a pool of candidates screened by executive search firms engaged by Treasury. Unlike observers, board members nominated by Treasury cannot be government employees. They will have the same fiduciary duties and obligations to the shareholders of the financial institution as any other member of the board and will receive the same compensation from the institution. They will serve until the institution pays its dividends or interest (when Treasury's right to appoint them expires) or Treasury chooses to nominate a replacement director.<sup>16</sup> Going forward, we will continue to monitor Treasury's development and implementation of policies and procedures for nominating board members and assess the extent to which the process is efficient and consistent with all applicable requirements and goals of CPP.

### Treasury Has Developed Policies and Procedures for Exchanging Assets

In the last year, Treasury has participated in a limited, but growing, number of exchanges of CPP preferred stock for other securities or in direct dispositions of CPP investments to new investors that can provide new equity, conduct capital restructurings, or otherwise strengthen the capital position of the institution. Treasury said that it took these actions

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<sup>16</sup>Even after Treasury's right to nominate a director expires, a financial institution could voluntarily choose to retain the director if it believes that doing so would be in the institution's best interests.

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to protect the taxpayers' interest in the CPP investments and promote financial stability. In October 2009, OFS finalized policies and procedures governing these exchanges and dispositions.<sup>17</sup> In considering an institution's proposal for an asset exchange, OFS stated that it assesses various factors, including:

- the impact on the quality of the institution's capital, especially in light of any concurrent efforts to raise capital and exchanges or recapitalizations involving other securities;
- the possible impact on Treasury's position relative to the holders of securities that are in equal standing with Treasury;
- the U.S. government's overall economic position; and
- whether any premium paid over the current market price of the securities to induce holders to participate in other transactions as part of a larger capital restructuring is reasonable and consistent with other similar third party transactions in the marketplace.

As of September 30, 2010, Treasury had completed 12 restructurings. These restructurings included exchanges of CPP preferred shares for other securities, such as mandatory convertible preferred shares, trust preferred securities, or common shares.<sup>18</sup> In two restructurings, Treasury sold its CPP preferred stock and warrants to third party institutions as part of a merger agreement and a capital raising investment with the CPP institutions. One institution with a restructured investment subsequently filed bankruptcy and had its banking subsidiary placed in receivership by its banking regulator, and it is unlikely that Treasury will receive any significant recovery.

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<sup>17</sup>The policy and procedures broadly apply to securities under various TARP programs.

<sup>18</sup>Mandatory convertible preferred is a type of preferred share that must be converted to common stock at the issuer's request if specific criteria are met by a certain date. A trust preferred security is a cumulative preferred stock instrument that is considered a hybrid security because it possesses features of both debt and equity and is created by establishing a trust and issuing debt to it.

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## Treasury Does Not Monitor Regulators' Decisions to Approve or Deny CPP Repayments

As of September 30, 2010, Treasury had received full repayments from 80 institutions and partial repayments from 9 additional institutions, and we have closely monitored the process for repaying CPP investments.<sup>19</sup> Our recent report on CPP identified weaknesses in Treasury's monitoring of regulators' decisions to approve or deny requests to repay CPP investments.<sup>20</sup> Under the original terms of the program, Treasury prohibited institutions from repaying CPP funds within 3 years unless the firm had completed a "qualified equity offering" to replace a minimum amount of the capital, but the American Recovery and Reinvestment Act of 2009 (Recovery Act) included provisions modifying the terms of CPP repayments.<sup>21</sup> These provisions require that Treasury allow any institution to repay its CPP investment subject only to consultation with the appropriate federal bank regulator, without considering whether the institution has replaced such funds from any other source or applying any waiting period. Treasury officials indicated that, as a result of these changes, they had not provided guidance or criteria to regulators on deciding when to allow institutions to repay CPP investments and had not collected information on the reasons for these decisions. However, according to Treasury, it helped facilitate meetings among the regulators in the spring of 2009 at which they discussed what would be in the standards for permitting TARP recipients to repay. Bank regulatory officials said that they used existing supervisory procedures that were generally applicable to capital reductions as a basis for reviewing CPP repurchase requests and that they approached the decision from the perspective of achieving regulatory rather than CPP goals.<sup>22</sup> Regulators also said that they provided a brief e-mail notification to Treasury

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<sup>19</sup>An additional 28 institutions had exchanged their CPP investments for investments under Treasury's CDCL.

<sup>20</sup>GAO-11-47.

<sup>21</sup>A "qualified equity offering" is the sale and issuance of tier 1 qualifying perpetual preferred stock, common stock, or a combination of such stock for cash. Prior to enactment of the Recovery Act, Pub. L. No. 111-5, 123 Stat. 115 (2009), CPP investments in the form of senior preferred shares could only be repurchased prior to 3 years from the date of investment with the proceeds of the "qualified equity offering" resulting in aggregate gross proceeds to the financial institution of not less than 25 percent of the issue price of the senior preferred. Section 7001 of the Recovery Act provides, in part, that "Subject to consultation with the appropriate Federal banking agency... Treasury *shall* permit a TARP recipient to repay any assistance previously provided under the TARP to such financial institution, without regard to whether the financial institution has replaced the funds from any other source or to any waiting period" (emphasis added).

<sup>22</sup>Regulatory goals focus on safety and soundness considerations, such as capital adequacy and financial condition.

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indicating whether they objected or agreed to allow an institution to repay its CPP investment. Treasury, in turn, communicated the regulators' decisions to the CPP firms and informed them whether it was able to process their request to repay.

While the decision to allow repayment ultimately lies with the bank regulators, the statute does not prohibit Treasury, as administrator of CPP, from monitoring regulators' decision-making process and collecting information or providing feedback about the regulators' decisions. While the regulators prepare a case decision memo to document their analysis of repayment requests that is similar to the memo that was used to document their evaluations of CPP applicants, officials from both Treasury and the regulators said that Treasury did not request or review the memo or other analyses supporting regulators' decisions. In our recent report, we found that while the decision ultimately lies with the regulators, without collecting information on or monitoring regulators' decisions, Treasury had no basis for determining whether decisions involving similar institutions were being made consistently and thus whether CPP participants were being treated equitably. Furthermore, absent information on why regulators made repayment decisions, Treasury cannot provide feedback to regulators. Accordingly, we recommended that Treasury periodically collect and review certain information from bank regulators on the analysis and conclusions supporting their decisions on CPP repayment requests and provide feedback for the regulators' consideration on the extent to which regulators are evaluating similar institutions consistently. In its response, Treasury stated that it would consider ways to address the objectives of our recommendations while also noting the constraints presented by the law and principles of regulatory independence.

### Treasury Has Responded to Our Recommendations for Improving Transparency and Accountability of CPP

We have made seven recommendations to strengthen transparency and accountability of CPP, a key TARP program, over the last 2 years and Treasury has largely addressed many of these recommendations. For example, responding to our recommendations for improving the program's transparency, Treasury required all CPP participants to participate in some form of monthly lending survey. However, as institutions leave the program, which includes the largest banks, they no longer report information on lending to Treasury. We also recommended that Treasury consider making the warrant valuation process transparent to the public by disclosing details of the warrant repurchase process. Treasury has addressed these recommendations by releasing bank survey information on lending and detailed reports on warrant repurchases.

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Consistent with our past recommendations, Treasury has also taken steps to ensure compliance with CPP requirements, which include limitations on dividends, stock repurchase restrictions, and executive compensation. Treasury tracks the number of missed payments in the monthly Dividends and Interest Report, which it posts on [www.financialstability.gov](http://www.financialstability.gov). Treasury, in conjunction with its outside asset managers and custodian (Bank of New York Mellon), monitors corporate actions, such as restrictions on stock repurchases and dividends. Instances of noncompliance with CPP requirements are reported to OFS Compliance within the Office of Internal Review, which evaluates them to determine if further action is required. Treasury has also created policies for ensuring that CPP institutions comply with restrictions on executive compensation and excessive or luxury expenditures.<sup>23</sup> For example, Treasury's interim final rule requires that the principal executive officer and principal financial officer certify to actions to be taken by the compensation committee, board of directors, and the company itself with regard to executive compensation.<sup>24</sup> Certifications from these officers are required to be filed within 90 days after the recipient's fiscal year-end. As of August 2010, 97 percent of all recipients have filed their certifications. Nine recipients have a fiscal year end of June 30 and are expected to submit their certification by September 30, 2010. All certifications and disclosures as well as correspondences are tracked and monitored by OFS Compliance within the Office of Internal Review. Treasury's Office of the Special Master for TARP Executive Compensation (Special Master) reviewed payments that taxpayer-assisted firms made to its "top 25" executives prior to February 17, 2009, when the Recovery Act introduced additional compensation and corporate governance standards for TARP recipients. The Special Master conducted the "lookback" review beginning in March 2010 by requesting compensation data from all 419 institutions that received taxpayer assistance prior to the passage of the Recovery Act.<sup>25</sup> All 419 institutions responded to the request, and the Special Master issued the results of the lookback review on July 23, 2010. Although the

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<sup>23</sup>Executive compensation requirements generally include limits on compensation that exclude incentives for senior executive officers to take unnecessary and excessive risks that threaten the value of TARP recipients and provide for the recovery of any bonus, retention award, or incentive compensation paid to certain employees based on materially inaccurate statements of earnings, revenues, gains, or other criteria.

<sup>24</sup>31 C.F.R. Part 30.

<sup>25</sup>Although authority to conduct the review and obtain compensation information was provided under the statute and regulations, the Special Master had no authority to force reimbursements from firms or executives, or require any other remedy.

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Recovery Act and Treasury rules later imposed much stricter limits on pay among participating institutions, the Special Master found that compensation, such as cash bonuses and retention awards, for the institutions reviewed was permitted by the rules in place at the time.

Treasury has hired nine asset management firms to provide market advice about its portfolio of investments in financial institutions participating in CPP and other TARP programs. These management firms are also responsible for helping Treasury monitor compliance with the key terms of the program. In past reports we noted that Treasury had not finalized specific guidance and performance measures for the asset managers' oversight responsibilities or identified the process for monitoring the asset managers' performance.<sup>26</sup> Treasury finalized its oversight policies for asset managers in April 2010 and developed qualitative and quantitative performance metrics based on the managers' core functions and responsibilities in July 2010.

Finally, in our June 2009 report, we recommended that Treasury ensure that the primary federal banking regulators use generally consistent criteria when considering repayment decisions under TARP.<sup>27</sup> Unless Treasury takes steps to help promote consistency in regulatory decisions to approve or deny repayment requests, regulators may not treat comparable TARP institutions equitably. In response, Treasury stated that it would consult with the primary federal regulators regarding their criteria and suggest that they follow consistent criteria unless they have valid regulatory reasons for using different standards.

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## Outstanding Balances Under TIP Were Repaid and the Program Terminated

TIP was designed to foster market stability and thereby strengthen the economy by investing in institutions on a case-by-case basis that Treasury deemed critical to the functioning of the financial system. Only two institutions—Bank of America and Citigroup—participated in this program, and each received \$20 billion in capital investment, which both repaid in December 2009. Both of these institutions also received \$25 billion each in exchange for preferred shares under CPP. Bank of America

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<sup>26</sup>See GAO, *Troubled Asset Relief Program: One Year Later, Actions Are Needed to Address Remaining Transparency and Accountability Challenges*, [GAO-10-16](#) (Washington, D.C.: Oct. 8, 2009).

<sup>27</sup>See GAO, *Troubled Asset Relief Program: June 2009 Status of Efforts to Address Transparency and Accountability Issues*, [GAO-09-658](#) (Washington, D.C.: June 17, 2009).

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repurchased these shares in December 2009. Treasury started selling its Citigroup common shares in April 2010 and finalized such disposition in December 2010.

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### AIFP Illustrates Both Progress and Ongoing Uncertainty in Recouping Assistance

Although Chrysler's and GM's financial performance has improved over the last year, the government's ability to fully recover its investments in these companies depends on a variety of factors. Further, the government's ability to recoup its investment in Ally Financial rests not only on economic conditions but on the company's ability to compete with other credit providers. From December 2008 through December 2009, Treasury announced \$86.3 billion in funding available to help stabilize the auto industry and disbursed \$79.7 billion of this funding, including about \$62 billion to fund Chrysler and GM while they restructured, about \$17 billion to provide capital assistance to Ally Financial, and \$1.5 billion to a special purpose vehicle (SPV) created by Chrysler Financial.<sup>28</sup> In return for its assistance to Chrysler and GM, Treasury received 9.85 percent equity in the reorganized Chrysler, 60.8 percent equity and \$2.1 billion in preferred stock in the reorganized GM, and \$13.8 billion in debt obligations between the two companies. In return for its investment in Ally Financial, Treasury received preferred shares. As of December 15, 2010, approximately \$26.9 billion of the \$79.7 billion had been repaid.

The federal government's ability to fully recoup its investments will depend on the profitability of Chrysler, GM, and Ally Financial and the success of future public stock offerings. Since we last reported on the financial condition of the auto industry in November 2009, Chrysler and GM have shown signs of progress in returning to profitability.<sup>29</sup> For example:

- *Positive financial statements.* In 2010, both the new Chrysler and new GM released financial statements for 2009 and the first three quarters of 2010. Thus far, according to Treasury officials, both companies are doing better than they had projected in the companies' viability plans during the bankruptcies and that Treasury had initially projected in terms of

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<sup>28</sup>The total announced amount includes \$5 billion for the Supplier Support Program announced in March 2009. In July 2009 the commitment for the Supplier Support Program was reduced by \$1.5 billion, and in July 2010 about \$3 billion was deobligated for this program, resulting in the difference between the asset purchase price referenced earlier in this report and the announced amount in this section.

<sup>29</sup>[GAO-10-151](#).



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revenues, operating earnings, and cash flow. We are in the process of reviewing the financial statements in more detail for a subsequent report.

- *Repayment of GM's loans.* In April 2010, GM repaid the remaining \$4.7 billion of the \$6.7 billion in debt it owed to Treasury from an escrow account that was created for the company through the restructuring process in summer 2009. According to Treasury officials, the escrow account was GM property and the funds in the account came from a portion of the proceeds of a loan made by both Treasury and the Canadian government. After the full repayment of this loan, approximately \$6.6 billion was left in the account and these funds became available for GM's general use. As of November 2010, Chrysler had made about \$440 million in interest payments on its loans from Treasury.
- *IPO held for GM and plans for a Chrysler offering.* In August 2010, Treasury announced that it had agreed to be named a selling shareholder of common stock in GM's registration statement for the company's IPO. On November 17, 2010, GM held an IPO with 478 million common stock shares held by several stockholders, including Treasury. On November 26, 2010, the underwriters for the IPO exercised the overallotment option, bringing the total number of shares sold to almost 550 million. The proceeds from the sale of common shares combined with those from the sale of the mandatory convertible preferred shares raised \$23.1 billion. Treasury sold more than 412 million of its shares, for which it received \$13.5 billion in net proceeds to repay the government's initial investment in GM. As a result of selling these shares, Treasury's ownership stake in GM has decreased from 60.8 percent to 33.3 percent. According to Treasury, the exact timing of further divestments in GM has not yet been determined. In December 2010, GM also repurchased Treasury's shares of preferred GM stock for \$2.1 billion. Chrysler has indicated that it expects to hold an IPO but not before the second half of 2011, subject to approval from its Board of Directors.

While these steps indicate progress in the companies' journey towards profitability, the government's ability to recoup its investment in the auto industry is uncertain, and the companies face several challenges in the coming years. These challenges will require Treasury to provide ongoing oversight. For instance:

- *Pension obligations and other future cash payments could be significant.* In April 2010, we reported on the impact of restructuring on

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Chrysler's and GM's pension plans.<sup>30</sup> We found that although the new companies had assumed sponsorship of the pension plans, the future of the plans remained uncertain, in part because the companies might need to make large contributions to comply with federal pension funding requirements and their ability to make such contributions was largely dependent on their ability to become profitable again. As of the most recent valuation, GM's U.S. and non-U.S. defined benefit pension plans were underfunded by more than \$27 billion as of December 31, 2009, due to a number of factors, including significant declines in financial markets and the deterioration of the value of plan assets.<sup>31</sup> In December 2010, GM announced that it had contributed \$4 billion in cash into its U.S. defined benefit pension plans and planned to contribute \$2 billion in stock to its U.S. plans in order to move these plans closer to being fully funded. Although determining exactly how much funding the plans will need in the future is reliant upon various assumptions and therefore difficult to pinpoint, GM's latest estimates indicate that the company may need to make billions of dollars in contributions to these plans in 2014 and beyond in order to meet minimum funding requirements.<sup>32</sup> As of December 31, 2009, Chrysler's worldwide defined benefit pension plans were underfunded by approximately \$3.9 billion.

- *Future sales levels for new vehicles remain uncertain.* While Chrysler and GM U.S. sales, and industry sales as a whole, were up substantially in 2010 from 2009—up 17 percent and 21 percent, respectively—seasonal trends were not uniformly positive. For example, compared with May 2010 levels, June 2010 U.S. sales for both companies decreased—12 percent for Chrysler and 13 percent for GM's core brands—which was more than the usual seasonal change of 3 percent between these months, while July 2010

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<sup>30</sup> [GAO-10-492](#).

<sup>31</sup> According to the registration statement GM filed with the Securities and Exchange Commission on August 18, 2010, the U.S. defined benefit pension plans were underfunded by \$17.1 billion and the non-U.S. plans by about \$10.3 billion, as of December 31, 2009. According to GM, adverse equity and credit markets reduced the market value of the plan assets, while the present value of pension liabilities rose significantly in response to declines in the discount rate, the effect of separation programs and increases in the level of pension benefits and number of beneficiaries.

<sup>32</sup> Statutorily prescribed pension funding requirements for single-employer plans specify how much a sponsor must contribute to its defined benefit plans each year. 26 U.S.C. §§ 412 and 430. In general, the minimum required contribution reflects the value of the plan's assets compared with the plan's benefit obligations, as measured by the present value of all benefits accrued or earned as of the beginning of the plan year (the plan's funding target) and the present value of all benefits that are expected to accrue or be earned under the plan during the plan year (the target normal cost).

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U.S. sales for both Chrysler and GM were up about 5 percent over July 2009.<sup>33</sup> In August 2010, Chrysler's U.S. sales increased 7 percent over August 2009 levels while GM's U.S. core brand sales decreased 11 percent. Yet in December 2010, U.S. sales for both companies were up over December 2009 levels (16 percent for Chrysler and 16 percent for GM's core brands). Vehicle sales volumes are highly dependent on economic and market conditions such as unemployment levels, consumer confidence, and credit availability. Improved economic conditions and, in turn, improved vehicle sales are critical to the future profitability of the companies and the timing and success of future public stock offerings, but current economic conditions remain fragile.

- *Ally Financial's financial health depends, in part, on the health of the auto industry and its ability to continue to diversify its portfolio.* Treasury's AIFP assistance to Ally Financial, a bank holding company, resulted in the government owning more than half of Ally Financial by the end of 2009. Recognizing the interconnectedness of auto financing companies and vehicle sales, Treasury purchased \$5 billion in preferred shares and received warrants from Ally Financial in December 2008 and purchased an additional \$7.5 billion in convertible preferred shares in 2009. Despite this infusion of capital, Ally Financial was required to raise additional capital by November 2009 based on the results of the Federal Reserve's stress test. Unable to raise sufficient additional capital in the private market, on December 30, 2009, Treasury provided Ally Financial with a capital investment of \$3.8 billion to fulfill its capital buffer requirement under the stress test, drawing funds from AIFP. Treasury did so through the purchase of mandatory convertible preferred shares and trust preferred securities.<sup>34</sup> Also, in December 2009, Treasury converted \$3 billion of existing mandatory convertible preferred shares into common stock, increasing its equity stake from 35 percent to 56.3 percent of Ally Financial common stock. As of September 30, 2010, Treasury owned \$11.4 billion of Ally Financial mandatory convertible preferred shares, \$2.7 billion of its trust preferred securities, and 56.3 percent of its common

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<sup>33</sup>GM's "core brands" include GMC, Chevrolet, Cadillac, and Buick but exclude brands GM has discontinued since 2009, such as Saturn, Pontiac, and Hummer. According to Edmunds.com, auto sales typically decrease by approximately 3 percent from May to June each year.

<sup>34</sup>Specifically, on December 30, 2009, Treasury purchased an additional \$1.25 billion of mandatory convertible preferred shares and received warrants that Treasury exercised at closing for an additional \$62.5 million in mandatory convertible preferred shares. Treasury also purchased \$2.54 billion in Ally Financial trust preferred securities and received warrants that Treasury exercised at closing for an additional \$127 million in Ally Financial trust preferred securities, which were all investments under AIFP.

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stock. As part of its rebranding and growth efforts, GMAC changed its name to Ally Financial, Inc. in May 2010. However, Ally Financial may face increased competition for its business in the future, including potentially from GM, which acquired Americredit, an auto finance company. On December 30, 2010, Treasury converted \$5.5 billion of its preferred stock in Ally Financial into common stock, raising its total common equity stake in the company to 74 percent. Ally Financial's chief executive officer noted that the conversion of these shares should help the company in its efforts to conform its capital structure to that more typical of a bank holding company. Treasury also reported that the conversion may improve Ally Financial's ability to raise debt financing.

To help address these challenges, we made several recommendations in our November 2009 report.<sup>35</sup> For example, we recommended that Treasury ensure that it had adequate staffing to monitor the government's investment in the auto companies. Subsequent to our recommendation, Treasury hired additional staff to monitor the government's investment in the auto companies. We also recommended that Treasury report to Congress on how it planned to assess and monitor the companies' performance. While Treasury agreed with the recommendation and has provided various updates and other information to Congress and to the public about the status of the taxpayers' investments in the auto companies, it has yet to report to Congress on its plans to assess and monitor the companies' performance. Treasury noted that it uses monthly financial and operating information from the companies, as set forth in the credit agreements, to closely monitor the companies' financial condition and that Congress has not requested additional information on the agency's efforts to assess and monitor the companies. While we recognize there is a wide range of publicly available information on the companies' financial performance, Treasury has not reported to Congress how it is using this information to ensure the companies are on track to further improve their financial condition and maximize taxpayer return on its investment. We will continue to work with Treasury on the implementation of this recommendation and review Treasury's actions in response to our recommendation on developing criteria for evaluating options for divesting the government's ownership stake in Chrysler and GM. We are continuing to monitor the financial condition of the industry and in ongoing work are reviewing the current financial condition and outlook of Chrysler and GM. As part of that ongoing work, we are also

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<sup>35</sup> [GAO-10-151](#).

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reviewing the status of the federal government's efforts to assist workers and communities that depend on the auto industry for their economic viability.

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### Treasury's Exposure to AIG Under TARP Is Tied to the Current and Future Health of the Company and the Insurance Industry

Treasury's exposure to AIG increased slightly in 2010, and its ability to fully recoup its assistance remains contingent on a number of factors related to the health of AIG and the insurance industry. Since September 2, 2009, Treasury has increased its level of assistance to AIG, funding an additional \$4.2 billion drawdown on the Equity Capital Facility. This brings Treasury's total assistance to AIG as of September 30, 2010, to about \$47.4 billion, not including \$1.6 billion in unpaid dividends exchanged for preferred stock.<sup>36</sup> Treasury's initial wave of assistance to AIG began in November 2008 under TARP's Systemically Significant Failing Institutions Program (now known as the AIG Investment Program) when the agency agreed to purchase \$40 billion in shares of AIG Series D cumulative preferred stock and received a warrant to purchase approximately 2 percent of the shares of AIG's common stock.<sup>37</sup> The proceeds were used by AIG to pay down part of the FRBNY Revolving Credit Facility. FRBNY also created and funded two special purpose vehicles—Maiden Lane II and Maiden Lane III—to purchase assets from AIG's securities lending portfolio and AIG Financial Product's credit default swap counterparties, respectively, both of which were contributing to AIG's liquidity problems.<sup>38</sup> Treasury provided additional assistance in April 2009 by agreeing to exchange this Series D stock for Series E fixed-rate noncumulative preferred stock and by providing a \$29.84 billion Equity Capital Facility to AIG to help the company meet its liquidity and capital needs, in exchange

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<sup>36</sup>The \$47.4 billion is provided by AIG's third quarter 2010 10Q filing, which we have used in previous reports on AIG, whereas the amounts cited earlier in this report, including Table 1, are based on our 2010 Audit of OFS's Financial Statements.

<sup>37</sup>Cumulative preferred stock is a form of capital stock in which holders of preferred stock receive dividends before holders of common stock, and dividends that have not been paid must be paid to preferred shareholders before common shareholders can receive dividends.

<sup>38</sup>From July through early September 2008, AIG was experiencing declines in the value and market liquidity of the residential mortgage-backed security assets that comprised the collateral for its securities lending program and declining values of collateralized debt obligations against which AIG Financial Product had written credit default swap protection. These losses forced AIG to use its cash reserves to repay securities lending counterparties that terminated existing agreements and to post additional collateral required by trading counterparties of AIG Financial Product. The rating agencies downgraded AIG's debt rating, which resulted in additional collateral demands.

for its purchase of 300,000 shares of fixed-rate noncumulative perpetual preferred stock (Series F) and a warrant to purchase up to 3,000 shares of AIG common stock.<sup>39</sup> As of September 30, 2010, AIG had drawn about \$7.4 billion from this equity facility, up from \$3 billion as of September 30, 2009. By comparison, the level of credit FRBNY has provided AIG through its Revolving Credit Facility has fallen from peaks reached in late 2008, when Treasury’s assistance was just beginning, to September 30, 2010— from \$72.3 billion to about \$20.5 billion for the Revolving Credit Facility primarily because the debt was restructured into equity (see table 4). For example, FRBNY accepted preferred interests in SPVs holding the American Life Insurance Company (ALICO) and American International Assurance Company, Ltd. (AIA), two life insurance holding company subsidiaries, and reduced the outstanding balance on the revolving facility by \$25 billion. As of September 30, 2010, the federal government’s total exposure to AIG was \$124.6 billion, up from \$120.7 billion as of September 2, 2009, but lower than \$129.1 billion as of December 31, 2009.

**Table 3: Composition of U.S. Government Efforts to Assist AIG and the Government’s Approximate Remaining Exposures, as of September 30, 2010, or Latest Available Data as Noted**

Dollars in billions

	Amount authorized	Direct AIG assistance		Indirect AIG assistance		Accrued interest dividends and fees	Total government exposure
		AIG debt owed to government	Government equity	Other debt owed to government	Government equity		
<i>Federal Reserve</i>							
Revolving Credit Facility	\$29.175	\$14.288 <sup>a</sup>	n/a	n/a	n/a	\$6.182	\$20.470 <sup>a</sup>
Maiden Lane II	22.5	n/a	n/a	\$13.656 <sup>b</sup>	n/a	.408	14.064
Maiden Lane III	30	n/a	n/a	14.638 <sup>b</sup>	n/a	.499	15.137
AIA and ALICO	25	n/a	\$25.955 <sup>c</sup>	n/a	n/a	n/a	25.955
<i>Treasury</i>							
Series D and E	40	n/a	40.000 <sup>d</sup>	n/a	n/a	1.605	41.605 <sup>d</sup>
Series F	29.835	n/a	7.378 <sup>e</sup>	n/a	n/a	n/a	7.378 <sup>e</sup>
<b>Total direct assistance</b>	<b>n/a</b>	<b>\$14.288</b>	<b>\$73.333</b>	<b>n/a</b>	<b>n/a</b>	<b>\$7.787</b>	<b>\$95.408</b>

<sup>39</sup>Unpaid dividends on the Series D shares were added to the principal amount of Series E shares that Treasury received.

Dollars in billions

	Direct AIG assistance			Indirect AIG assistance		Accrued interest dividends and fees	Total government exposure
	Amount authorized	AIG debt owed to government	Government equity	Other debt owed to government	Government equity		
<b>Total indirect assistance</b>	n/a	n/a	n/a	\$28.294	n/a	\$ .907	\$29.201
<b>Total direct and indirect assistance to benefit AIG</b>	\$176.510	\$14.288	\$73.333	\$28.294	n/a	\$8.694	\$124.609

Source: GAO analysis of AIG Securities and Exchange Commission filings, and Federal Reserve Statistical Release H.4.1.

Note: Data as of September 30, 2010, or latest available.

<sup>a</sup>FRBNY created a revolving credit facility to provide AIG a revolving loan that AIG and its subsidiaries could use to enhance their liquidity positions. In exchange for the facility and \$0.5 million, a trust received Series C preferred stock for the benefit of the Treasury, which gave the trust a 77.9 percent voting interest in AIG. FRBNY reduced the amount of the commitment fee on the revolving credit facility by \$500,000 to pay for the Series C stock. The AIG loan balance reported in the H.4.1 reflects the outstanding principal balance, capitalized interest, unamortized deferred commitment fees, and the allowance for the loan restructuring, which was initially recorded in July 2009.

<sup>b</sup>FRBNY created an SPV—Maiden Lane II LLC—to alleviate liquidity and capital pressures on AIG by purchasing residential mortgage-backed securities from AIG U.S. insurance subsidiaries, and another SPV called Maiden Lane III LLC to alleviate liquidity and capital pressures on AIG by purchasing collateralized debt obligations from AIGFP’s counterparties in connection with the termination of credit default swaps. Principal owed as of September 29, 2010, was \$13.656 billion for Maiden Lane II LLC and \$14.638 billion for Maiden Lane III LLC.

<sup>c</sup>AIG created two SPVs to hold the shares of certain of its foreign life insurance businesses (AIA and ALICO). In November 2010, the company announced that it sold ALICO to MetLife for approximately \$16.2 billion (including approximately \$7.2 billion in cash and the remainder in MetLife securities) and in October 2010 it announced that it had raised more than \$20.5 billion in the IPO of two-thirds of the shares of AIA. AIG announced that it expects to use the cash proceeds from the ALICO and AIA transactions to repay the FRBNY revolving credit facility and make payments on other interests owned by the government, per the terms in the recapitalization plan announced in September 2010.

<sup>d</sup>Treasury purchased Series D cumulative preferred stock of AIG. AIG used the proceeds to pay down part of the revolving credit facility. Series D stock was later exchanged for Series E noncumulative preferred stock. Unpaid dividends on the Series D shares were added to the liquidation preference amount of Series E stock that Treasury received. When the Series D preferred shares were exchanged for Series E preferred shares, \$1.605 billion of accrued but unpaid dividends were included in the liquidation preference of Series E preferred stock. As part of the recently announced recapitalization of AIG and restructuring plan, Treasury’s shares of AIG’s Series E preferred stock will be exchanged for approximately 924.5 million shares of AIG common stock.

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<sup>40</sup>Treasury purchased Series F noncumulative preferred stock of AIG. Treasury has committed to provide AIG with up to \$29.835 billion through an equity capital facility to meet its liquidity and capital needs in exchange for an increase in the aggregate liquidation preference of the Series F shares. As part of the recently announced recapitalization of AIG and restructuring plan, AIG is to draw down amounts remaining on the Series F preferred stock and use them to repurchase all or a portion of FRBNY's preferred interests in the AIA and ALICO SPVs. In addition, AIG and Treasury will amend and restate the Series F securities purchase agreement to provide for the issuance of Series G preferred stock by AIG to Treasury, after which AIG's right to draw on Treasury's equity capital facility will be terminated. Treasury's shares of the Series F preferred stock then will be exchanged for (1) preferred interests in the AIA and ALICO SPVs transferred to Treasury, (2) newly issued shares of Series G preferred stock, and (3) approximately 167.6 million shares of AIG common stock.

While AIG's financial condition over the past year has remained relatively stable or showed signs of improvement, as measured by several indicators, federal assistance has played a key role in stabilizing AIG's liquidity, equity structure, and credit ratings.<sup>40</sup> The government's prospect for recouping the assistance it has provided largely rests with the December 8, 2010, master agreement to restructure the federal assistance and recapitalize AIG as agreed to by AIG, FRBNY, Treasury, the AIG Credit Facility Trust, AIA, and ALICO. First, AIG is to repay FRBNY in cash all the amounts owed under the FRBNY revolving credit facility, which as of September 30, 2010, was approximately \$20.5 billion, and the credit facility will be terminated. The funds for repayment are to come from loans to AIG from the SPVs that hold the AIA and ALICO net cash proceeds from the IPO of AIA and the sale of ALICO. Second, AIG is to draw down an amount available under Treasury's equity capital facility established pursuant to the Series F preferred stock securities purchase, less an amount up to \$2 billion. AIG will use the amount drawn down to repurchase all or a portion of FRBNY's preferred interests in the AIA and ALICO SPVs and then transfer the repurchased preferred interests to Treasury in partial consideration for the Series F shares.<sup>41</sup> Third, AIG and Treasury will amend and restate the securities purchase agreement related to the Series F preferred stock so that AIG can issue to Treasury Series G preferred stock at closing, and AIG's right to draw on the Series F preferred stock will be terminated. AIG's right to draw on the Series G preferred stock will be subject to terms and conditions substantially similar to those in the

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<sup>40</sup>[GAO-10-475](#).

<sup>41</sup>In connection with the issuance of the Series E and F preferred stocks and as a participant in TARP, AIG had agreed to a number of covenants with Treasury related to corporate governance, executive compensation, political activity, and other matters. These covenants will continue to apply after the closing. Also, AIG will agree to provide Treasury and FRBNY with certain control and information rights.



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current agreement.<sup>42</sup> Fourth, the various preferred stock held by the Trust and Treasury will be exchanged for common stock. Treasury will then hold approximately 1.655 billion shares of AIG common stock, representing approximately 92.1 percent of the AIG common stock that will be outstanding as of the closing. Fifth, AIG is to issue to holders of AIG common stock, by means of a dividend, 10-year warrants to purchase up to 75 million shares of AIG common stock at an exercise price of \$45 per share.<sup>43</sup> Completion of the plan depends on a number of conditions, such as FRBNY is not to hold preferred interests in AIA and ALICO with an aggregate liquidation preference exceeding \$2 billion immediately after closing.

In addition, AIG must have achieved its year-end 2010 targets for the derisking (unwinding) of AIGFP. Also, the trustees of the Trust must be reasonably satisfied with the insurance and indemnification arrangements provided to them in connection with the recapitalization. Also, the closing will be subject to regulatory approvals in many of the more than 130 countries and jurisdictions where AIG operates. Any of the parties may terminate the recapitalization agreement if it is not completed by March 15, 2011. We will continue to monitor the government's investment and the status of AIG's repayment efforts. Our ongoing work on AIG also include a review of the Federal Reserve facilities implemented to assist AIG.

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<sup>42</sup>AIG may not directly redeem the Series G preferred stock while FRBNY continues to hold any preferred interests in AIA and ALICO, but AIG will have the right to use cash to repurchase a corresponding amount of the preferred interests in the SPVs from FRBNY, which will then be transferred to Treasury to reduce the aggregate liquidation preference of the Series G preferred stock. If FRBNY no longer holds preferred interests in AIA and ALICO, AIG may redeem in cash the Series G preferred stock, at the liquidation preference plus accrued and unpaid dividends.

<sup>43</sup>Exercise price is the price at which the option holder may buy or sell the underlying asset.

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## HAMP Trial Modifications Have Declined and Some TARP-Funded Housing Programs Are Still In the Early Stages of Implementation

As we have noted in our past reports, Treasury has continued to make efforts to help borrowers facing potential foreclosures, but its efforts have continued to face challenges.<sup>44</sup> In particular, Treasury's cornerstone effort under TARP to meet EESA's purposes of preserving homeownership and protecting home values—HAMP—had a slow start and has not performed as anticipated. Moreover, a number of key TARP-funded housing programs are still in the early stages of implementation. In February 2009, Treasury announced that HAMP would use up to \$75 billion—including \$50 billion of TARP funds—to help three to four million homeowners struggling to stay in their homes by modifying their mortgages to reduce the monthly payments to affordable levels (31 percent of their gross monthly income).<sup>45</sup> However, through the end of November 2010, fewer than 550,000 permanent modifications had begun.<sup>46</sup> Furthermore, Treasury had not yet begun reporting activity for other key components of HAMP and other TARP-funded housing programs, such as the Second Lien Modification Program and the Principal Reduction Alternative.

As shown in figure 3, the number of trial modifications started each month peaked in October 2009 and then declined from roughly 118,000 new trials in December 2009 to about 31,000 new trials in November 2010. According to Treasury, this decline may be due, in part, to the new program requirement that lenders determine HAMP eligibility using verified information rather than the verbal financial information that was initially accepted for all HAMP trial periods starting June 1, 2010. Additionally, the number of trial modifications canceled exceeded the number of

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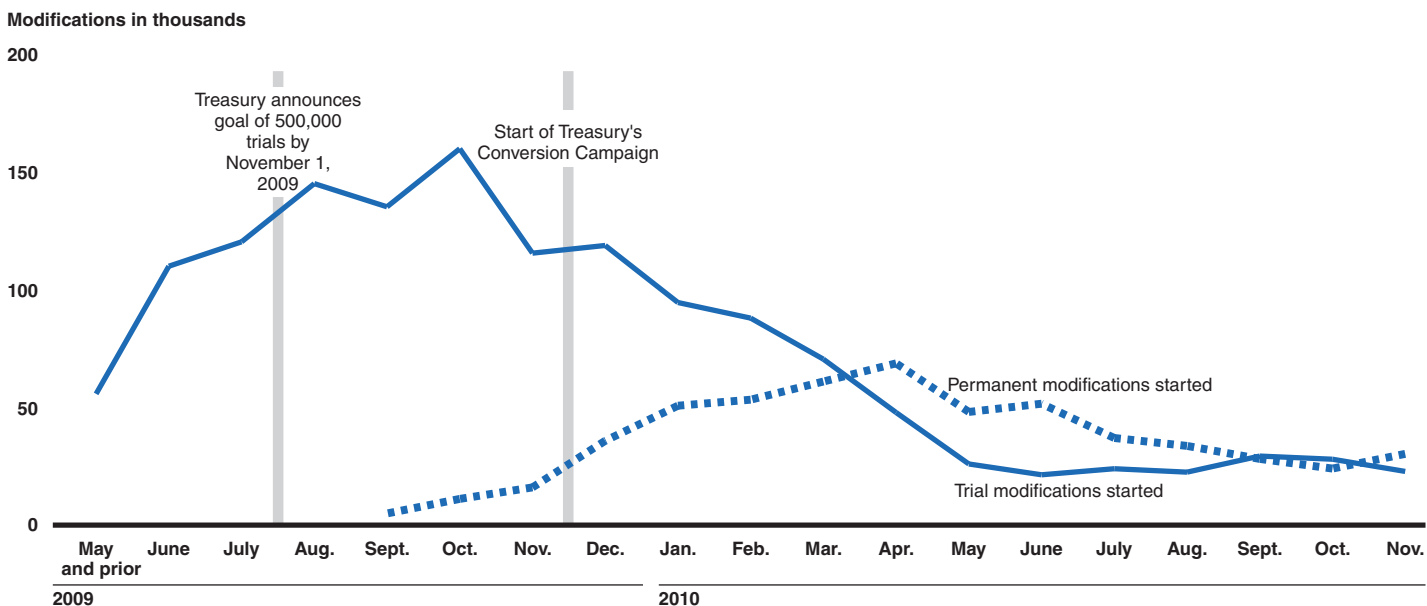
<sup>44</sup>See [GAO-10-634](#); [GAO-10-556T](#); and GAO, *Troubled Asset Relief Program: Treasury Actions Needed to Make the Home Affordable Modification Program More Transparent and Accountable*, [GAO-09-837](#) (Washington, D.C.: July 23, 2009).

<sup>45</sup>To do this, servicers are required to follow a sequential modification process that begins with reducing interest rates to a minimum of 2 percent. Then, if the target payment amount is not reached, the servicer extends the maturity and/or amortization period of the loan in 1-month increments up to 40 years. Finally, if needed, the servicer forbears, or defers, principal.

<sup>46</sup>Under HAMP, servicers and mortgage holders or investors can receive various financial incentive payments to encourage the modification of mortgage loans. According to Treasury, up to approximately \$30 billion in TARP funds will be used primarily to encourage the modification of mortgages that financial institutions own and hold in their own portfolios and mortgages held in private-label securitization trusts. In addition, Fannie Mae and Freddie Mac, two GSEs, are expected to provide up to \$25 billion in additional funding to encourage servicers to modify loans they own or guarantee. In order to receive a permanent loan modification, borrowers must meet the HAMP eligibility requirements (single-family dwelling, owner-occupied, primary residence, etc.) and must successfully complete a 3-month trial modification period.

conversions to permanent modification from the program's inception through November 2010. Of the about 1.4 million trial modifications started, roughly 729,000 were cancelled and roughly 550,000 trials were converted to permanent modifications during this period. The number of new permanent modifications started each month increased from roughly 36,000 in December 2009 to more than 68,000 in April 2010 and then decreased to about 31,000 in November 2010.

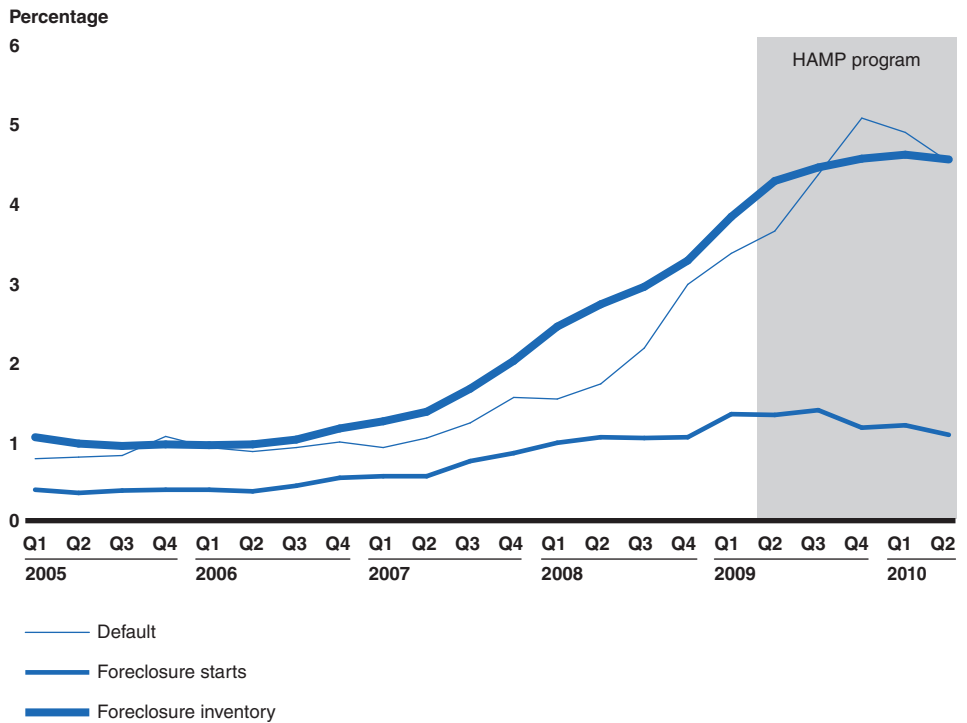
**Figure 3: GSE and Non-GSE HAMP Trial and Permanent Modifications Made Each Month, through November 2010**



Source: GAO analysis of Treasury data.

Further, recent data on default and foreclosure rates indicate that many borrowers continue to struggle with making their mortgage payments (see fig. 4). As of June 2010, an estimated 4.6 percent of all mortgages nationwide were in some stage of foreclosure. Default rates (loans 90 days or more past due) in the second quarter of 2010 were still more than five times higher than they were at the start of 2005, increasing from less than 1 percent to roughly 4.5 percent of all mortgages. In addition, foreclosure starts grew from about 0.4 percent to about 1.1 percent during this period, meaning roughly 490,000 mortgages entered the foreclosure process in the second quarter of 2010, compared with about 165,000 in the first quarter of 2005. Finally, as of the end of the second quarter of 2010, loans in the foreclosure inventory have increased more than three times since the first quarter of 2005, to more than 2 million loans.

**Figure 4: National Default and Foreclosure Trends, 2005 through June 2010**



Source: GAO analysis of MBA data.

Treasury’s initial HAMP guidelines in March 2009 included programs to modify the first and second liens of borrowers facing financial hardship. In addition, Treasury noted that compensation would be provided to investors, servicers, and borrowers to help when borrowers transition to more affordable housing and avoid the stigma of a foreclosure in cases where borrowers meet basic HAMP eligibility criteria (single-family dwelling, owner-occupied, primary residence, etc.) but did not qualify for or defaulted under HAMP.<sup>47</sup> While the HAMP first-lien modification program was implemented in April 2009, specific guidelines for the second

<sup>47</sup>These foreclosure alternatives include deeds-in-lieu of foreclosure and short sales. Under a deed-in-lieu of foreclosure, the homeowner voluntarily conveys all ownership interest in the home to the lender. In a short sale, the homeowner sells the house for less than the balance on the mortgage. The lender must give permission to such a transaction and can agree to forgive the shortfall between the loan balance and the net sales proceeds. Under the Home Affordable Foreclosure Alternatives program, accepting a deed-in-lieu must satisfy the borrower’s entire mortgage obligation in addition to releasing the lien on the subject property.

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lien and foreclosure alternatives programs were not issued until March and April 2010, respectively. Seventeen servicers signed agreements to modify second liens when the corresponding first lien had been modified under HAMP, and the largest servicers had begun offering alternatives to foreclosure under the Home Affordable Foreclosure Alternatives program. As of the end of December 2010, Treasury had not begun reporting activity under the second-lien modification program. In addition, Treasury had not specified the number of people these programs were expected to help, and servicers were still in the early stages of implementation. As we noted in June 2010, to improve the transparency and accountability of these programs, Treasury will need to develop performance measures and benchmarks for the recently announced TARP-funded housing programs, including measures to assess the extent to which the programs are helping additional borrowers.

In an effort to reach a broader range of borrowers, including those who are unemployed or have mortgages with high loan-to-value ratios, Treasury announced four additional TARP-funded homeowner assistance programs in March 2010 (see table 4):

- The Home Affordable Unemployment Program, implemented in July 2010, would require servicers to offer eligible unemployed borrowers temporary reduction or suspension of monthly payments for the lesser of a minimum of 3 months or until the borrower finds employment.
- The HAMP Principal Reduction Alternative Program requires servicers to consider principal reductions for HAMP-eligible borrowers with loan-to-value ratios above 115 percent. However, while this program was implemented, as of October 1, 2010, servicers will not be required to offer principal reduction, even when it is more beneficial for mortgage holders and investors to do so.
- The Federal Housing Administration Short Refinance Option would allow certain borrowers to refinance their mortgages into loans insured by the Federal Housing Administration (FHA). Treasury has designated up to \$11 billion for this program, which is effective for loans issued on or after September 7, 2010, and are closed on or before December 31, 2012.
- The Housing Finance Agency Innovation Fund for the Hardest-Hit Housing Markets designates funds to be used by eligible entities of 19 housing finance agencies (18 states and Washington, D.C.) to develop more localized programs to preserve homeownership and protect home values. The implementation time frames and number of borrowers to be helped by

these programs will vary by state. Treasury designated \$7.6 billion of the \$45.6 billion intended for housing programs to this program.

**Table 4: TARP-Funded Housing Programs**

<b>Program</b>	<b>Program description</b>	<b>Program status</b>
HAMP First-Lien Modification	First-lien loan modifications	<ul style="list-style-type: none"> <li>Announced in March 2009</li> <li>Implemented in April 2009</li> <li>117 participating servicers</li> <li>About 1.4 million trials started—505,000 active permanent modifications, 148,000 active trials, 729,000 trial cancellations, and 45,000 permanent cancellations through November 2010</li> <li>Roughly \$474 million disbursed in incentive payments as of September 30, 2010</li> </ul>
Second-Lien Modification	Second-lien loan modifications for HAMP first-lien borrowers	<ul style="list-style-type: none"> <li>Announced in March 2009</li> <li>Implemented in March 2010</li> <li>17 servicers have signed agreements</li> <li>Roughly \$11,000 in incentive payments have been made as of the end of September 2010</li> <li>Expected cost and number of borrowers to be helped unknown</li> </ul>
Home Affordable Foreclosure Alternatives	Incentives for short sales or deeds-in-lieu of foreclosure	<ul style="list-style-type: none"> <li>Announced in March 2009</li> <li>Implemented in April 2010</li> <li>\$1.6 million in incentive payments have been made as of the end of September 2010</li> <li>Expected cost and number of borrowers to be helped unknown</li> </ul>
HAMP Principal Reduction Alternative	Principal reduction for HAMP-eligible borrowers with high loan-to-value ratios	<ul style="list-style-type: none"> <li>Announced in March 2010</li> <li>Implemented October 2010</li> <li>Expected cost and number of borrowers to be helped unknown</li> </ul>
Home Affordable Unemployment Program	Temporary reduction or suspension of monthly payments for unemployed borrowers	<ul style="list-style-type: none"> <li>Announced in March 2010</li> <li>Implemented in July 2010</li> <li>No expected TARP funds and number of borrowers to be helped unknown</li> </ul>
FHA Short Refinance Option	Partial loss coverage for first liens refinanced into FHA insured loans, and full or partial extinguishment of second liens in conjunction with FHA refinance	<ul style="list-style-type: none"> <li>Announced in March 2010</li> <li>Implemented September 2010</li> <li>14 servicers have signed agreement</li> <li>Up to \$11 billion designated and number of borrowers to be helped unknown</li> </ul>

Program	Program description	Program status
Housing Finance Agency Hardest-Hit Fund	Funding for state housing finance agencies in 18 states and Washington, D.C., hardest-hit by the foreclosure crisis	<ul style="list-style-type: none"> <li>• Announced in February, March, and August 2010</li> <li>• Implementation dates will vary by state</li> <li>• \$7.6 billion designated for 19 HFAs</li> <li>• Expected number of borrowers to be helped unknown</li> </ul>

Source: Treasury.

As with other TARP-funded programs, Treasury was required to finalize the total amount of TARP funds allocated to housing programs by October 3, 2010. However, Treasury officials said that at any point before the program ends on December 31, 2012, HAMP servicers will be able to use their allocated amount for any of the TARP-funded programs they have implemented, with the exception of the Hardest-Hit Fund and the loss coverage portion of the FHA Refinance program. Additionally, after October 3, 2010, Treasury will still be able to modify TARP-funded housing programs, as long as Treasury does not enter into any new servicer agreements.

In July 2009 and June 2010, we reported on the challenges Treasury faced in implementing HAMP and made recommendations to improve the transparency and equitable implementation of the program.<sup>48</sup> For example, in July 2009 we noted that while Treasury required borrowers with high levels of total debt to agree to obtain counseling before receiving a HAMP modification, it was not monitoring whether these borrowers in fact received counseling. In addition, we noted that Treasury had yet to establish a comprehensive system of internal control for HAMP, including metrics and benchmarks for servicers' performance. Three out of the six recommendations we made in July 2009 have yet to be fully implemented and remain open.

In June 2010, we reported that while HAMP's goal was to create clear, consistent, and uniform guidance for loan modifications across the industry, we found wide variation in servicers' practices with respect to tracking HAMP complaints and evaluating borrowers who were current or not yet 60 days delinquent on mortgage payments ("imminent default" borrowers). In addition, while Treasury had taken some steps to address ongoing challenges, such as limiting redefaults and addressing potential foreclosures among those who owe more than the value of their homes, it urgently needed to finalize and fully implement the various components of

<sup>48</sup> [GAO-09-837](#) and [GAO-10-634](#).

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HAMP and better ensure the transparency and accountability of these efforts. We reported that as Treasury continues with its first-lien mortgage loan modification program and implements the second-lien modification, foreclosure alternatives, and other TARP-funded housing programs, adhering to standards for effective program management and establishing sufficient program planning and implementation capacity will be critical. We have an ongoing engagement focused on the implementation of a few of the recently announced TARP-funded housing programs, as well as the outcomes of borrowers who are denied or cancelled from HAMP modifications, and will continue to monitor Treasury’s implementation and management of TARP-funded housing programs as part of our ongoing oversight of TARP to help ensure that these programs are appropriately designed and operating as intended. At the request of several members of Congress, we are also beginning an engagement examining federal oversight of mortgage servicers in light of recent reports about potential shortcomings in the processing of foreclosure documents.

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**Assets under PPIP Have Shown Positive Returns, but Continued Monitoring is Important Given That Returns on Assets Can Fluctuate and Treasury Must Still Oversee the Program’s Asset Managers**

The legacy securities program of PPIP, announced in March 2009, was designed to facilitate price discovery in markets for these assets, repair balance sheets throughout the financial system, and increase the availability of credit to households and businesses through the purchase of “legacy” residential mortgage-backed securities (RMBS) and commercial mortgage-backed securities (CMBS). Through the program, Treasury and private sector fund managers and investors partnered to purchase eligible securities from banks, insurance companies, mutual funds, pension funds, and other eligible sellers—though the fund managers have sole discretion in making purchases and investment decisions according to the terms of the agreements between Treasury and the PPIFs. PPIP, as originally conceived, was also to include a partnership between Treasury and FDIC to purchase and hold legacy loans (the legacy loans program). FDIC has conducted a pilot sale of receivership assets to test the funding mechanism contemplated for this program but the program itself was never implemented as part of TARP.

PPIP is similar to what was envisioned when TARP was first conceived as an asset-purchase program, but it faced delays in the implementation and did not reach the announced levels of participation. First announced as a program that could account for up to \$100 billion, Treasury reduced the



PPIP allocation to about \$30 billion for the legacy securities program.<sup>49</sup> Subsequently the PPIP allocation decreased further to about \$22 billion. As of September 30, 2010, Treasury had used about \$14 billion to fund PPIP.

The eight Public Private Investment Funds (PPIF) of PPIP have had positive returns as of September 30, 2010, and have invested in a variety of legacy assets (see table 5). As of September 30, 2010, Treasury has invested a total of \$14.1 billion in debt and equity into the PPIFs. Of this investment, \$13.7 billion remained outstanding and Treasury had seen unrealized capital gains of approximately \$750 million. In addition, the PPIFs had paid \$228 million in interest and dividends to Treasury over fiscal year 2010.<sup>50</sup> However, returns could fluctuate over time, as they are subject to market risk factors until the PPIFs close.

**Table 5: PPIFs and Investable Funds as of September 30, 2010**

Dollars in millions

<b>PPIF</b>	<b>Maximum Treasury equity available (matched with private equity)</b>	<b>Maximum Treasury debt available</b>	<b>Total investable funds available (maximum Treasury and private equity plus maximum Treasury debt)</b>
AG GECC PPIF Master Fund	\$1,243	\$2,487	\$4,973
AlianceBernstein Legacy Securities Master Fund	1,150	2,301	4,602
BlackRock PPIF	695	1,390	2,780
Invesco Legacy Securities Master Fund	856	1,712	3,424
Marathon Legacy Securities Public-Private Investment Partnership	475	949	1,898
Oaktree PPIP Fund	1,161	2,322	4,643
RLJ Western Asset Public/Private Master Fund	621	1,241	2,482

<sup>49</sup>Treasury officials pointed out that this initial \$100 billion amount included the PPIP legacy securities program along with PPIP legacy loans (a partnership with the FDIC), and an anticipated PPIP expansion related to TALF.

<sup>50</sup>A ninth PPIF was liquidated in the first quarter of 2010. According to Treasury, the return to the Treasury was about \$20 million on Treasury's equity investment of about \$156 million, and the interest earned by Treasury amounted to approximately \$342,000 on the \$200 million in loans disbursed.

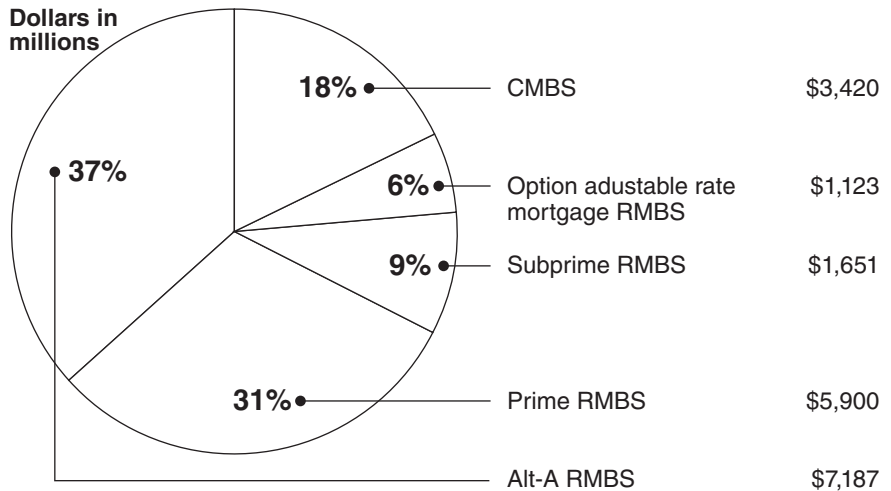
Dollars in millions

PPIF	Maximum Treasury equity available (matched with private equity)	Maximum Treasury debt available	Total investable funds available (maximum Treasury and private equity plus maximum Treasury debt)
Wellington Management Legacy Securities PPIF Master Fund	1,149	2,299	4,598
<b>Total</b>	<b>\$7,350</b>	<b>\$14,700</b>	<b>\$29,400</b>

Source: Treasury.

PPIFs are invested mostly in legacy RMBS, representing 82 percent of market value held in all PPIFs as of September 30, 2010, with the remaining 18 percent invested in CMBS (see fig. 5).

**Figure 5: PPIF Assets By Market Value and Asset Class, as of September 30, 2010**



Source: GAO analysis of Treasury data.

Note: Total does not add to 100 percent due to rounding.

In June 2010, we reported improvements in RMBS and CMBS markets as indicated by an increase in prices for highly rated CMBS after PPIP was announced.<sup>51</sup> Specifically, highly-rated CMBS prices rebounded from their lows in late-2008, and average spreads tightened in the same time period. According to Treasury, improvements in certain CMBS and RMBS prices are indications of the program's success. However, market prices can fluctuate while the funds are still managing assets, and Treasury will need

<sup>51</sup>GAO-10-531.

to maintain oversight responsibility for the program’s asset managers until the funds no longer hold assets.

**Treasury Initially Launched TARP Programs to Assist Small Businesses but Has Shifted Primary Focus to Efforts outside of TARP**

Given the importance of small businesses to the overall economy, Treasury created several programs to help address small business credit constraints. Subsequently, Treasury decided to shift its primary focus to establishing a program outside of TARP. The existing TARP programs that are intended to assist small businesses focus on capitalizing certain depository institutions and stabilizing secondary markets for SBA-guaranteed loans, including the CDCI, SBA 7(a) Securities Purchase Program, and TALF. Table 6 provides a brief description and status of each program.

**Table 6: TARP Small Business-Related Programs**

Program	Program description	Program status
CDCI	Provides capital to CDFIs that have a federal depository institution supervisor. <sup>a</sup> The program is structured like CPP but expands to credit unions and provides more favorable capital terms.	<ul style="list-style-type: none"> <li>Announced in October 2009 and closed in September 2010.</li> <li>As of September 2010, Treasury provided about \$570 million to 84 CDFIs, 28 of which had already participated in CPP.<sup>c</sup></li> </ul>
SBA 7(a) Securities Purchase Program	Purchases securities backed by SBA 7(a) guaranteed loans to provide market liquidity.	<ul style="list-style-type: none"> <li>Announced in March 2009 and closed in September 2010.</li> <li>As of September 30, 2010, Treasury has made 31 purchases of SBA 7(a) securities totaling about \$357 million.</li> </ul>
TALF	Provided loans to investors to purchase securitizations for various asset classes to improve access to credit for consumers and businesses. Treasury provides credit protection for TALF. <sup>b</sup>	<ul style="list-style-type: none"> <li>Announced in November 2008 and closed in June 2010.</li> <li>TALF loans secured by SBA 7(a) and 504 securitizations represented 3 percent of TALF loans.</li> <li>The Federal Reserve Board estimates that about 850,000 small business loans were financed in part by securities supported by TALF.</li> </ul>

Sources: GAO analysis of information from the Department of the Treasury, Office of Financial Stability, and the Federal Reserve.

<sup>a</sup>CDFIs are financial institutions that provide financing and related services to communities and populations that lack access to credit, capital, and financial services. The CDFI Fund provides the designation, which allows CDFIs to apply for CDFI Fund’s financial assistance. The federal depository institution supervisors for this program include the FDIC, the Federal Reserve, the Office of the Comptroller of the Currency, the OTS, and the National Credit Union Administration.

<sup>b</sup>Treasury's credit protection takes the form of loans to TALF LLC in the event that TALF loans are not repaid and the asset-backed securities or CMBS collateral securing the loans is surrendered to TALF LLC. TALF LLC is an SPV created by FRBNY to purchase the underlying collateral. Treasury originally provided \$20 billion of credit protection, but the Federal Reserve announced on July 20, 2010, that Treasury and the Federal Reserve had agreed to reduce the credit protection to \$4.3 billion.

<sup>c</sup>Of this amount, about \$207 million is new funds, while the remainder was already disbursed through CPP.

Although these programs were intended to increase the amount of credit available to small businesses, their impact has been limited for several reasons. First, the amount of funding announced for these programs was small in comparison to other TARP programs and the amount expended on these programs as of September 30, 2010, has been even less. As table 7 shows, while OFS originally announced almost \$66 billion in funding for TARP programs for small business-related initiatives, over the last year that commitment has been cut to about \$5.3 billion. As of September 30, 2010, about \$548 million has been expended. Treasury noted that the small expenditures for these programs were not a sign of program failure, but an indication that the markets were functioning on their own.

**Table 7: Changes in TARP Small Business Program Commitments and Comparisons to Expenditures**

Dollars in millions

	Original Announcement	Current commitment	Expenditures (as of September 30, 2010)	Expenditures as percent of original announcement	Expenditures as percent of current commitment
TALF	\$20,000	\$4,300	\$100	0.5%	2.3%
Small Business Lending Fund <sup>a</sup>	30,000	0	0	n/a	n/a
CDCI	800	570	207	25.9	36.3
SBA 7(a) and 504 Securities <sup>b</sup>	15,000	400	241	1.6	60.3
<b>Total</b>	<b>\$65,800</b>	<b>\$5,270</b>	<b>\$548</b>	less than 1%	10.4%

Source: GAO analysis of OFS data.

<sup>a</sup>As discussed in greater detail below, the Small Business Lending Fund was initially planned to be part of TARP, but was ultimately funded apart from TARP.

<sup>b</sup>Treasury officials noted that the original announcement included plans to purchase both SBA 7(a) and SBA 504 securities. Subsequently, Treasury did not purchase SBA 504 securities. Currently, this program is known as the SBA 7(a) Securities Purchase Program.

Second, these TARP programs targeted markets and institutions that represent a small percentage of small business lending. Part of the TALF portfolio and all of the SBA 7(a) Securities Purchase Program focused on SBA lending markets, which represent a small proportion of small business financing overall, further limiting the impact the programs might

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have on small business lending more broadly. CDCI focuses on CDFIs, which represent about 1 percent of regulated depository institutions and less than 1 percent of total assets of regulated depositories. Total lending related to small businesses—as measured by business loans of \$1 million or less for banks and thrifts, and loans more than \$50,000 for credit unions—is also a relatively small percentage compared with such loans at other regulated depositories, at about 0.5 percent.<sup>52</sup> Moreover, Treasury does not require CDFIs to use the capital to increase small business lending as a condition of participating in CDCI, according to a Treasury official. Reports from the National Credit Union Association (NCUA) and OTS—regulators of certain CDFIs—on how CDCI applicants intend to use their funds indicate that most CDFIs did not specifically state they had a plan to increase small business lending. However, two of the three thrifts recommended by OTS and half of the credit unions recommended by NCUA indicated they would increase or maintain lending in general.<sup>53</sup>

Finally, Treasury officials told us that TARP requirements and the public's negative opinion of TARP have curtailed overall interest and participation in TARP programs. The reduced interest in TARP programs stems from what Treasury officials refer to as “TARP stigma”—that is, financial institutions dislike of participating in TARP programs because doing so exposed them to criticism and they were not willing to comply with TARP requirements. For example, as we previously reported, concerns about TARP requirements slowed implementation of the SBA 7(a) Securities Purchase Program because participants did not agree with the terms.<sup>54</sup> Treasury attempted to mitigate the concerns by making the program terms on executive compensation and warrants (in this case, known as senior

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<sup>52</sup>For this analysis, we selected commercial and industrial and commercial real estate loans of \$1 million or less for banks, and thrifts and business loans of \$50,000 or more at credit unions, which are considered proxies for small business lending. For further details, see appendix II.

<sup>53</sup>Treasury does not require the depository institution regulators to collect this information. However, OTS and NCUA collect it for internal purposes, including anticipation of reporting for post-award requirements.

<sup>54</sup>[GAO-09-658](#).

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Communication about Small Business Programs Initially Lacked Clarity but Has Improved

securities) less onerous.<sup>55</sup> According to Treasury officials, TARP stigma also became an obstacle to introducing additional TARP small business programs.

Treasury has not always been clear or consistent in describing the intent of its TARP small business programs, although recent communications have been clearer about the purpose of the CDCI program. Treasury officials told us that CDCI's purpose was mainly to capitalize CDFIs so they could achieve their economic development goals. However, early public announcements and congressional testimony about the program emphasized that the goal of the program was to increase small business lending. Based on some of these public statements, NCUA and officials from a credit union industry group raised concerns about the program's focus on small business lending, pointing out that some of their institutions do not make many small business loans. However, NCUA and credit union officials said that in subsequent discussions Treasury officials assured them that CDCI participants would not need to demonstrate an increase in small business lending, because CDCI also aims to capitalize CDFIs to carry out their other economic development goals. A recent announcement on CDCI closing, along with Treasury's Two-Year Retrospective report on TARP, provided more clarity on the purpose of CDCI that is consistent with concerns we had about the goals of CDCI being clear. As we previously reported, clear and transparent communication about TARP programs is important.

Treasury Is Now Focusing Efforts to Assist Small Businesses outside of TARP

Given concerns about TARP stigma, Treasury shifted its efforts to assist small businesses outside of TARP by creating a separate Small Business Lending Fund (SBLF). The administration first announced SBLF in October 2009 and originally planned to use TARP to fund it. However, Treasury officials told us that they repeatedly heard from potential participants that they were reluctant to participate in any program associated with TARP. After considering a variety of options and getting input from potential participants, Treasury officials concluded that SBLF would not ultimately succeed unless it was completely separated from

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<sup>55</sup>For senior securities, Treasury allowed any SBA securities sellers to immediately repurchase senior securities issued to Treasury. Senior securities and warrants are issued to Treasury, as required by EESA, when Treasury purchases assets under TARP. For executive compensation, Treasury officials told us that they drafted a legal determination that compensation limits were not required because the senior securities are immediately purchased and therefore there is no period of time for Treasury to apply the executive compensation restrictions.

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TARP. Therefore, Treasury announced in spring 2010 that it was seeking a separate appropriation to establish SBLF outside of TARP.

Under the Small Business Jobs Act of 2010, enacted on September 27, 2010, SBLF will be a \$30 billion bank capital support program encouraging small and midsize banks to lend to small businesses.<sup>56</sup> The program will set benchmarks for increasing banks' lending to small businesses, in part by measuring changes in the amount of loans of \$10 million or less for commercial and industrial lending, certain kinds of commercial real estate, and farm-related lending. The more a bank can demonstrate increased lending based on such measures, the lower the dividend it will pay to Treasury. The Small Business Jobs Act of 2010 established SBLF and contains metrics for measuring increases in small business lending. We will be reviewing SBLF in the future, as required by the act.

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### Assets in the TALF will Require Continued Monitoring to Allow Treasury to Anticipate Future Needs for Credit Support

TALF provided loans to private investors to purchase asset-backed securities (ABS) and CMBS to encourage the issuance of new securitizations and provide liquidity for new consumer and business loans.<sup>57</sup> To assist in this effort, Treasury provides credit protection for TALF as part of TARP's Financial Stability Plan under the Consumer and Business Lending Initiative.<sup>58</sup> TALF made about \$71 billion in loans from March 2009 through June 2010, with most of them secured by credit card ABS, auto loan ABS, legacy CMBS, and student loan ABS (see fig. 6). According to the Federal Reserve, although none of the loans have come due, more than half of these loans have been repaid. Moreover, Treasury has not had to disburse any TARP funds to cover losses from unpaid loans.

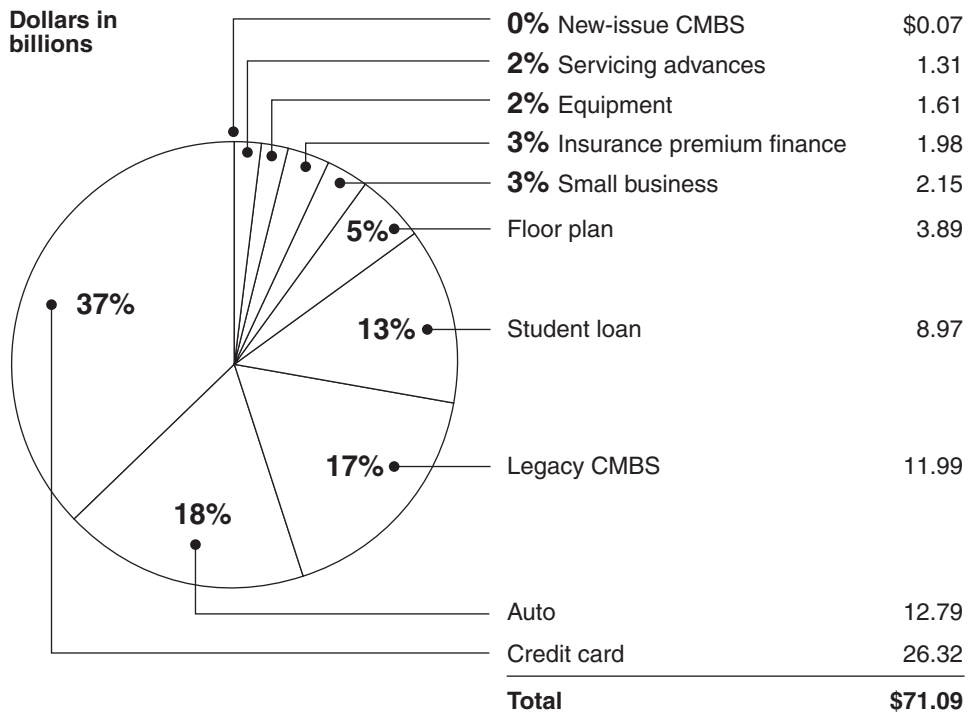
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<sup>56</sup>Small Business Jobs Act of 2010, Pub. L. No. 111-240, Title IV, Subtitle A, 124 Stat. 2504 (2010).

<sup>57</sup>The program provided nonrecourse loans to investors to purchase AAA-rated ABS and CMBS, which were in turn pledged as collateral for the loans.

<sup>58</sup>Treasury's credit protection takes the form of loans to TALF LLC, a special-purpose vehicle created to purchase TALF's underlying collateral, in the event that TALF loans are not repaid and the ABS or CMBS collateral securing the loans is surrendered to TALF LLC. Treasury originally provided \$20 billion of credit protection, but the Federal Reserve announced on July 20, 2010, that Treasury and the Federal Reserve had agreed to reduce the credit protection to \$4.3 billion.

**Figure 6: TALF Loan Categories, March 2009 through June 2010**



Source: GAO analysis of FRBNY data.

In February and June 2010, we reported that the ABS markets had improved largely due to TALF’s activity for the more frequently traded TALF-eligible sectors after the program’s first activity in March 2009.<sup>59</sup> The dollar volume of TALF issuance peaked in the third quarter of 2009 and until that point represented a significant portion of all ABS issued. But by the fourth quarter of 2009, TALF volume decreased significantly and at a faster rate than the total ABS volume, indicating that ABS markets were relying less on TALF financing. TALF’s impact on credit rates is less clear, however, as we did not find clear evidence that most consumer credit rates changed significantly after TALF started with the exception of auto loans from finance companies. FRBNY officials said that interest rates on consumer and small business loans could have been much higher without TALF.

<sup>59</sup> GAO-10-25 and GAO-10-531.



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Treasury has addressed the recommendations we made in our February 2010 TALF report. First, we recommended that Treasury give greater attention to risks in commercial real estate and CMBS markets, and Treasury developed internal tracking reports to assess such trends. Second, we found that Treasury had not fully documented the rationale for final decisions on managing TALF risks, and we recommended that Treasury develop a formal decision-making policy to strengthen transparency and internal controls. In response, Treasury created a process for assessing changes to TALF program terms and outside analyses and now has a process for documenting such analyses. Third, because Treasury bears the first-loss risk from assets that TALF borrowers surrender in conjunction with unpaid loans, we recommended that Treasury review the data it might collect and publicly report in the event that any collateral was surrendered to TALF LLC. Treasury responded that if assets are surrendered, its plan is to direct the public to the Federal Reserve for public reports it maintains about its securities holdings. Treasury officials also stated that Treasury has the ability to retain a third party to advise and assist it in making asset disposition decisions and noted that Treasury was committed to transparency regarding such assets.<sup>60</sup> Finally, we issued a matter for consideration requesting that Congress provide us with audit authority over all Federal Reserve operational and administrative actions taken with respect to TALF so that we could audit TARP support for TALF most effectively. Congress provided authority in the Dodd-Frank Act for us to review various aspects of Federal Reserve facilities initiated in response to the financial crisis. This related work is underway, and we will issue a future report on the results.

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**Outstanding Funds under Other TARP Programs Have Been Repaid and the Programs Terminated**

Treasury had created two other programs that were terminated in 2009 and the funds repaid.

- *CAP was terminated without any funds being used.* CAP was designed to further improve confidence in the banking system by helping ensure that the largest 19 U.S. bank holding companies had sufficient capital to cushion themselves against larger than expected future losses, as determined by the Supervisory Capital Assessment Program (SCAP)—or “stress test”—conducted by the federal banking regulators. CAP made TARP funds available to any institution not able to raise private capital to

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<sup>60</sup>As of September 30, 2010, no TALF assets have been surrendered to TALF LLC.

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meet SCAP requirements. In the end, 9 of the 10 institutions that needed additional capital as a result of SCAP raised more than \$70 billion from private sources, and as mentioned previously, Ally Financial received additional capital from Treasury under AIFP.<sup>61</sup>

- *AGP was terminated and Treasury retained a guarantee fee.* AGP was established as the Treasury insurance program, which provided federal government assurances for assets held by financial institutions that were deemed critical to the functioning of the U.S. financial system. Citigroup and Bank of America were the only two institutions that participated in the Treasury program before it was terminated. As previously reported, Bank of America paid Treasury and others a fee for terminating the term sheet before any assets were segregated. Treasury entered into a loss sharing arrangement with Citigroup under which Treasury assumed \$5 billion of exposure and in exchange received cumulative nonvoting preferred shares and warrants to purchase common shares.<sup>62</sup> In December 2009, FRBNY (which has made a loan commitment to Citigroup in connection with the Treasury guarantee), FDIC, Treasury, and Citigroup agreed to terminate the Citigroup AGP agreement. Like FDIC, Treasury retained a portion of the trust preferred shares received as payment for the asset protection provided under AGP as well as warrants associated with this assistance. Treasury sold its interest in the trust preferred securities on September 30, 2010, for approximately \$2.25 billion. The FRBNY obtained a termination fee for agreeing to terminate its loan commitment.

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<sup>61</sup>On June 30, 2009, GMAC LLC changed its corporate structure and was renamed GMAC Inc., and on May 10, 2010, GMAC Inc. changed its name to Ally Financial Inc.

<sup>62</sup>Under the AGP agreement, Treasury, FDIC, and FRBNY provided protection against the possibility of large losses on an asset pool of approximately \$301 billion which remained on Citigroup's balance sheet. The following loss-sharing terms applied to the transaction: (1) Citigroup was to absorb the first \$39.5 billion in losses and (2) losses more than the \$39.5 billion were to be shared by the U.S. government (90 percent) and Citigroup (10 percent) with the U.S. government piece being paid in the following order and amounts: First, Treasury in an amount up to \$5 billion, then FDIC in an amount up to \$10 billion, and lastly had Treasury and FDIC paid out the full amount of their commitments, Citigroup would have been able to obtain a one-time non-recourse (except with respect to interest and Citigroup's 10 percent share of loss) loan from FRBNY. The Citigroup AGP agreement has been terminated and no losses were paid by the U.S. government, and stock, warrants, and fees were obtained by the government and FRBNY in exchange for entering into the agreement.

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## OFS has Made Progress in Staffing Key Positions, Managing Its Contracts, and Maintaining Internal Controls

OFS has continued to make progress in staffing key positions, managing its contracts, and maintaining internal controls. While OFS's organization structure has stabilized as it moves into maintenance mode, more could be done to address retention of key staff as TARP winds down. Treasury continued to rely on a network of financial agents and contractors for certain activities and will likely do so as the program comes to a close. Finally, Treasury has taken steps to develop a system of internal control.

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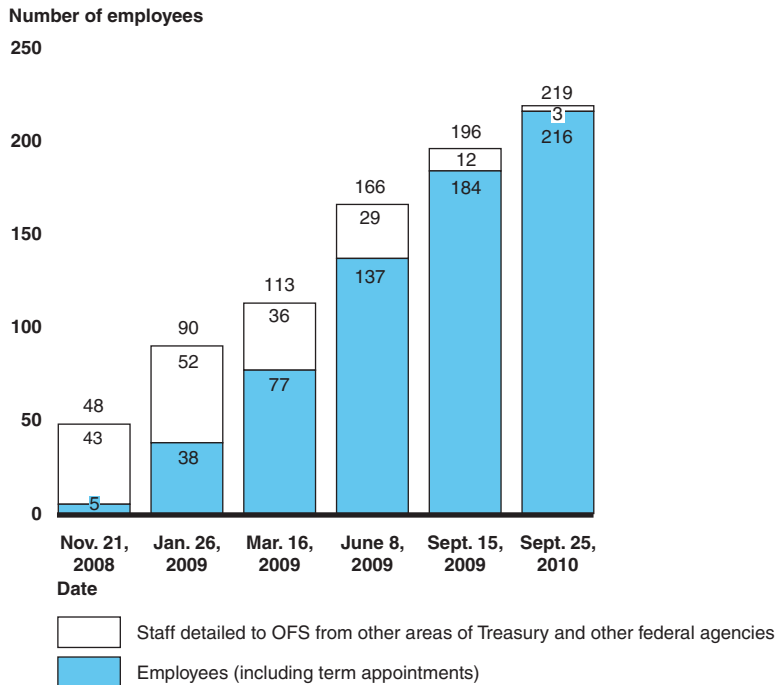
## OFS Staffing Has Stabilized, but OFS Has Not Finalized a Plan for Addressing Staff Retention Challenges as TARP Winds Down

In the last year, OFS staffing has stabilized. Over the past two years, the number of OFS employees has increased steadily with the number of employees increasing and the number of detailees decreasing (see fig. 7). In addition, Treasury has filled key leadership positions in OFS, including the position of Chief of the Homeownership Preservation Office.<sup>63</sup> However, this stability is fragile. For example, on September 30, 2010, the Assistant Secretary of Financial Stability resigned and this key leadership position is temporarily filled.

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<sup>63</sup>See [GAO-09-837](#). In July 2009, we emphasized that the lack of a permanent head of the Homeownership Preservation Office, along with the number of vacancies in the office itself, could impact Treasury's ability to effectively monitor HAMP and recommended that these staffing needs be given high priority.

**Figure 7: Number of Employees and Detailees, November 21, 2008 through September 25, 2010**



Source: GAO analysis of Treasury data.

In general, the organizational structure of OFS has also remained stable. We reported in October 2009 that the Assistant Secretary of Financial Stability was establishing an Office of Internal Review that would perform the functions of the former Chief Risk and Compliance Officer, among other duties. This office, which has been established, is responsible for identifying risks that TARP faces and works with relevant program offices to develop procedures for overall compliance with EESA. The compliance staff monitors TARP recipients to help ensure they are adhering to program requirements and financial agents and contractors to help ensure they are complying with the TARP conflict-of-interest requirements. In addition, OFS now has an Office of Reporting that includes a senior communications officer and director of oversight and reporting.<sup>64</sup> This office helps to ensure that OFS is meeting all of its reporting requirements

<sup>64</sup>The other divisions within OFS include the Office of the Chief Investment Officer, Office of the Chief Financial Officer, Office of the Chief Homeownership Preservation Officer, and Office of the Chief of Operations Officer.

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and coordinates OFS's work with oversight entities such as GAO, Special Inspector General for TARP, Congressional Oversight Panel, and the Financial Stability Oversight Board.

In August 2010, Treasury officials estimated that OFS would need 275 full-time equivalents to be fully staffed. As of August 14, 2010, the office had 59 vacancies. Treasury officials told us that they were actively seeking candidates for about half of the vacancies, most (about 23) in the Office of Internal Review, and reassessing whether the remaining positions were still needed. For example, the Chief of Operations Officer is in the process of determining whether a vacant administrative officer position that would report directly to her is still needed given that division managers within the office already report directly to her. OFS continues to use direct-hire and other appointment authorities to expedite hiring of qualified candidates. Treasury officials said that hiring for the Office of Internal Review has been difficult because of competition for auditors who could conduct internal assessments and compliance reviews. In addition, they noted that these OFS positions are temporary positions and under the federal government pay scale, which can make competing with other employers more challenging.

Although TARP's authority to establish new programs has expired, OFS will have to operate existing programs going forward. However, eventually OFS will need to hire fewer staff as TARP programs continue to wind down. Treasury officials said that while the expiration of TARP authority has not yet resulted in employees leaving, they noted that the Assistant Secretary recently emphasized to staff that OFS still have significant responsibilities and that OFS employees are still needed. To address concerns about staff retention, OFS officials told us that they had started to take steps to help address employee satisfaction. For example, in April 2010 OFS conducted its first employee satisfaction survey. Officials told us that the survey results had generally been positive but had highlighted two areas—communication and staff development—that OFS plan to focus on going forward:

- Internally, OFS has several methods for communicating across the organization, including a monthly staff meeting and monthly employee newsletter. In addition, the Assistant Secretary has two weekly meetings with the chiefs, and the chiefs also meet once a week. Treasury officials told us that a key initiative to improve communication was to revamp its internal Web site using more collaborative software that would make

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sharing information easier. In addition, OFS will identify communications training for OFS managers and employees.

- To enhance staff development, OFS is drafting a training policy and will soon have staff fill out individual development plans. OFS is also planning to develop a “Government 101” course for employees new to the federal government and re-establish an OFS mentoring program.<sup>65</sup> In addition, OFS allows staff to rotate among positions within the office, enabling employees to gain additional knowledge and skills and helping to keep them engaged in OFS’s mission.

Treasury officials also said that OFS could use the retention incentives that are available to all government agencies if necessary to help ensure that the office retained key skills and competencies.

OFS is also beginning to address the concerns of employees who were hired under term appointments. Because OFS is a temporary office, more than half of its employees (115 as of September 25, 2010) are term appointed. Most of these employees were hired under 1- or 2-year appointments that can be extended but are limited to a total of 4 years.<sup>66</sup> In addition, several leadership positions were filled with limited-term Senior Executive Service appointments that are limited to 3 years, including the Chief Investment Officer, Chief of Operations Officer, Chief Counsel, and Chief of Homeownership Preservation.<sup>67</sup> Although the use of term appointments is appropriate for a temporary organization such as OFS, these employees may also be difficult to retain for the full period of their term appointment. For example, Treasury officials told us that some of these employees have stated that they wanted to seek permanent career positions in the federal government, and Treasury’s Office of Human Resources has offered seminars on the federal hiring process. OFS’s employee survey also confirmed that some staff are considering employment elsewhere. For example, Treasury officials stated that about one-third of staff responded affirmatively to a question asking whether the

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<sup>65</sup>OFS officials said that the office had a formal mentor program in early 2009 that included training for all participants and matched up mentors and employees who met regularly every 2 weeks.

<sup>66</sup>5 C.F.R. part 316, subpart C. At an agency’s request, the Office of Personnel Management may authorize exceptions beyond the 4-year limit when the extension is clearly justified and consistent with applicable statutory provisions.

<sup>67</sup>5 U.S.C. §§ 3132(a)(5) and 3134.

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employees planned to leave OFS in the next 6 months. However, Treasury officials noted that in the last 6 months (between April and September 2010), only about 6 percent of employees have left OFS.

Workforce planning for OFS has presented and continues to present some unique challenges. When OFS was initially created, it staffed the office largely by relying on detailees until it could hire more permanent employees, and as we have seen, more than half of its employees have been hired under term appointments. Early in 2009, OFS developed a Strategic Workforce Plan that generally focused on the issues related to acquiring qualified staff. Along with its fiscal year 2011 budget request issued February 1, 2010, Treasury included a broad human capital strategy for OFS that included:

- using hiring authorities to recruit new employees for short- and long-term assignments,
- hiring experts or consultants and detailees for temporary or intermittent employment,
- establishing training and development interventions to ensure that existing staff are engaged and possess the requisite skill set, and
- performing regular strategic workforce assessments to refine the organization and identify and eliminate competency gaps in OFS's workforce.

The human capital strategy does not provide any details for these various efforts. According to Treasury officials, this strategy is in the process of being modified to emphasize staff retention and will be issued along with OFS's fiscal year 2012 budget submission. They also told us that OFS no longer had regular workforce assessment meetings because staffing had stabilized. For staffing-related decisions, OFS has created a staffing board that consists of the Chief of Operations Officer, Chief Financial Officer, and a senior representative from Treasury's Office of Human Resources. The board meets as needed to approve new positions and incentive payments, among other things.

We have reported on the importance of strategic workforce planning to address two critical needs: (1) aligning an organization's human capital program with its current and emerging mission and programmatic goals

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and (2) developing long-term strategies for acquiring, developing, and retaining staff to achieve programmatic goals.<sup>68</sup> Although Treasury has established a human capital strategy for OFS, OFS has not updated its strategic workforce plan to reflect its changing environment as TARP moves from largely implementing to maintaining and terminating programs or to address the unique challenges associated with maintaining high-quality staff in a temporary organization. As we have seen, OFS continues to have many responsibilities and some programs may need staff for years to come. For example, HAMP could be in operation until 2017.<sup>69</sup> In addition, when Treasury will completely divest its TARP investments in entities such as GM, and Chrysler is unclear. In 2013, term employees may be at the 4-year limit, and even before then some term employees may choose to leave OFS rather than accept an extension. Further, filling key leadership positions that are under limited-term Senior Executive Service appointments will be a challenge. Treasury officials told us that the chiefs in OFS have begun to discuss future staff needs and various options for addressing these needs but have not yet fully developed a plan. For example, they said although staff needs may be somewhat lower by 2014, OFS will still be performing many of the same functions, and they have considered options, such as creating permanent positions that will be around for some time.

OFS has undertaken succession management planning in order to better ensure that leadership positions remain filled and is participating in a succession planning pilot program. According to OFS officials, the succession planning pilot began on September 1, 2010, and its purpose is to help ensure that OFS can fill leadership positions with qualified staff. The pilot is to include a review of senior positions to identify the key skills and competencies and a review of OFS employees who could move into these positions and to identify any skills gaps. Addressing these gaps should help to inform developmental and training opportunities for individual development plans. The pilot will also assess whether any of the leadership positions are at risk of being vacant in the next 6 months.

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<sup>68</sup>GAO, *Human Capital: Key Principles for Effective Strategic Workforce Planning*, GAO-04-39 (Washington, D.C.: Dec. 11, 2003).

<sup>69</sup>Servicers can sign up for HAMP until October 3, 2010 and borrowers can sign up until December 31, 2012. After 2012, servicers can continue to receive incentives, funded by TARP, for 5 years, until December 31, 2017.



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In past reports, we raised concerns about Treasury having enough staff with the appropriate skills to effectively support certain TARP programs. For example, we noted in a July 2009 report on HAMP that having enough staff with appropriate skills was essential to governing HAMP effectively and recommended that Treasury place a high priority on fully staffing Homeownership Preservation Office.<sup>70</sup> Since then, the Home Ownership Preservation Office has not yet conducted a workforce assessment, despite the recent addition of several new programs. In November 2009, we reported that Treasury was planning to disband the auto team and would lose dedicated staff with industry- and company-specific knowledge and expertise. We raised concerns that OFS would not have adequate staff resources with the expertise needed to adequately monitor and divest the government's investment in Chrysler and GM and recommended that it obtain needed expertise in areas where gaps are identified.<sup>71</sup> Subsequently, Treasury has hired two additional analysts dedicated solely to monitoring Treasury's investments in Chrysler and GM, and plans to hire one more. OFS will likely continue to face such scenarios going forward. Without a workforce plan that considers various scenarios, particularly the potential outflow of term employees, OFS risks not being adequately prepared to manage and oversee ongoing TARP investments and programs.

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### Treasury Continues to Rely on a Growing Network of Financial Agents and Contractors to Support TARP Administration and Operations

Since the inception of TARP in October 2008, Treasury has continued to rely on private sector resources to assist OFS with a variety of activities. These include providing the infrastructure needed to inject capital into key financial institutions, implementing programs to address problems in the financial markets, providing assistance to the automobile industry and AIG, and working to help homeowners struggling to keep their homes. Treasury has used two mechanisms for engaging private sector firms. First, Treasury has exercised its statutory authority to retain 15 financial agents (depository and related financial institutions designated to perform

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<sup>70</sup>GAO-09-837.

<sup>71</sup>GAO-10-151.

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## Treasury Increased Its Use of Financial Agents and Small Business Contractors

assigned functions on its behalf).<sup>72</sup> Second, Treasury has entered into contracts and blanket purchase agreements under the Federal Acquisition Regulation for a variety of legal, investment consulting, accounting, and other services and supplies. According to Treasury's data, as of September 30, 2010, Treasury had 81 contracts and blanket purchase agreements, up from 39 about a year ago.<sup>73</sup> In total, Treasury had 96 financial agency agreements and contractual arrangements with a total potential value of almost \$841 million as of September 30, 2010.<sup>74</sup>

As shown in table 8, the majority of financial agent agreements were awarded in 2009, many in late December. According to OFS procedures, financial agents are used for services that cannot be provided with existing Treasury, financial agent, or contractor resources. Treasury's decision to use a financial agent as opposed to a contractor or other provider is generally based on the inherently governmental or fiduciary nature of the required service. According to Treasury, all of its financial agents provide vital support in managing billions of dollars in disbursements, repayments, and additional proceeds for a variety of TARP programs, some of them ongoing and some winding down.<sup>75</sup> The functions that Treasury has

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<sup>72</sup>To implement TARP, Treasury used its authorities to enter into financial agency agreements with financial institutions. Section 101(c)(3) of EESA (codified at 12 U.S.C. §5211(c)(3)); see also 31 C.F.R. Part 202. The financial agency agreements have been completed through Treasury's Office of the Fiscal Assistant Secretary. Financial agency agreements are not federal procurement contracts and are therefore not subject to the provisions of the Federal Property and Administrative Services Act (41 U.S.C. §§ 251-260), the Federal Acquisition Regulation (48 C.F.R. Chapter 1), or any other federal procurement law.

<sup>73</sup>The 81 contracts and blanket purchase agreements include 7 interagency agreements for contractual arrangements in which OFS is engaging vendors that have existing contracts with other Treasury offices or bureaus or other federal agencies.

<sup>74</sup>The potential award value of all 96 TARP financial agency agreements and contracts—some completed and some scheduled to run until April 2019—totals almost \$841 million (\$435 million in FAA and \$406 million in contracts.) The dollar amount does not include the seven interagency agreement contract values. Consistent with our prior recommendation to improve transparency and accountability, Treasury now publishes information on active and completed procurement contracts and financial agency agreements online. A listing of TARP procurement contracts and agreements can be viewed at <http://www.financialstability.gov/impact/contractDetail2.html>

<sup>75</sup>Treasury's additional proceeds include dividends from equity securities, proceeds from repurchases of warrants and warrant preferred stock, and proceeds from warrant auctions. According to Treasury officials, with financial agent Morgan Stanley's Capital Markets Disposition support to dispose of shares as instructed by the Treasury, Treasury has sold all of its 7.7 billion shares of Citigroup common stock.

assigned these financial agents include asset management for Treasury's purchase of "troubled assets," custodial and infrastructure support services, and program administration services for OFS's homeownership preservation programs.

**Table 8: Financial Agent Involvement in TARP Programs**

Financial agent and award date	TARP investment program	Role of financial agent
AllianceBernstein (4/21/2009)	<ul style="list-style-type: none"> <li>• CPP</li> <li>• AIFP</li> <li>• AIG Investments (SSFI)</li> </ul>	<ul style="list-style-type: none"> <li>• CPP Asset Manager</li> <li>• GM Asset Manager</li> <li>• AIG Asset Manager</li> </ul>
Avondale Investments (12/22/2009)	CPP	CPP Asset Manager
Bank of New York Mellon (10/14/2008)	All programs	Custodian
Bell Rock Capital (12/22/2009)	CPP	CPP Asset Manager
EARNEST Partners (3/16/2009)	SBA 7(a) Securities Purchase Program	SBA 7(a) Asset Manager
Fannie Mae (2/18/2009)	HAMP	HAMP Program Administrator
Freddie Mac (2/18/2009)	HAMP	HAMP Compliance Agent
FSI Group (4/21/2009)	<ul style="list-style-type: none"> <li>• CPP</li> <li>• ABP</li> </ul>	CPP Asset Manager, Citi TRuPS Asset Manager
Howe Barnes Hoefler & Arnett (12/22/2009)	CPP	CPP Asset Manager
KBWAM (12/23/2009)	<ul style="list-style-type: none"> <li>• CPP</li> <li>• AIFP</li> </ul>	CPP Asset Manager; GMAC Asset Manager; AIFP Transaction Structuring Support
Lazard Freres (5/17/2010)	AIFP	AIFP Transaction Structuring
Lombardia Capital Partners (12/22/2009)	CPP	CPP Asset Manager
Morgan Stanley (3/29/2010)	<ul style="list-style-type: none"> <li>• CPP</li> <li>• TIP</li> </ul>	Disposition Agent for Citigroup Common Stock
Paradigm Asset Management (12/22/2009)	CPP	CPP Asset Manager
Piedmont Investment Advisors (4/21/2009)	CPP	CPP Asset Manager

Source: Treasury.

The share of work by small businesses and minority- and women-owned businesses under TARP contracts and financial agency agreements has grown substantially since November 2008, when only one of Treasury's prime contracts was with a small business and only one minority small business firm had teamed as a subcontractor with a large business contractor. Since we reported in October 2009, the number of prime contracts and financial agency agreements with small and/or minority firms has grown from 8 to 20, according to Treasury's data. From the outset, Treasury encouraged small businesses to pursue opportunities for TARP contracts and financial agency agreements. For example, in 2010 Treasury resolicited all OFS legal services contracts. It received and

evaluated 81 proposals and awarded 13 indefinite-delivery/indefinite-quantity contracts, including two small businesses. As shown in table 9, the majority of small and/or minority- and women-owned businesses participating in TARP are subcontractors.

**Table 9: TARP Contracts, Financial Agency Agreements, and Subcontracts with Minority-Owned, Women-Owned, and Other Small Businesses**

Socioeconomic business category	Prime contracts <sup>a</sup>	Financial agency agreements <sup>a</sup>	Subcontracts under prime contracts and contracts under financial agency agreements <sup>b</sup>	Total participation by small businesses
Minority-owned <sup>c</sup>	2	5	16	23
Woman-owned	2	1	14	17
Other small <sup>d</sup>	8	2	19	29
<b>Total</b>	<b>12</b>	<b>8</b>	<b>49</b>	<b>69</b>

Source: GAO analysis of Treasury data.

<sup>a</sup>Data as of September 30, 2010. GAO's analysis does not include task orders.

<sup>b</sup>As of June 30, 2010, TARP financial agents and prime contractors have awarded 95 subcontracts.

<sup>c</sup>Includes both small and nonsmall minority-owned businesses and minority woman-owned businesses.

<sup>d</sup>Includes small businesses, service-disabled veteran-owned small businesses, and small disadvantaged businesses.

Treasury Continues to Strengthen Management and Oversight of Financial Agents and Contractors and Conflicts-of-Interest Requirements

When Treasury set up OFS in 2008 and quickly began to implement numerous TARP initiatives in response to the nation's financial crisis, OFS had not yet finalized its procurement oversight procedures and lacked comprehensive internal controls for its growing number of contractors and financial agents. Further OFS did not have a comprehensive compliance system to monitor and fully address vendor-related conflicts of interest. Recognizing Treasury's substantial reliance on the private sector and the challenging contracting environment, we made a series of recommendations between December 2008 and June 2009 intended to strengthen Treasury's management and oversight of its vendors and improve the transparency of contracted operations. By 2009, when the financial crisis focus shifted to stimulating economic recovery and TARP program priorities had already significantly evolved, we noted OFS's sustained progress in overcoming the initially challenging contracting environment. One year after implementation, OFS had put in place an appropriate infrastructure to manage and monitor its network of financial agents and contractors. As we have previously reported, OFS took a number of actions to address our recommendations, including:

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- ensuring that sufficient OFS personnel were assigned and properly trained to oversee the performance of all contractors and financial agents;
  - expeditiously issuing regulations on conflicts of interest involving Treasury's financial agents, contractors, and their employees and related entities;<sup>76</sup> and
  - issuing guidance requiring that key communications and decisions concerning potential or actual vendor-related conflicts of interest be documented.

Our discussions with OFS officials and a review of supporting documentation revealed that since September 2009 OFS has continued to strengthen key aspects of its infrastructure for managing and overseeing the cost and performance of TARP financial agents and the compliance system for conflicts-of-interest requirements. Particularly noteworthy are OFS's actions since fall 2009 to define organizational roles and responsibilities and establish written policies and procedures for the management and oversight of TARP financial agents, which have doubled in number since September 2009. Specifically, according to the Director of the Office of Financial Agents (OFA), the office was reorganized in fall 2009 where common oversight processes are centralized for consistency across financial agents. According to a Treasury official, installing full-time leadership and providing adequate staffing and organization within OFS for more active oversight of the financial agents has enabled this office to more effectively manage the billion-dollar TARP programs and Treasury operations that the financial agents support. The ongoing enhancement of management and oversight for financial agents is expected to help support Treasury's goals of helping ensure the overall stability and liquidity of financial systems and protecting taxpayer interests. Highlights of OFS's actions to strengthen the management and oversight of financial agents are presented in table 10.

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<sup>76</sup>TARP Conflicts of Interest, 74 Fed. Reg. 3431-3436 (Jan. 21, 2009) (codified at 31 C.F.R. Part 31). With this action, Treasury put in place a set of clear requirements to address conflicts that may arise during the selection of retained entities seeking a contract or financial agency agreement with Treasury, particularly those involved in the acquisition, valuation, management, and disposition of troubled assets.

**Table 10: Treasury’s Actions since September 2009 to Enhance Management and Oversight of TARP Financial Agents**

Category	Actions
Organization	The Office of the Fiscal Assistant Secretary reorganized the Office of Financial Agents into four teams—Investment Program Agent Services, Financial Agent Operations, Home Ownership Program Services, and Financial Agent Information Technology. This structure supports the office’s mission to support OFS TARP programs and exercise oversight to ensure that the financial agents (1) perform the scope of work defined by OFS; (2) adhere to guidance and direction provided by OFS; (3) deliver quality services that meet OFS’s expectations; (4) submit payment claims that are accurate, justified, and reasonable; and (5) ensure financial agents’ information technology systems meet OFS’s information needs and comply with Treasury requirements.
Staffing	Treasury’s Office of the Fiscal Assistant Secretary installed a permanent full-time OFA director in September 2009 and hired six full-time staff between November 2009 and June 2010 for its four teams in order to apply dedicated resources to each financial agent. Each financial agent now has a dedicated OFA staff contact for questions on the administration and budgeting of financial agency agreements.
Guidance	OFS issued written policy and procedures that identified the roles and responsibilities of various Treasury and OFS offices in regard to financial agents, including (1) selection and designation, (2) oversight, (3) guidance and direction, (4) performance measurement, (5) subcontractor (i.e. vendor) approvals, and (6) payment and compensation.
Oversight	<p>OFS established the Council of Asset Managers for quarterly scheduled conferences for CPP asset managers and Chief Investment Officer staff to meet with the CPP asset managers to set broad direction and share common practices and solutions together.</p> <p>OFS also established the Budget and Compensation Review Committee established for the HAMP financial agents. The committee, chaired by the Director, OFA, serves as a weekly OFS forum where staff from OFA, Office of the Chief Financial Officer, Homeownership Preservation Office, and Internal Review Office coordinate direction of Fannie Mae and Freddie Mac on issues concerning their agreements and Treasury’s funding of HAMP’s administration and compliance costs.</p> <p>OFS has installed qualitative and quantitative financial agent performance measures for Bank of New York Mellon and the CPP asset managers each developed and managed by OFS staff on behalf of OFS. Agents that exceed performance measures in quarterly reviews can earn a maximum 5 percent incentive payment. The idea is to measure the financial agent’s delivery of products on-schedule objectively and their performance and responsiveness subjectively. OFS also installed similar performance measurement and incentive compensation structures, each developed and managed by OFA staff on behalf of OFS, for Lazard Frères and Freddie Mac.<sup>a</sup></p>

Source: GAO analysis of OFS information.

<sup>a</sup>According to Treasury officials, after September 2010, OFA issued performance measures for other financial agents—EARNEST Partners, Morgan Stanley, Greenhill and Co., LLC., and Fannie Mae. In addition, Treasury officials commented in January 2011, that only Bank of New York Mellon and the CPP asset managers will have the ability to receive incentive payments for exceeding performance measures. Incentive payments for exceeding performance measures are not applicable to Freddie Mac, Fannie Mae, Lazard Frères, EARNEST Partners, Morgan Stanley, and Greenhill.

Finally, since 2009 and consistent with our prior recommendations, OFS has continued to implement its comprehensive system of oversight for conflicts of interest that may arise with financial agents or contractors seeking or performing work under TARP. For example, between October 2009 and January 2010, the compliance team within OFS’s Office of Internal Review completed complex renegotiations of the remaining three

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contracts that predated the TARP conflicts-of-interest regulations.<sup>77</sup> In addition, the steps OFS took in 2009 to develop and implement conflicts-of-interest procedures, guidance documents, and an internal reporting database enable staff to document and track all vendor conflict-of-interest certifications, inquiries, and requests for waivers. These actions also have helped OFS automate the workflow process and monitor vendor compliance in submitting periodic conflict-of-interest certifications on time. Also, according to OFS officials, these management and oversight enhancements since 2009 enabled them to manage the conflict-of-interest inquiries they receive—which totaled more than 700 by December 2010—in a timely manner.

According to OFS, when conflict-of-interest inquiries arise with TARP contractors or financial agents, they are brought to the attention of the Office of Internal Review’s compliance team. The team determines whether an actual or potential conflict-of-interest exists, and if so, whether it can be addressed with a conflict-of-interest mitigation plan. All conflict-of-interest inquiries are handled in as timely a manner as possible and are usually resolved within a few days, according to OFS. OFS provided examples of personal and organizational conflict-of-interest issues that have arisen among external financial agents:

- A financial agent requested approval of a personal conflicts-of-interest mitigation plan for an employee it was seeking to move from a business area that did not provide TARP-related services to one that did. However, the employee owned financial holdings in various TARP recipients. OFS concluded that considering the employee’s financial holdings and the contemplated scope of the employee’s work, the proposed mitigation plan was not adequate to address the potential conflicts of interest. OFS did not approve the mitigation plan, and the employee did not move to the group providing support to Treasury.
- A financial agent requested approval of a revised conflicts-of-interest mitigation plan for one of its subcontractors to broaden the scope of the work the subcontractor performed under TARP. The revised mitigation plan included a provision stating that the subcontractor would not maintain any kind of relationship with any current, former, or future entity

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<sup>77</sup>Consistent with our prior recommendations to renegotiate mitigation plans that predated the TARP conflicts-of-interest regulation, Treasury renegotiated contracts and mitigation plans with Ernst & Young, LLP and PricewaterhouseCoopers LLP, and the financial agency agreement and mitigation plan with Bank of New York Mellon.

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that helped manage or administer the added programs without the prior written consent of OFS. OFS determined that the revisions to the mitigation plan adequately mitigated the potential conflicts and thus approved the plan.

These examples illustrate the ongoing nature of conflicts-of-interest scenarios. OFS officials told us that with the conflicts-of-interest compliance infrastructure they have in place—including dedicated resources, consistent policies and procedures, and an internal reporting database for tracking the disposition of each action item—OFS was positioned and committed to remaining vigilant in overseeing contractors' and financial agents' compliance with conflict-of-interest requirements.

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### OFS Maintained Effective Internal Control over Its Financial Reporting as of September 30, 2010, and Has Taken Steps to Develop a System of Internal Control for TARP Programs

In our December 2008 report, shortly after TARP was created, we highlighted the importance of internal control and recommended that Treasury continue to develop a comprehensive system of internal control over TARP, including policies and procedures for program activities that were robust enough to ensure that the objectives and requirements of TARP programs were being met.<sup>78</sup> Over the last 2 years, Treasury has taken steps to address our recommendation for both financial reporting and program activities. As part of its control environment, OFS established an organizational structure that provides management's framework for planning, directing, and controlling operations to achieve its goals. OFS implemented a risk assessment process that it uses as a basis to identify, analyze and manage its risks. OFS has also implemented a monitoring function to verify whether internal controls are designed and operating effectively. As discussed below, we issued an opinion on OFS's internal control over financial reporting as of September 30, 2010, and we have reviewed specific control activities over compliance with certain program requirements.

### Internal Control over Financial Reporting

Our 2010 financial audit report<sup>79</sup> concluded that although certain internal controls could be improved, OFS maintained, in all material respects, effective internal control over financial reporting as of September 30, 2010, that provided reasonable assurance that misstatements, losses, or

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<sup>78</sup>GAO-09-161. We repeated this recommendation in *Troubled Asset Relief Program: Status of Efforts to Address Transparency and Accountability Issues*, GAO-09-296 (Washington, D.C.: Jan. 30, 2009).

<sup>79</sup>See GAO-11-174.



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noncompliance material in relation to the financial statements would be prevented or detected and corrected on a timely basis. Our opinion on internal control is based on criteria established under 31 U.S.C. § 3512 (c), (d), commonly known as the Federal Managers' Financial Integrity Act.

During fiscal year 2010, OFS addressed one significant deficiency and made progress in addressing the other significant deficiency that we reported for fiscal year 2009.<sup>80</sup> Specifically, OFS sufficiently addressed the issues that resulted in a significant deficiency in fiscal year 2009 regarding OFS's verification procedures over the data used for asset valuations such that we no longer consider this to be a significant deficiency as of September 30, 2010. In addition, OFS addressed many of the issues related to the other significant deficiency we reported for fiscal year 2009 concerning its accounting and financial reporting processes. However, the remaining control issues along with other control deficiencies in this area that we identified in fiscal year 2010 collectively represent a continuing significant deficiency in OFS's internal control over its accounting and financial reporting processes. Specifically, we found the following:

- While improvements were noted in OFS's review and approval process for preparing its financial statements, notes, and Management's Discussion and Analysis for TARP from what we had found for fiscal year 2009, we continued to identify incorrect amounts and inconsistent disclosures in OFS's draft financial statements, notes, and Management's Discussion and Analysis that were significant, but not material, and that were not detected by OFS.
- For fiscal year 2009, we reported that OFS had not finalized its procedures related to its process for accounting for certain program transactions, preparing its September 30, 2009, financial statements, and its oversight and monitoring of financial-related services provided to OFS by asset managers and certain financial agents. During fiscal year 2010, we found that most of these procedures were finalized. However, we identified

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<sup>80</sup> A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. A material weakness is a deficiency, or a combination of deficiencies, in internal controls such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis.

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instances where OFS's procedures were not always followed or effectively implemented.

- OFS's documentation was incomplete for certain areas of its asset valuation process. Specifically, some valuation methodology changes and the basis for certain assumptions derived from informed opinion that were used in valuing TARP's assets were not included in its written documentation.<sup>81</sup> After we notified OFS that the documentation was incomplete, it was able to provide adequate additional information about its asset valuation process.
- OFS did not have adequate procedures to determine whether the tool and related guidance it used properly calculated valuations for certain TARP assets with projected future disbursements.<sup>82</sup> OFS's use of the tool and related guidance resulted in errors in the valuation of such assets.

OFS had other controls over TARP transactions and activities that reduced the risk of misstatements resulting from these deficiencies. For significant errors and issues that were identified, OFS revised the financial statements, notes, and Management's Discussion and Analysis, as appropriate. Properly designed and implemented controls over the accounting and financial reporting processes are key to providing reasonable assurance regarding the reliability of the balances and disclosures reported in the financial statements and related notes in conformity with generally accepted accounting principles. Misstatements may occur in other financial information reported by OFS and not be prevented or detected because of this significant deficiency.

We reported on the two significant deficiencies identified last year and provided OFS recommendations to address these and other less significant issues.<sup>83</sup> The significant deficiency identified for fiscal year 2010, although not considered to be a material weakness, is important enough to merit management's attention. We will be reporting additional details concerning this significant deficiency separately to OFS management,

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<sup>81</sup>Informed opinion refers to the judgment of agency staff or others who make subsidy estimates based on their programmatic knowledge, experience, or both. Informed opinion is considered an acceptable approach under Federal Accounting Standards Advisory Board *Technical Release 6* when adequate historical data does not exist.

<sup>82</sup>The tool and related guidance used by OFS in its TARP asset valuation process is provided to federal agencies for performing valuations under the Federal Credit Reform Act of 1990.

<sup>83</sup>[GAO-10-743R](#).

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along with some recommendations for corrective actions. During our fiscal year 2010 audit, we also identified other deficiencies in OFS's system of internal control that we consider not to be material weaknesses or significant deficiencies. We have communicated these matters to management and, where appropriate, will report on them separately. We will follow up in our fiscal year 2011 audit on OFS's progress in implementing our recommendations.

### Internal Control for Program Activities

Treasury has taken steps to develop an internal control system to ensure compliance with program requirements, including limitations on executive compensation, stock repurchases, and dividends. For example, as noted earlier in this report, Treasury's interim final rule requires that the principal executive officer and principal financial officer at firms that received TARP funds certify to actions to be taken by the compensation committee, board of directors, and the company itself with regard to executive compensation. All certifications and disclosures are monitored by compliance staff within the Office of Internal Review. Also, Treasury relies on financial agents—including the custodian and individual asset managers—to perform additional oversight responsibilities. For example, Treasury, in conjunction with its outside asset managers and custodian (Bank of New York Mellon) monitor corporate actions, such as restrictions on stock repurchases and dividends. Further, Treasury has retained nine asset management firms to provide oversight of CPP participants. Treasury finalized its oversight policies for financial agents in April 2010 and developed qualitative and quantitative performance metrics based on the managers' core functions and responsibilities in July 2010.

OFS's Office of Internal Review has a key role in helping to ensure compliance with program requirements. As noted earlier, this office is responsible for identifying risks to TARP, working with program offices to develop procedures for compliance with EESA, monitoring recipients' compliance with program requirements, monitoring financial agents' and contractors' compliance with the conflict of interest interim rule, and reviewing controls to help ensure that they are in compliance with program requirements. In particular, instances of noncompliance with program requirements are evaluated to determine if further action is required.

Though Treasury has generally developed an overall system of internal control for compliance with program requirements, we have continued to monitor internal controls and identify areas in which certain controls for specific programs, such as HAMP, could be improved. In particular, Treasury has not fully implemented our recommendation to develop a

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comprehensive system of internal control for HAMP. For example, though Treasury, in conjunction with Fannie Mae as the HAMP program administrator, has developed risk control matrixes that identify various risks associated with the first-lien modification process, such as potential inaccuracies in the accruals of incentive payments, additional areas of internal control may be needed. For example, Treasury has yet to develop benchmarks, or goals, for specific HAMP performance measures such as conversion and redefault rates. In the absence of benchmarks to indicate acceptable levels of performance, assessing the results of these measures will be difficult. We will continue to monitor Treasury's actions to address these deficiencies.

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## Indicators Suggest That Credit Markets Have Largely Held the Gains They Achieved since October 2008

The concerted actions by Treasury, the Federal Reserve, and others since the crisis began have been credited with helping to avert a more severe financial crisis, but the ultimate impact of the interventions on the economy as a whole remains to be seen. The panic that stressed financial markets in October 2008 has largely disappeared along with the prospect that systemically significant financial institutions would fail and precipitate widespread financial instability. Although the long-term implications of the interventions remain unknown and no one can know what would have happened without the actions that were taken, some quantitative evidence indicates that the economy would be worse off today had the government not acted.<sup>84</sup> Critics, however, question the rationale for particular programs, point to policy missteps early on in the crisis that may have exacerbated the situation, or believe that the long-term effects of the massive interventions will eventually outweigh the short-term benefits.<sup>85</sup>

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<sup>84</sup>For example see Blinder, A. and M. Zandi, "How the Great Recession was Brought to an End", Unpublished Working Paper, (July 2010). The crisis-driven interventions—both within and outside of TARP—can be roughly categorized into programs that: (1) provided capital directly to financial institutions, (2) enhanced financial institutions' access to liquid assets through collateralized lending or other credit facilities, (3) purchased nonperforming or illiquid assets, (4) guaranteed liabilities, (5) intervened in specific financial markets, and (6) mitigated home foreclosures. Some programs involved exceptional assistance to particular institutions such as AIG because of their systemic importance or supported particular markets, while others involved assistance to individuals through refinance or loan modification programs.

<sup>85</sup>While there is general agreement that financial crises can result in costly interruptions to economic growth and the road to recovery can be long, economists differ in their views on the appropriate role for government policy. Therefore the debate is likely to continue on the effectiveness of the government response to this crisis.

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Nevertheless, 2 years after the passage of EESA, some credit markets are beginning to show signs of a sustained recovery, even as other areas of the economy remain fragile (see table 11). While the effectiveness of the programs has varied, some have reportedly had the desired effects, especially if stabilizing the financial system and restoring confidence was considered to be the principal goal of the intervention. We have noted in prior reports that many of the anticipated effects of TARP on credit markets and the economy have materialized including:

- declines in perceptions of risks in various financial markets, including asset spreads in ABS markets;
- declines in the cost of credit in interbank, mortgage and corporate debt markets;
- renewed ability by banks to access private capital markets and issue new equity;
- increasing issuance in ABS markets; and
- recovery in prices from some legacy or “troubled” assets.

For example, the cost of credit and perceptions of risk (as measured by premiums over Treasury securities) fell significantly in interbank, mortgage, and corporate debt markets, while the volume of credit, as measured by new mortgage loans, increased from October 2008 to October 2009. Although the recovery in securitization markets was more tentative than that in the broader financial market, spreads for most TALF-eligible assets tightened significantly from their heights at the beginning of 2009, and new asset-back security issuances began to occur in larger volumes.<sup>86</sup> Treasury has said that banks’ renewed ability to access capital markets and improvements in securitization markets helped motivate the decision to close bank capital programs and TALF even before the Dodd-Frank Act ended its authority to incur new obligations under TARP.<sup>87</sup> Since October

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<sup>86</sup>Eligible TALF ABS include those backed by credit cards; auto, student, and equipment loans and leases; insurance premium finance loans; mortgage servicer advances; and floorplan loans, as well as SBA 7a and SBA 504 securities as well as certain pre-existing, or “legacy” CMBS. Considering the excesses of the recent credit expansion, the desirability of returning to precrisis lending levels is debatable.

<sup>87</sup>“Closed” means that no new agreements will be made but does not necessarily mean that no activity is occurring. Many programs involved equity investments, loans, and commitments that remain outstanding.

2009, perceptions of risk in these markets were up slightly in some cases although these trends appear to be more related to concerns about sovereign debt in the European Union and other market dynamics.

**Table 11: Select Credit Market Indicators, as of November 1, 2010<sup>a</sup>**

<b>Indicator</b>	<b>Description</b>	<b>Basis point change from October 13, 2008 to October 12, 2009</b>	<b>Basis point change since October 12, 2009</b>
<i>Credit market rates and spreads</i>			
LIBOR	Three-month London interbank offered rate (an average of interest rates offered on dollar-denominated loans)	Down 447	Unchanged
TED Spread	Spread between 3-month LIBOR and 3-month Treasury yield	Down 429	Down 6
Aaa bond rate	Rate on highest quality corporate bonds	Down 124	Down 43
Aaa bond spread	Spread between Aaa bond rate and 10-year Treasury yield	Down 75	Up 31
Baa bond rate	Rate on corporate bonds subject to moderate credit risk	Down 239	Down 57
Baa bond spread	Spread between Baa bond rate and 10-year Treasury yield	Down 190	Up 17
Mortgage rate	30-year conforming loan rate	Down 154	Down 69
Mortgage spread	Spread between 30-year conforming loan rate and 10-year Treasury yield	Down 95	Up 7
ABS spreads	Spread between the yields on AAA-rated securities backed by auto, credit card, student and commercial real estate loans and Treasury, LIBOR, or interest rate swap, yields of a similar maturity		
Auto	Spread for AAA-rated securities backed by Auto Loans	Down 220	Down 20
Credit cards	Spread for AAA-rated securities backed by credit cards	Down 225	Down 28
Student loans	Spread for AAA-rated securities backed by student loans	Down 50	Down 213
CMBS	Spread for AAA-rated securities backed by commercial mortgages	Down 119	Down 253
<i>Indices</i>			
<b>Indicator</b>	<b>Description</b>	<b>Percent change from October 13, 2008 to October 12, 2009</b>	<b>Percent change since October 12, 2009</b>
ABX-AAA	Index referencing a basket of 20 subprime mortgage-backed securities that were issued in 2006 and originally rated AAA	Down 13.6%	Up 12.3%
ABX-BBB	Index referencing a basket of 20 subprime mortgage-backed securities that were issued in 2006 and originally rated BBB	Down 54.6	Up 58.9

Quarterly mortgage and ABS volumes, and mortgage defaults

Indicator	Description	Change from fourth quarter 2008 to fourth quarter 2009	Change from fourth quarter 2009 to third quarter 2010 <sup>b</sup>
Mortgage originations	New mortgage loans	Up \$130 billion to \$390 billion	Up \$20 billion to \$410 billion
Asset-backed security issuance	New securities backed by auto loans, credit cards, student loans, and commercial mortgages	Up \$18 billion to \$20 billion	Up \$3 billion to \$23 billion
Foreclosure rate	Percentage of homes in foreclosure	Up 128 basis points to 4.58	Down 19 basis points to 4.39

Source: GAO analysis of data from the Federal Reserve, Thomson Reuters, a broker-dealer, and Inside Mortgage Finance.

<sup>a</sup>Rates and yields are daily except mortgage rates, which are weekly. Interest rate swaps are contracts in which one party agrees to pay a fixed interest rate to another party in exchange for a floating rate. Higher spreads (measured as premiums over Treasury securities, LIBOR, or swaps of comparable maturity) represent higher perceived risk in lending to certain borrowers. Higher rates represent increases in the cost of borrowing for relevant borrowers. As a result, “down” suggests improvement in market conditions for credit market rates and spreads. Foreclosure, asset-backed security issuance and mortgage origination data are quarterly. See previous TARP reports for a more detailed discussion ([GAO-09-161](#) and [GAO-09-296](#)).

<sup>b</sup>Asset backed security issuance data are through the second quarter of 2010 due to data availability.

While the movements in most of these indicators since October 2009 are likely more reflective of market developments outside of TARP, some metrics we have monitored for programs with later start dates like PPIP, HAMP, and to a lesser extent TALF, remain relevant. PPIP indicators show substantial improvements during the second year of the TARP program. For example during the second year of the TARP program the price of AAA and BBB tranches of certain RMBS rose significantly. As we noted in our June 2010 report, Treasury stated that the stabilization of certain legacy asset prices, namely those in RMBS and CMBS markets, was one indicator that the PPIP had achieved its stated purpose and influenced the decision not to commit additional funds to the program. Similarly, TALF-eligible ABS spreads have continued to narrow since October 2009 (see table 11).<sup>88</sup>

Over the last 2 years indicators for the Making Home Affordable (MHA) program continued to highlight challenges in the area of residential housing. The nationwide foreclosure rate reached an unprecedented high of 4.63 percent in March 2010.<sup>89</sup> Estimates of the total mortgages

<sup>88</sup>TALF expired on March 31, 2010, for loans backed by ABS and legacy CMBS, and in June 30, 2010, for loans backed by newly issued CMBS.

<sup>89</sup>While we discuss the foreclosure inventory here, by any measure foreclosure and delinquency statistics for housing remain well above their historical averages.

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outstanding suggest that this percentage amounts to roughly 2.5 million loans that were in some stage of the foreclosure process.<sup>90</sup> While the foreclosure inventory increased by 128 basis points to 4.58 percent from December 2008 to December 2009, it has decreased by 19 basis points between December 2009 and October 2010, suggesting a leveling off of the foreclosure inventory and some signs of stabilization.<sup>91</sup> However, the reasons for the change in the foreclosure inventory are unclear. For example, the slowdown could be driven by any combination of (1) the foreclosure mitigation programs, including those under MHA; (2) banks forbearing or delaying foreclosures; and (3) other forces related to the economic fundamentals of the housing market. Analysis of delinquency and foreclosure data suggests that mortgages are not rolling from delinquency to foreclosure as expected and that lenders are not initiating foreclosures on many loans that would normally be subject to such actions. A recent International Monetary Fund report estimated that this “shadow inventory” could be as much as 1.7 million homes.<sup>92</sup>

In our October 2009 report, we recommended that any decision to extend TARP be made in coordination with relevant agencies and that Treasury use quantitative analysis whenever possible to support its rationale.<sup>93</sup> Treasury subsequently dedicated additional funds to preserving homeownership and improving financial conditions for small banks and businesses while winding down and terminating other programs. We reviewed the analytical process underpinning the decision to extend TARP and in June 2010 reported on Treasury’s process. We found that Treasury had coordinated and consulted with other agencies and considered a number of qualitative and quantitative factors, as we recommended.<sup>94</sup> Although we found Treasury’s framework for deciding to extend TARP

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<sup>90</sup>As Treasury notes, not all foreclosures are preventable, given that many homeowners overextended themselves by purchasing homes that were not affordable to them in the long run or suffering from unanticipated life events that left them unable to pay their mortgages. It is possible that a large number of the trial modifications under HAMP and other MHA programs represent unavoidable foreclosures, complicating the ability to assess HAMP’s effectiveness using foreclosure rates.

<sup>91</sup>As of June 2010 the foreclosure rate was 4.57 percent, down 6 basis points from March 2010.

<sup>92</sup>See International Monetary Fund, *United States: 2010 Article IV Consultation* (July 2010).

<sup>93</sup>[GAO-10-16](#).

<sup>94</sup>[GAO-10-531](#).



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sufficient, we recommended that the Secretary (1) formalize coordination with FDIC for future TARP decisions and (2) improve the transparency and analytical basis for TARP program decisions. Because TARP will be winding down concurrently with other important interventions by federal regulators, decisions about the sequencing of the exits from these programs will require bringing a larger body of regulators to the table to plan and sequence the continued withdrawal of federal support.

Although the economy is still fragile and potential threats remain, U.S. financial regulators have begun to shift their focus from stabilizing the economy to exiting from crisis-driven interventions and transferring risk back into the hands of the private sector. As a result, even as some programs have ramped up to address specific issues, many others have either expired or are already winding down. As discussed earlier, TARP recipients have begun to repay loans and repurchase shares and warrants; however, signs that the recovery is not robust raise some concerns about the government withdrawing support rapidly and completely. For example, in addition to weak housing markets, consumer spending, private investment and employment growth have remained weak and real gross domestic product growth is estimated to be about one-half of its full potential.<sup>95</sup> Moreover, sovereign debt issues in Europe may have led to an increase in risk aversion that translated into strains in short-term U.S. dollar funding markets.

As table 11 shows, interest rates have generally continued to decline since October 2009. Despite the unwinding of TARP, its early termination, the general exit from other government interventions, and the turmoil in Europe, credit spreads, while rising slightly for the mortgage and bond markets, are down in the interbank market and all remain well below their October 2008 peaks. In particular, the average value for the TED spread for 2010 through November 1, 2010, is 32 basis points below its 2009 average and 131 basis points below its value in 2008 (see fig. 8). Similarly the banking sector credit default swap index, which provides an indicator of the credit risk associated with U.S. banks (as judged by the market), is well below its value in 2008 and 2009, despite increasing in response to sovereign debt issues in May 2010.<sup>96</sup> Collectively, our indicators suggest

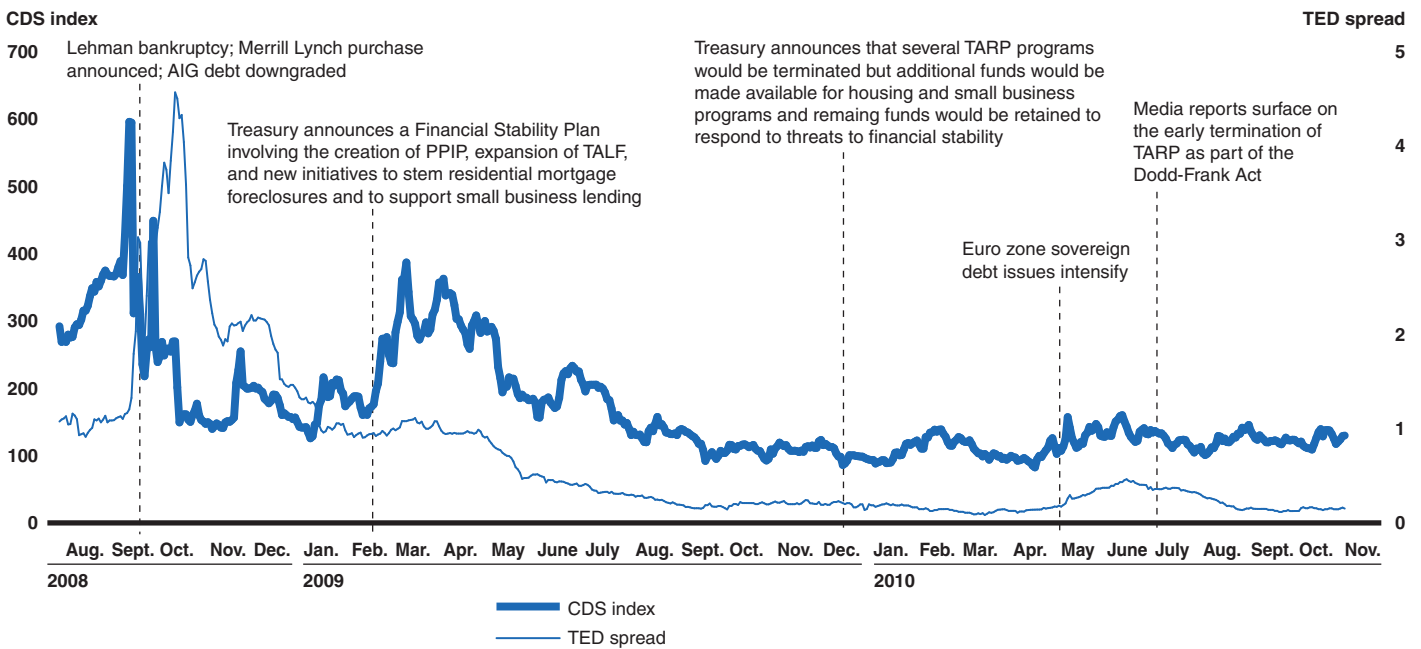
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<sup>95</sup>International Monetary Fund (2010).

<sup>96</sup>A credit default swap index is a credit derivative used to hedge credit risk or to take a position on a basket of credit entities. Unlike a credit default swap, which is an over the counter credit derivative, a credit default swap index is a completely standardized credit security and may therefore be more liquid and trade at a smaller bid-offer spread.

that recovery in credit markets has thus far withstood the unwinding of government interventions.<sup>97</sup>

**Figure 8: TED Spread and Banking Sector Credit Default Swap Index, January 1, 2008 through November 1, 2010**



Source: GAO analysis of Thomson Reuters data.

We tested whether the announcement of a deal to pass financial regulatory reform (the Dodd-Frank Act) and end Treasury’s authority to incur new obligations under TARP several months early had an impact on perceptions of risk in the interbank lending market as measured by changes in the TED spread.<sup>98</sup> The TED spread has declined modestly since June 29, 2010, media reports of the early end of TARP. In theory, the early end of TARP could, in isolation, increase perceptions of risk in lending to banks, as Treasury would no longer be able to use TARP funds to respond to new threats to financial stability—an authority that has allowed it to respond to urgent problems in the banking sector several times over the

<sup>97</sup>These indicators, although imperfect, might inform the proper timing for winding down the remaining programs and liquidating any investments.

<sup>98</sup>See appendix III for more information on our econometric model.

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life of TARP.<sup>99</sup> Alternatively, the early end of TARP could have no effect if financial institutions were perceived to have built up adequate capital and liquidity to weather a new shock to the financial system. In several versions of our model, we consistently found that the announcement of the early end of TARP had no statistically or economically significant impact on the interbank market. Given the substantial impact of the initiation of TARP and other crisis programs, this result may indicate some durability of the improvements in the interbank market. However, the extent to which this result reflected purely the market response to the end of TARP is unclear, as the response may have been muted by the passage of regulatory reform, or other factors. For example, the early end of TARP could have increased credit risk in the interbank market, while the passage of financial regulatory reform could have simultaneously reduced credit risk, yielding the no net impact we found in the interbank market. Furthermore, this test assesses market participants' initial expectations and not the ultimate impact of the early end of TARP and passage of regulatory reform. Over time, analysis of the exits from remaining TARP programs will provide a more complete assessment of the resilience of the financial system.

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## Conclusions

TARP programs implemented over the last 2 years covered a broad range of activities: they were designed to inject capital into financial institutions, address issues in the securitization markets, provide assistance to the automobile industry and AIG, and offer incentives for modifying residential mortgages, among other things. Many credit markets have shown signs of a sustained recovery even as other areas of the economy, particularly housing markets and jobs starts, remain fragile. While the degree of effectiveness has varied across programs, some programs reportedly have had the desired effects, especially where stabilizing the financial system and restoring market confidence are considered to be the principal goals of the government's interventions.

Going forward, Treasury continues to face unique oversight and monitoring challenges, as TARP programs are currently at every phase of development and significant investments remain that must be managed. Treasury is attempting to address ongoing challenges in certain areas,

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<sup>99</sup>Because the economy was still fragile and downside risks remained, Treasury identified the need to retain resources to respond to threats to financial stability as an important consideration in deciding to extend TARP in December 2009.

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including home foreclosures and small business lending. Thus far, the existing TARP programs in these areas have been far less successful than other TARP initiatives. While we and others have argued that some of these programs have been ill-designed, the complexity of the issues involved have contributed to ongoing difficulties in designing programs that achieve desired goals.

Although HAMP was first announced in February 2009 as Treasury's primary effort to preserve homeownership and protect home values, the program has had a slow start and has not performed as anticipated. Despite program changes that were intended to increase the number of mortgage loan modifications made under HAMP, more borrowers have had their trial modifications canceled than have received permanent modifications. Further, while Treasury has added TARP-funded program enhancements in an effort to reach more borrowers and address persistently high default and foreclosure levels, the newly announced programs are in the early stages of implementation and the number of additional borrowers they will ultimately help remains unclear. Treasury has not yet fully implemented all of our prior recommendations to increase the transparency, accountability, and consistency of the program

Treasury also has two remaining TARP programs aimed at increasing lending to small businesses—CDCI and the SBA 7(a) Securities Purchase Program. But given the relatively small amount of funding allocated for these programs and the fact that SBA and CDFIs account for a small proportion of total small business lending, the question of whether these programs will have a significant impact is debatable. Moreover, the success of the SBA 7(a) Securities Purchase Program and other potential small business programs appeared to have been hampered by lenders' reluctance to participate due to concerns about the stigma of participating in a TARP program and objections to TARP requirements such as executive compensation restrictions. Given these types of concerns, whether TARP could have created an effective small business program is unclear. CDCI was also plagued with initial confusion about whether the program's primary goal was to increase small business lending. Treasury officials and early public statements placed different emphasis on the two goals of CDCI: (1) to assist in small business lending and (2) to capitalize certain small financial institutions, some of which do not lend much to small businesses. However, in more recent communications about CDCI, Treasury clarified the importance of both goals of the program. Now that SBLF has been signed into law, using the experience learned from TARP small business programs to clearly articulate how SBLF complements and differs from ongoing TARP small business programs will be important.

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While additional programs—AIG and PPIP—remain active, others have closed but have substantial outstanding balances that will require Treasury’s ongoing attention and oversight. For programs with outstanding balances, the prospect for repayment from some institutions, both large and small, and the ultimate cost of TARP remain unknown. For example:

- Reflecting continued improvements in its financial condition, AIG has announced plans to restructure its assistance from the federal government. While a number of transactions associated with the restructuring will occur throughout the first quarter of 2011, to the extent the plan is successful, it will eliminate the Federal Reserve’s exposure to AIG. However, for Treasury, the ultimate return that OFS will realize from its investments in AIG will be determined by the long-term health of AIG and subject to uncertainty arising from the likelihood of future changes in general economic, regulatory, and market conditions.
- CPP, one of TARP’s oldest and most widely used programs, had recouped more than \$152 billion in payments and almost \$20 billion in additional proceeds but continued to have \$49.8 billion outstanding as of September 30, 2010, and faces growing questions about the ability of some participants, especially small participants, to repurchase their preferred shares. A growing number of institutions that have also missed at least one dividend payment could mean that Treasury will be appointing members to some institutions’ boards of directors. While institutions continue to repurchase their preferred shares, the program will require ongoing oversight and monitoring until all these assets are divested.

The remaining programs will require ongoing oversight, and Treasury will have to manage the remaining investments. For example, AIFP, which closed, continues to pose a number of challenges, and the health and ultimate ability of the participants—GM, Chrysler, and Ally Financial—to repay Treasury depends on a number of external factors, including substantial uncertainty arising from the likelihood of future changes in general economic and market conditions. Conversely, while no TARP funds have been disbursed to purchase TALF collateral as of September 2010, ongoing challenges in commercial real estate markets warrant ongoing attention. Finally, while AGP was terminated in December 2009, Treasury kept a portion of the trust preferred securities issued under this program in exchange for the guarantee provided to Citigroup.

Although OFS has become a more stable organization over the past year, with more than 200 employees, it faces new challenges as the TARP

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authority to make new commitments has expired, some programs wind down, and others continue to operate. For example:

- OFS has begun to take steps that will help to retain staff, but staff retention could be a significant challenge for OFS, as term appointees making up more than half of its workforce. Most of these employees can be extended only up to 4 years, and some may seek more permanent employment elsewhere. Moreover, several key leadership positions were filled under limited-term Senior Executive Service appointments. Positions could become more difficult to fill, given that TARP authority has expired and most programs are winding down. While OFS has begun to assess options for future staff needs, including succession planning for senior positions, its workforce plan has not been updated since March 2009 to reflect the changing environment. Without a plan that considers various scenarios, particularly the potential outflow of term employees, OFS may find itself unprepared to adequately manage and oversee the TARP investments and programs that remain.
- OFS has overcome an initially challenging contracting environment. It has strengthened its management and oversight of a growing network of contractors and financial agents to support TARP administration and operations. With an appropriate infrastructure in place, Treasury should remain vigilant in monitoring and managing performance issues and conflicts of interests that may arise with the use of private sector sources.
- Treasury's development of a system of internal control for financial reporting and compliance with program requirements has evolved over the last two years and will continue to be an important area for oversight. Although certain internal controls could be improved, OFS has in all material respects maintained effective internal control over financial reporting as of September 30, 2010, that provided reasonable assurance that misstatements, losses, or noncompliance material in relation to the financial statements would be prevented or detected and corrected on a timely basis.<sup>100</sup> Treasury has also developed a system of internal control to ensure compliance with program requirements, including limitations on executive compensation, stock repurchases, and dividends. However, we have continued to identify areas where certain controls for specific programs, such as HAMP, could be improved.

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<sup>100</sup>See [GAO-11-174](#).

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Two years after the passage of EESA, indicators generally suggest that credit markets have improved and that many of the anticipated effects of TARP have materialized. However, the economy remains fragile, and the ultimate impact of the interventions on the real economy remains to be seen. While movements in most of these indicators during the second year of TARP are likely more reflective of other non-TARP market developments, some metrics we have monitored for programs with later start dates (PPIP, HAMP, and to a lesser extent TALF) show some improvements. For example, PPIP indicators show substantial improvement and TALF indicators continue to improve. However, indicators for MHA continue to highlight the challenges in the area of residential housing. During the second year of TARP, Treasury made decisions about winding down particular programs and making additional funds available to others. In our July 2010 TARP report, we found that the framework Treasury used in making these decisions was sufficient but offered additional recommendations to enhance and formalize coordination with FDIC and improve the transparency and analytical basis for remaining TARP program decisions. Our indicators suggest that credit markets have largely held the gains achieved since October 2008, despite the unwinding of TARP programs, the early termination of TARP's authority, the general exit from other government interventions, and the turmoil in Europe.

While Treasury has taken a number of steps to help ensure that TARP programs are operating effectively and being adequately overseen, it has yet to fully implement all of our previous recommendations. These recommendations are generally aimed at improving communication, working with regulators to ensure consistency of repurchase decisions, and numerous aspects of HAMP. Moreover, the Federal Reserve has yet to implement 5 recommendations related to SCAP.

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## Agency Comments and Our Evaluation

We provided a draft of this report to Treasury for its review and comment. We also provided the draft report to the FDIC, Federal Reserve, OCC, OTS, and the SBA to verify the factual information they provided about certain TARP programs and small business trends. Treasury provided written comments that we have reprinted in appendix IV. Treasury, the Federal Reserve, and FDIC also provided technical comments that we have incorporated as appropriate.

In its comments, Treasury noted that TARP and other government actions have contributed to stabilizing the financial system and restoring market confidence. While we agree that there have been broad improvements in

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the financial system and the economy, the economy remains fragile and there continues to be notable uncertainty in areas such as the housing markets and employment. Further, as we note in the draft report, Treasury continues to face unique oversight and monitoring challenges, as TARP programs are currently at every phase of development and significant investments remain that must be managed. In addition, each TARP program has demonstrated varying degrees of success in meeting its goals. For example, we acknowledged the role of TALF in restarting frozen securitization markets, but we also pointed out that HAMP has not fulfilled its intended goal of addressing the foreclosure crisis and while conditions appear to be improving, the ultimate success of OFS's interventions into AIG and the auto industry continues to be unknown. We will continue to monitor active TARP programs in our future work.

Treasury also had a differing view on the number of our prior recommendations that it had fully or partially implemented. While Treasury continues to make progress in addressing our prior recommendations, in some cases, we have a different view about whether sufficient actions have been taken to fully address our prior recommendations. For example, Treasury believes that our recommendation that Treasury communicate to Congress its plans to monitor the companies' performance should be considered closed, noting that it uses monthly financial and operating information from the companies to monitor the companies' financial condition and that Congress has not requested additional information on the agency's efforts to assess and monitor the companies. While we recognize that Treasury and the auto companies have made a range of information on the companies' financial performance publicly available, Treasury has not reported to Congress how it is using this information to ensure the companies are on track to further improve their financial condition and maximize taxpayer return on Treasury's investment. As we stated in our previous report on Treasury's oversight of its financial interests in the auto companies, transparency as to how the companies are being monitored is important to ensuring accountability and providing assurances that the taxpayers' investment is being appropriately safeguarded. In other cases, Treasury has yet to provide sufficient documentation for us to fully ascertain the status of open recommendations. For example, for the TARP-funded housing programs, Treasury noted that it has considered methods of monitoring whether borrowers with total household debt of more than 55 percent of their income have received housing counseling, but Treasury has not provided us with documentation to show the methods that were considered and the analysis conducted to determine the feasibility of these methods. Reconciliation of the status of our recommendations was



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ongoing at the close of our review and going forward, as we have previously discussed with OFS officials, we will continue to review and consider any additional support and documentation related to the progress of actions taken to address our recommendations and will continue to update the status of the recommendations as appropriate.

Finally, Treasury agreed with our recommendation on OFS workforce planning, and stated that it will continue to refine this document and other staffing initiatives.

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## Recommendation for Executive Action

As TARP enters its next phase, OFS must continue to build on its past experiences and take steps to better ensure that it is effectively managing its programs and resources. Therefore, we recommend that OFS take the following action:

- OFS should finalize a plan for addressing how it will manage its workforce, in particular term-appointed employees and key SES positions, including plans for various staffing scenarios.

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

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



Thomas J. McCool  
Director  
Center for Economics, Applied Research and Methods

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The Honorable Thad Cochran  
The Honorable Kent Conrad  
The Honorable Orrin Hatch  
The Honorable Daniel K. Inouye  
The Honorable Tim Johnson  
The Honorable Jeff Sessions  
The Honorable Richard C. Shelby  
United States Senate

The Honorable Hal Rogers  
Chairman  
The Honorable Norm Dicks  
Ranking Member  
Committee on Appropriations  
House of Representatives

The Honorable Paul Ryan  
Chairman  
The Honorable Chris Van Hollen  
Ranking Member  
Committee on the Budget  
House of Representatives

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

The Honorable Dave Camp  
Chairman  
The Honorable Sander M. Levin  
Ranking Member  
Committee on Ways and Means  
House of Representatives

# Appendix I: Status of GAO Recommendations, as of December 30, 2010

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

**Appendix I: Status of GAO Recommendations,  
as of December 30, 2010**

<b>GAO Recommendations</b>	<b>Status</b>
Review and renegotiate existing conflict-of-interest mitigation plans, as necessary, to enhance specificity and conformity with the new interim conflicts of interest regulation, and take continued steps to manage and monitor conflicts of interest and enforce mitigation plans.	Implemented
<i>March 31, 2009</i>	
Develop a communication strategy that includes building an understanding and support for the various components of the program. Specific actions could include hiring a communications officer, integrating communications into TARP operations, scheduling regular and ongoing contact with congressional committees and members, holding town hall meetings with the public across the country, establishing a counsel of advisors, and leveraging available technology.	Implemented
Require that the American International Group, Inc. (AIG) seek concessions from stakeholders, such as management, employees, and counterparties, including seeking to renegotiate existing contracts, as appropriate, as it finalizes the agreement for additional assistance.	Closed, not implemented
Update OFS documentation of certain internal control procedures and the guidance available to the public on determining warrant exercise prices to be consistent with actual practices applied by OFS.	Implemented
Improve transparency pertaining to TARP program activities by reporting publicly the monies, such as dividends, paid to Treasury by TARP participants.	Implemented
Complete the review of, and as necessary renegotiate, the four existing vendor conflicts-of-interest mitigation plans to enhance specificity and conformity with the new interim conflicts-of-interest rule.	Implemented
Issue guidance requiring that key communications and decisions concerning potential or actual vendor-related conflicts of interest be documented.	Implemented
<i>June 17, 2009</i>	
Ensure that the warrant valuation process maximizes benefits to taxpayers and consider publicly disclosing additional details regarding the warrant repurchase process, such as the initial price offered by the issuing entity and Treasury's independent valuations, to demonstrate Treasury's attempts to maximize the benefit received for the warrants on behalf of the taxpayer	Implemented
In consultation with the Chairman of the Federal Deposit Insurance Corporation (FDIC), the Chairman of the Board of Governors of the Federal Reserve System (Federal Reserve), the Comptroller of the Currency, and the Acting Director of the Office of Thrift Supervision, ensure consideration of generally consistent criteria by the primary federal regulators when considering repurchase decisions under TARP.	Open
Fully implement a communication strategy that ensures that all key congressional stakeholders are adequately informed and kept up to date about TARP	Partially implemented
Expedite efforts to conduct usability testing to measure the quality of users' experiences with the financial stability Web site and measure customer satisfaction with the site, using appropriate tools such as online surveys, focus groups, and e-mail feedback forms.	Implemented
Explore options for providing to the public more detailed information on the costs of TARP contracts and agreements, such as a dollar breakdown of obligations and/or expenses.	Implemented
Finally, to help improve the transparency of Capital Assistance Program (CAP)—in particular the stress tests results—we recommend that the Director of Supervision and Regulation of the Federal Reserve consider periodically disclosing to the public the aggregate performance of the largest 19 U.S. bank holding companies against the more adverse scenario forecast numbers for the duration of the 2-year forecast period and whether or not the scenario needs to be revised. At a minimum, the Federal Reserve should provide the aggregate performance data to OFS program staff for any of the 19 institutions participating in CAP or CPP.	Implemented

**Appendix I: Status of GAO Recommendations,  
as of December 30, 2010**

<b>GAO Recommendations</b>	<b>Status</b>
<i>July 23, 2009</i>	
Consider methods of monitoring whether borrowers with total household debt of more than 55 percent of their income who have been told that they must obtain housing counseling do so, and assessing how this counseling affects the performance of modified loans to see if the requirement is having its intended effect of limiting redefaults.	Closed, not implemented
Re-evaluate the basis and design of the Home Price Decline Protection (HPDP) program to ensure that Home Affordable Modification Program (HAMP) funds are being used efficiently to maximize the number of borrowers who are helped under HAMP and to maximize overall benefits of utilizing taxpayer dollars.	Implemented
Institute a system to routinely review and update key assumptions and projections about the housing market and the behavior of mortgage-holders, borrowers, and servicers that underlie Treasury's projection of the number of borrowers whose loans are likely to be modified under HAMP and revise the projection as necessary in order to assess the program's effectiveness and structure.	Partially implemented
Place a high priority on fully staffing vacant positions in the Homeownership Preservation Office—including filling the position of Chief Homeownership Preservation Officer with a permanent placement—and evaluate the office's staffing levels and competencies to determine whether they are sufficient and appropriate to effectively fulfill its HAMP governance responsibilities.	Partially implemented
Expediently finalize a comprehensive system of internal control over HAMP, including policies, procedures, and guidance for program activities, to ensure that the interests of both the government and taxpayer are protected and that the program objectives and requirements are being met once loan modifications and incentive payments begin.	Partially implemented
Expediently develop a means of systematically assessing servicers' capacity to meet program requirements during program admission so that Treasury can understand and address any risks associated with individual servicers' abilities to fulfill program requirements, including those related to data reporting and collection.	Implemented
<i>October 8, 2009</i>	
Consider TARP in a broad market context, and as part of determining whether to extend TARP work with the Chairmen of the Federal Reserve and FDIC to develop a coordinated framework and analytical basis to determine whether an extension is needed. And if so, clearly spell out what objectives and measures of any extended programs would be, along with anticipated costs and safeguards.	Implemented
Document its analytical decision-making process and clearly communicate the results to Congress and the American people for determining whether an extension is needed.	Implemented
Update its projected use of funds and if the program is extended, continue to reevaluate them on a periodic basis.	Implemented
<i>November 2, 2009</i>	
Ensure that Treasury has the expertise needed to adequately monitor and divest the government's investment in Chrysler Group LLC (Chrysler) and General Motors Company (GM), and obtain needed expertise in areas where gaps are identified (either through in-house or external means).	Implemented
Report to Congress on Treasury's plans to assess and monitor the auto companies' performance and ability to repay their loans. When reporting, balance the need for transparency with need to protect proprietary information.	Open
Develop criteria for evaluating the optimal method and timing for divesting the government's ownership stake in Chrysler and GM, including evaluating the full range of available options, such as initial public offerings or private sales.	Open

**Appendix I: Status of GAO Recommendations,  
as of December 30, 2010**

<b>GAO Recommendations</b>	<b>Status</b>
<i>February 5, 2010</i>	
To enable GAO to audit TARP support for Term Asset-Backed Securities Loan Facility (TALF) most effectively, Congress may wish to provide GAO with audit authority over all Federal Reserve operational and administrative actions taken with respect to TALF, together with appropriate access authority.	Implemented
To improve transparency of decision making on the use of TARP funds for TALF and to ensure adequate monitoring of risks related to TALF collateral, given the distressed conditions in the commercial real estate market, as part of its ongoing monitoring of TALF collateral, the Secretary of the Treasury should direct theOFS to continue to give greater attention to reviewing risks posed by commercial mortgage-backed securities.	Implemented
To improve transparency of decision making on the use of TARP funds for TALF and to ensure adequate monitoring of risks related to TALF collateral, the Secretary of the Treasury should direct the OFS to strengthen the process for making major program decisions for TALF and document how it arrives at final decisions with the Federal Reserve and Federal Reserve Bank of New York (FRBNY). Such decisions should include how Treasury considers expert and contractor recommendations and resolves those recommendations that differ from those of the Federal Reserve and FRBNY.	Implemented
To improve transparency of decision making on the use of TARP funds for TALF and to ensure adequate monitoring of risks related to TALF collateral, the Secretary of the Treasury should direct the OFS to conduct a review of what data to track and metrics to disclose to the public in the event that TALF LLC purchases surrendered assets from FRBNY. Such data and metrics should relate to the purchase, management, and sale of assets in TALF LLC that potentially impact TARP funds. Metrics related to TALF LLC could include periodic reports on the date and purchase price of assets; fluctuations in the market value of assets held; the date, price, and rationale when assets are sold; and the total amount of loans outstanding to Treasury.	Implemented
<i>June 24, 2010</i>	
Establish clear and specific criteria for determining whether a borrower is in imminent default to ensure greater consistency across servicers.	Open
Develop additional guidance for servicers on their quality assurance programs for HAMP, including greater specificity on how to categorize loans for sampling and what servicers should be evaluating in their reviews.	Open
Specify which complaints servicers should track to ensure consistency and to facilitate program oversight and compliance.	Open
More clearly inform borrowers that the HOPE Hotline may also be used if they are having difficulty with their HAMP application or servicer or feel that they have been incorrectly denied HAMP, monitor the effectiveness of the HOPE Hotline as an escalation process for handling borrower concerns about potentially incorrect HAMP denials, and develop an improved escalation mechanism if the HOPE Hotline is not sufficiently effective.	Open
Finalize and issue consequences for servicer noncompliance with HAMP requirements as soon as possible.	Open
Report activity under the principal reduction program, including the extent to which servicers determined that principal reduction was beneficial to investors but did not offer it, to ensure transparency in the implementation of this program feature across servicers.	Open
Finalize and implement benchmarks for performance measures under the first-lien modification program, as well as develop measures and benchmarks for the recently announced TARP-funded homeowner assistance programs.	Open
Implement a prudent design for remaining TARP-funded housing programs.	Open

**Appendix I: Status of GAO Recommendations,  
as of December 30, 2010**

<b>GAO Recommendations</b>	<b>Status</b>
<i>June 30, 2010</i>	
Formalize and document coordination with the Chairman of the FDIC for decisions associated with the expiration of TARP (1) by including the Chairman at relevant FinSOB meetings, (2) through formal bilateral meetings, or (3) by utilizing other forums that accommodate more structured dialogue.	Partially implemented
Publicly identify clear program objectives, the expected impact of programs, and the level of additional resources needed to meet those objectives. Set quantitative program objectives for its small business lending programs and identify any additional data needed to make program decisions.	Open
<i>September 29, 2010<sup>a</sup></i>	
To gain a better understanding of the Supervisory Capital Assistance Program (SCAP) and inform the use of similar stress tests in the future, the Federal Reserve should compare the performance of the 19 largest bank holding companies against the more adverse scenario projections following the completion of the 2-year period covered in the SCAP stress test ending December 31, 2010, and disclose the results of the analysis to the public.	Open
The Federal Reserve, in consultation with the other banking regulators, should develop a plan that reconciles the divergent views on transparency and allows for increased transparency in the regular supervisory process. Such a plan should, at a minimum, outline steps for releasing supervisory methodologies and analytical results for stress testing.	Open
The Federal Reserve, in consultation with the other banking regulators, should develop more specific criteria to include in its guidance to examiners for assessing the quality of stress tests and how these tests inform bank holding companies capital adequacy planning. These guidelines should clarify the stress testing procedures already incorporated into banking regulations and incorporate lessons learned from SCAP.	Open
The Federal Reserve, in consultation with the other banking regulators, should fully develop its plan for maintaining and improving the use of data, risk identification and assessment infrastructure, and requisite systems in implementing its supervisory functions and new responsibilities under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). This plan should also ensure the dissemination of these enhancements throughout the Federal Reserve System and other financial regulators, as well as new organizations established in the Dodd-Frank Act.	Open
The Federal Reserve, in consultation with the other banking regulators, should take further steps to more effectively coordinate and communicate among the banking regulators, including that all applicable agencies are included in discussions and decisions regarding multi-agency activities, such as horizontal examinations of financial institutions.	Open

**Appendix I: Status of GAO Recommendations,  
as of December 30, 2010**

<b>GAO Recommendations</b>	<b>Status</b>
<i>October 4, 2010</i>	
Apply lessons learned from the implementation of CPP to similar programs, such as Small Business Lending Fund, and enhance procedural controls for addressing the risk of inconsistency in regulators' decisions on withdrawals. Specifically, establish a process for collecting information from federal bank regulators on all applicants that withdraw from consideration in response to a regulator's recommendation, including the reasons behind the recommendation. Evaluate the information to identify trends or patterns that may indicate whether similar applicants were treated inconsistently across different regulators and take action, if necessary, to help ensure a more consistent treatment.	Open
Periodically collect and review certain information from federal bank regulators on the analysis and conclusions supporting their decisions on CPP repayment requests and provide feedback for the regulators' consideration on the extent to which regulators are evaluating similar institutions consistently.	Open

Source: GAO.

Notes: This table does not include 20 recommendations related to the fiscal year 2009 financial audit as detailed in [GAO-10-743R](#). For the latest status on the two significant deficiencies included in [GAO-10-743R](#), see [GAO-11-174](#).

\*These recommendations were made to the Federal Reserve.

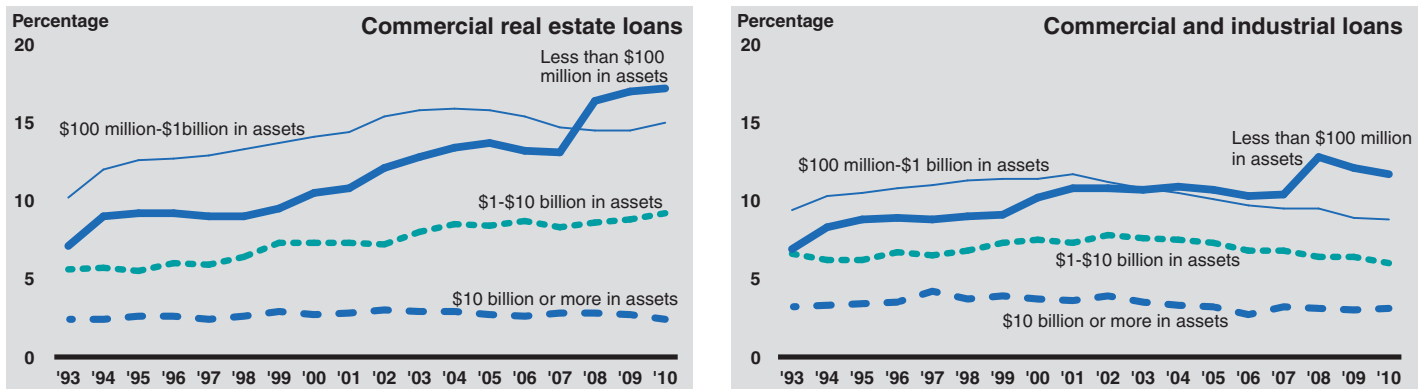


# Appendix II: Small Business Credit

## Large Banks Devote a Small Percentage of Total Lending to Small Business Loans, although the Total Dollar Value of the Loans Is Significant

As a proportion of their outstanding value of total loans, large banks have the smallest percentage of small business loans of all lenders.<sup>1</sup> In examining the proportion of the outstanding value of small business loans at banks and credit unions, we found that the largest banks—banks with \$10 billion or greater in total assets—consistently held the smallest share of small business loans as a percentage of their total loans (see fig. 9).

**Figure 9: Small Commercial and Industrial and Small Commercial Real Estate Loans at Banks, as a Percent of Total Loans, 1993 through First Quarter 2010**

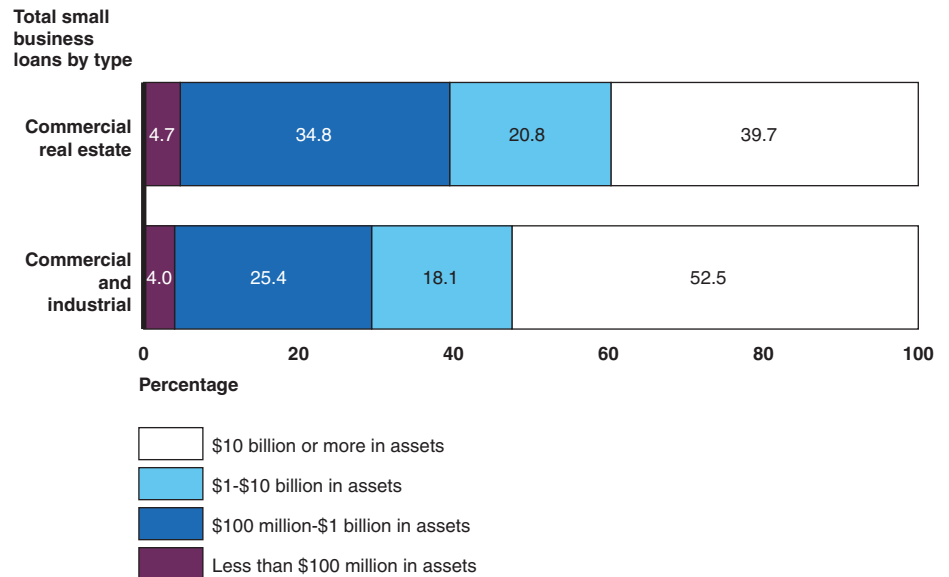


Source: GAO analysis of FDIC call report data accessed through SNL Financial.

<sup>1</sup>We defined the outstanding value of small business loans at banks as commercial and industrial (C&I) and commercial real estate (CRE) loans of \$1 million or less, and refer to these as small C&I and small CRE loans. At credit unions, the proxy for small business lending is the outstanding value of member business loans more than \$50,000. These proxies for small business lending are consistent with reporting on the small business schedules of bank and credit union call reports. C&I loans, as defined by the Federal Financial Institutions Examination Council in the commercial bank call reports, include loans for commercial and industrial purposes to sole proprietorships, partnerships, corporations, and other business enterprises, whether secured (other than by real estate) or unsecured, single-payment, or installment. Also included are loans to individuals for commercial, industrial, and professional purposes, but not for investment or personal expenditure purposes. Commercial real estate loans are defined as loans for financing commercial and multifamily residential properties such as business and industrial properties, hotels, motels, churches, hospitals, and apartment buildings. The data we analyzed dates to 1993 for banks and 1997 for credit unions and was downloaded from SNL Financial.

Despite the small number of small business loans to total loans, larger banks consistently deliver the largest dollar amount of loans to small businesses (see fig. 10).

**Figure 10: Outstanding Value of Small Business Loans by Commercial and Savings Bank Asset Size, as of December 31, 2009**



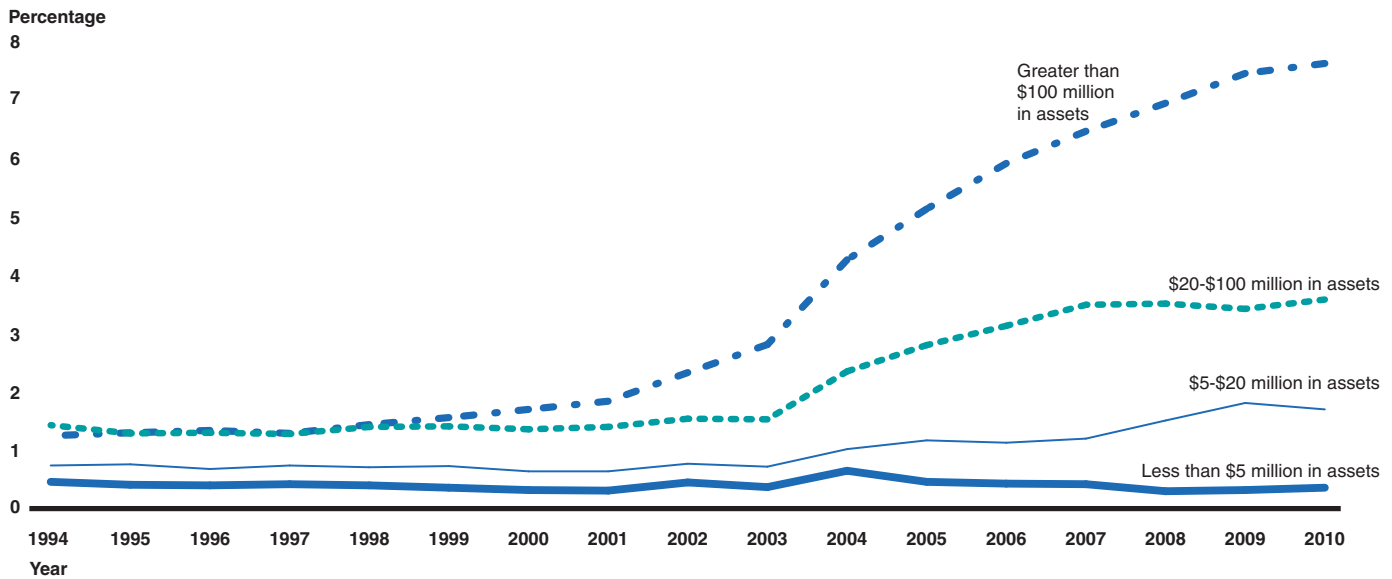
Source: GAO analysis of FDIC call report data accessed through SNL Financial.

### Credit Unions Overall Devote a Small Percentage of Total Lending to Small Business Loans, though Larger Credit Unions Do More Small Business Lending

Credit unions have smaller business loan portfolios than other depository institutions, in part because they are restricted in the dollar value of small business loans they can extend.<sup>2</sup> By 2009, the largest credit unions had significantly increased their value of small business loans to 6.5 percent (see fig. 11). The National Credit Union Association has noted in a supervisory letter to their credit unions that business loans have grown by 60 percent from 2005 to 2009. The smallest credit unions—those with less than \$20 million in assets—hold less than 2 percent of member business loans to total loans.

<sup>2</sup>Pursuant to the Credit Union Membership Access Act, enacted in 1998, a credit union's member business loans may generally not exceed 1.75 times its net worth or 12.25 percent of total assets.

**Figure 11: Outstanding Value of Small Member Business Loans at Credit Unions, as a Percent of Total Loans, 1994 through First Quarter 2010**



Source: GAO analysis of NCUA financial report data accessed through SNL Financial.

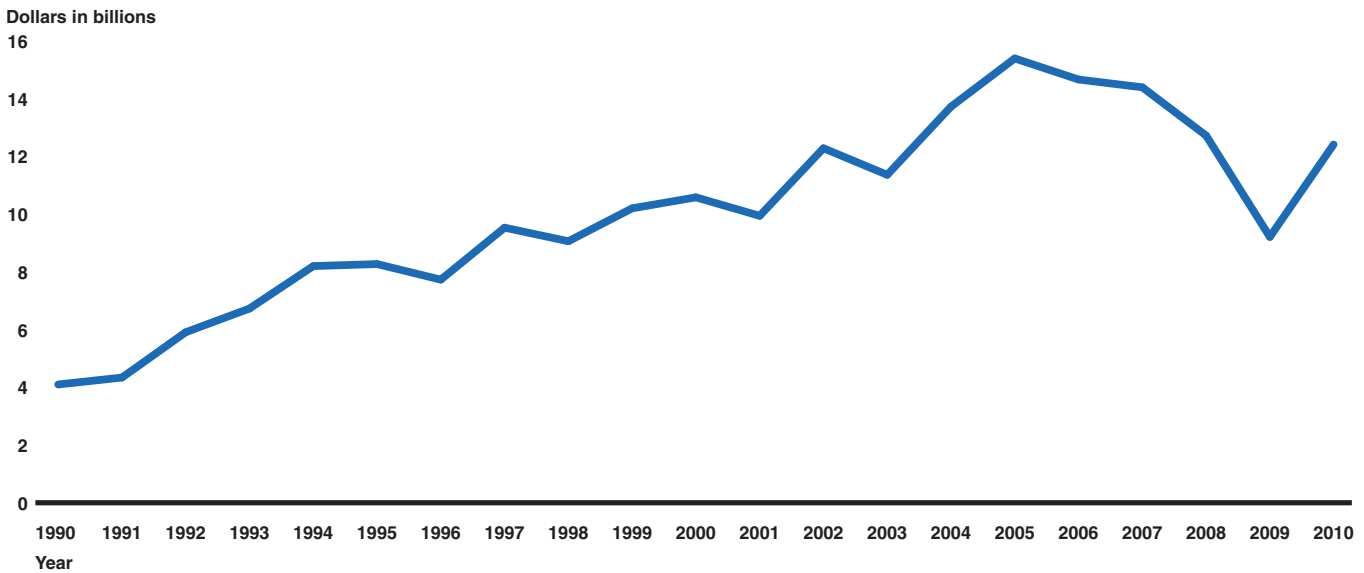
**The Small Business Administration Also Provides Financing to Small Businesses, and Those Markets Are Beginning to Recover after Sharp Declines**

The Small Business Administration’s (SBA) 7(a) and 504 loan programs are intended to facilitate the capacity of small businesses to raise financing they cannot obtain from other private lending institutions.<sup>3</sup> Originations of government-guaranteed small business loans (by dollar value) faced steep declines during the onset of the financial crisis, though volumes have since recovered. SBA loan approvals sharply declined in 2009 from 2008 levels but increased guarantees and reduced fees on 7(a) loans initiated through the American Recovery and Reinvestment Act

<sup>3</sup>The 7(a) program is the SBA’s primary program used for working capital and other business needs, while the 504 program is typically used for purchasing long-term, fixed assets.

(Recovery Act) helped increase loan volumes from fiscal year 2009 to fiscal year 2010 (see fig. 12).<sup>4</sup>

**Figure 12: SBA 7(a) Gross Loan Approvals, Fiscal Year 1990 through Fiscal Year 2010**

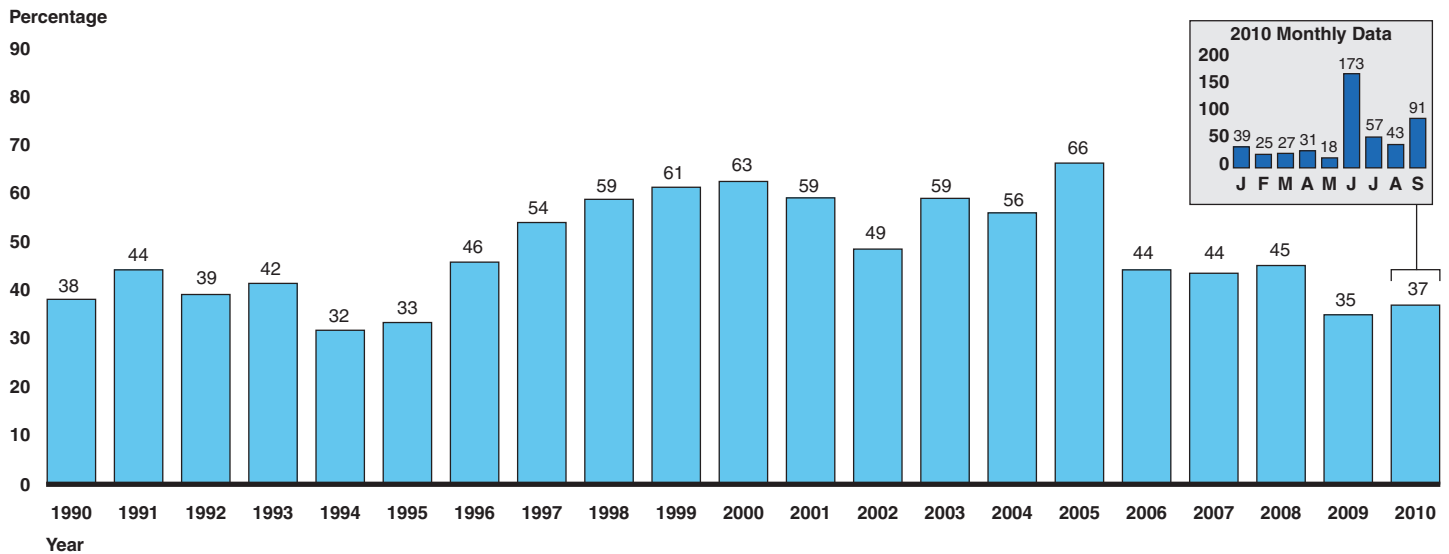


Source: GAO analysis of SBA data.

The SBA data also show that secondary markets have recently stabilized. For example, figure 13 illustrates that the guaranteed portion of 7(a) loans sold on the secondary market averaged about 45 percent from fiscal years 2006 through 2008, but declined to 35 percent in fiscal year 2009 and increased to 37 percent in fiscal year 2010.

<sup>4</sup>As reported in [GAO-10-298R](#), under the Recovery Act enacted on February 17, 2009, SBA was required to implement eight new authorities to primarily help facilitate small business lending and enhance liquidity in the secondary markets. (Pub. L. No. 111-5, Division A, Title V, 123 Stat. 115, 151-161 (2009)). ARRA appropriated to SBA \$730 million to help small businesses, including \$375 million to increase the SBA guarantee on 7(a) loans from 85 to 90 percent and to reduce or eliminate program fees on most 7(a) and 504 loans. The funds for the 7(a) and 504 loan programs were exhausted on November 23, 2009. Since then, SBA has received \$305 million in supplemental appropriations to support these programs. By May 26, 2010, SBA exhausted these supplemental appropriations. Recently passed legislation provides additional funding to further support these programs (Small Business Jobs Act of 2010, Pub. L. No. 111-240, § 1704, 124 Stat. 2504 (2010)).

**Figure 13: Proportion of 7(a) Guaranteed Loan Amount Sold on Secondary Market, Fiscal Year 1990 through Fiscal Year 2010**



Source: GAO analysis of SBA data.

Note: According to an SBA official, at the end of the second quarter of 2010 many active lenders sold substantial portfolios of SBA loans because of concerns related to the publication of Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 166: Accounting for Transfers of Financial Assets, an amendment of FASB Statement No. 140. This sales activity resulted in an unusual spike in loans coming to the secondary market in June 2010.

Since the Department of the Treasury (Treasury) began its purchases of SBA 7(a) securities (see fig. 14), the market has improved but whether this trend will continue remains unknown

**Figure 14: SBA 7(a) Securities Purchase Program Purchases, as of October 6, 2010**



Source: GAO analysis of Treasury data.

Note: Though Treasury has committed to these transactions, it has yet to fund all of them.

### Data Suggest that Small Businesses Face Credit Constraints

During the recent financial crisis, many financial institutions faced severe capital shortfalls that threatened their solvency and limited their ability to lend. In addition, the securitization markets came to a virtual halt, freezing sources of funds for new lending to consumers and businesses.<sup>5</sup> This contraction has affected many businesses, but in particular small businesses. For example, the Federal Reserve Senior Loan Officer Opinion Survey on Bank Lending Practices (SLOOS) in April 2010 showed somewhat larger net fractions of banks having tightened loan terms for small firms than had done so for medium-sized and large firms. However,

<sup>5</sup>Securitization is a process in which financial assets, such as loans or leases, are brought together into interest-bearing securities that are sold to investors. These securities, known as asset-backed securities, provide a source of liquidity for consumers and small businesses because financial institutions can take assets that they would otherwise hold on their balance sheets, sell them as securities, and use the proceeds to originate new loans, among other purposes.

the July 2010 survey showed a slight easing of standards for credit to small firms—the first such loosening since 2006.<sup>6</sup> Further, the August 2010 Small Business Economic Trends survey from the National Federation of Independent Business (NFIB) shows that 9 percent of small businesses reported their borrowing needs had not been satisfied, an increase from about 6 percent since the fourth quarter of 2007.<sup>7</sup> In comparison, during the recession in 2001, there was no change in this number.

Since the recent financial crisis, bank lending trends suggest that access to credit for small businesses has become more restricted. Because small banks tend to be concentrated in small business lending, measuring lending trends at small banks should provide particular insight into credit conditions facing small businesses.<sup>8</sup> The Board of Governors of the Federal Reserve (Federal Reserve) calculates interest rate spreads (a measure of the risk and other costs banks perceive in making loans) on loans from large and small banks based on the Survey of Terms of Business Lending.<sup>9</sup> Spreads for loans less than \$1 million—a proxy for

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<sup>6</sup>The SLOOS Survey asks banks about demand and supply changes for loans to businesses and households over the past 3 months prior to the survey's publication. Questions to respondents include whether lending standards and terms have tightened or eased for commercial and industrial loans to small firms and to medium-sized and large firms.

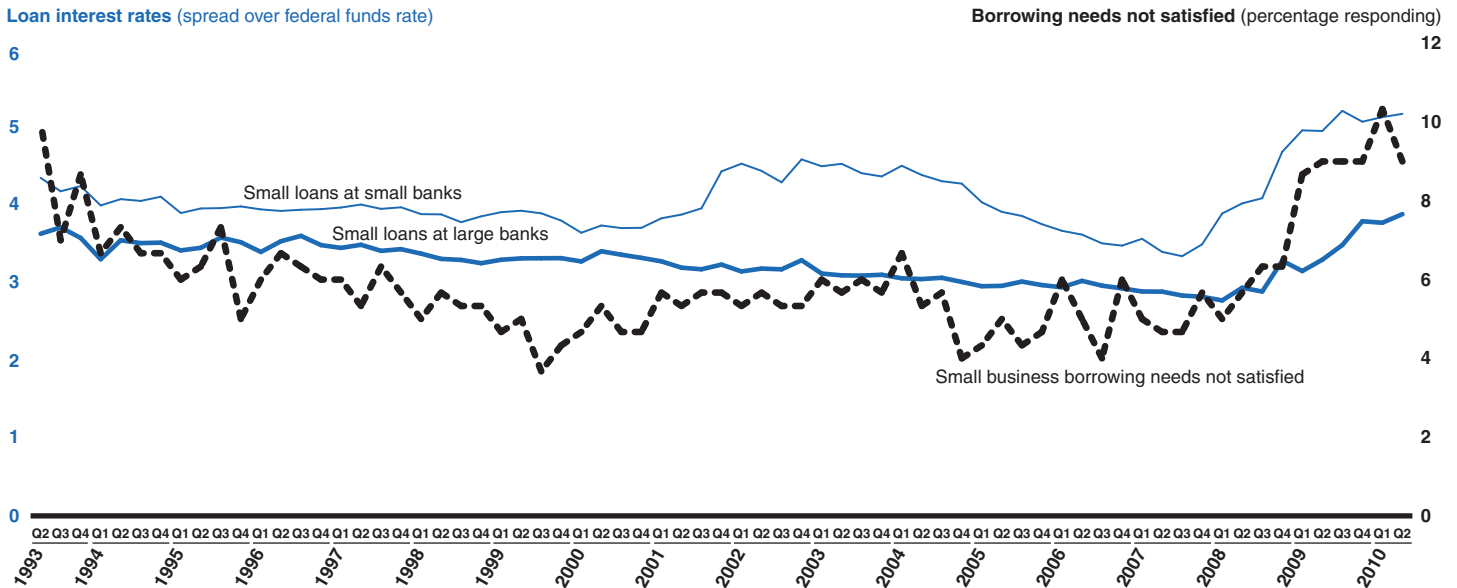
<sup>7</sup>The NFIB Research Foundation has collected Small Business Economic Trends data with quarterly surveys since 1974 and monthly surveys since 1986. The survey asks NFIB members about economic outlook, employment, earnings, sales, prices, credit conditions, interest rates, inventories, and capital outlays. The specific question used in our analysis is "During the last three months, was your firm able to satisfy its borrowing needs?" Respondents are NFIB members, with nearly half of all respondents from firms with five or fewer employees. In previous work we found that the composition of NFIB survey respondents is broadly representative of the size distribution of firms in the United States. However, we found that the survey over-represents some industries, including manufacturing and construction, while under-representing some skilled service industries. As such, respondents may not reflect the credit experiences of all firms in the economy.

<sup>8</sup>Small businesses generally rely on depository institutions in part because they have difficulty directly accessing capital markets as an alternative source of financing, relative to larger corporations. We previously reported on this in [GAO-10-531](#). In addition, according to our analysis in this appendix, small banks had a larger portion of their balance sheet devoted to small loans than large banks, although the total value of small loans was greater at large banks.

<sup>9</sup>A spread is a difference between two numbers. In this case, it is the difference between the interest rate on small loans and the federal funds rate. The spread is the weighted-average effective loan rate for each category of loans over the average federal funds rate during the survey week. The weights are a function of the face amount of the loan, the outstanding C&I loans of the surveyed bank, the number of days during the week that the bank reports, and the fraction of the bank branches that report. The federal funds rate measures the cost of credit in the overnight market for balances at the Federal Reserve.

loans to small businesses—made by small banks have risen 181 basis points from their precrisis lows (see fig. 15) and remain among the highest levels recorded since 1986.<sup>10</sup> Increased spreads at small banks—more so than large banks—are likely to indicate increased perceptions of risk for small business loans.<sup>11</sup>

**Figure 15: Interest Rate Spreads for Small Loans (Less Than \$1 Million), by Bank Size, and Small Business Borrowing Needs, Second Quarter 1993 through Second Quarter 2010**



Source: GAO analysis of data from the Federal Reserve and National Federation of Independent Business.

Interest rate spreads for small loans are highly correlated with the percentage of small businesses that reported in NFIB’s monthly survey that their borrowing needs had not been satisfied. This correlation is

<sup>10</sup>A basis point is a common measure used in quoting yields on bills, notes, and bonds. A basis point represents .01 percent, or one-hundredth of a percent. In other words, 100 basis points equals 1 percent. For example, the difference between 1 percent and 1.5 percent would be expressed as 50 basis points.

<sup>11</sup>Spreads for small loans at large banks have risen less dramatically—110 basis points from recent lows. However, these loans may not represent small business loans and may instead be small amounts drawn on loan commitments to large firms.



somewhat higher for small banks than for large banks.<sup>12</sup> In addition, both interest rate spreads and small businesses reporting unsatisfied borrowing needs show a substantial increase in recent years. Moreover, the high correlation between interest rate spreads for small loans, especially at small banks, and the proportion of small businesses able to satisfy their borrowing needs suggests that the perceived deterioration in credit quality is contributing to the reduced access to credit for small businesses. In essence, small businesses are finding it harder to get credit in part because banks believe those firms are at increased risk of default.

Whether the supply of or the demand for credit plays a larger role in explaining the tighter credit conditions for small businesses remains unclear. According to the recent NFIB Economic Trends survey, the majority of respondents cited poor sales, taxes, and government requirements as their single most important problem, with only a small fraction of respondents citing access to credit—indicating that concerns about credit access are important but not the most important issue facing small businesses. SLOOS survey responses in July 2010 also point to weaker demand for credit across both small firms and medium-sized and large firms. With declining sales, these results indicate that many small businesses are not growing and therefore have less need for credit. In contrast, some small businesses that are growing may face challenges in accessing credit or may not seek it for fear of being denied, according to some small businesses.<sup>13</sup>

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<sup>12</sup>In both cases the correlations were significantly different from zero, well beyond conventional levels. The correlation was higher for small banks than large banks (0.69 vs. 0.59); however, based on a test for correlated correlations, the small bank correlation was not significantly different from the large bank correlation at the 10 percent level.

<sup>13</sup>Participants of the Federal Reserve System’s Small Business Meeting Series, reported in a summary paper in July 2010 titled “Addressing the Financing Needs of Small Businesses,” raised concerns that small businesses that are growing may not be able to access credit. NFIB survey data show 34.5 percent of respondents did not seek the credit that they wanted because they thought they would be denied. The question asked in NFIB’s February 2010 “Small Business Credit In A Deep Recession,” is “Since the beginning of the year, was there credit you wanted, but did not apply for because you didn’t think you could get it?” In this same survey, respondents answered questions about whether they were denied certain kinds of credit. Denials included 20.6 percent for new credit cards, 46.3 percent for loans, 49.7 percent for new lines of credit, and 22 percent for extensions and renewals on lines of credit.

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## Small Business Data Have a Number of Limitations

We and others have noted that limitations in the available data hinder a complete analysis of the credit constraints facing small businesses, which creates challenges in trying to address this issue.<sup>14</sup> First, definitions of small businesses vary across data sources and many sources are survey-based and not always nationally representative.<sup>15</sup> Second, because banks are not generally required to collect and report information on lending to small businesses, certain data sources use proxies for such lending. Some quantitative loan origination data are available, but these data are also limited. For example, the largest Capital Purchase Program (CPP) recipients were required to report loan origination information on their small business lending until they fully repaid their capital; thus Treasury only received this type of information for a short period of time for most of these institutions. Based on our analysis of the data and interviews with Treasury and Federal Reserve officials, table 11 summarizes the key benefits and limitations of the sources considered to assess small business credit conditions for small business programs.<sup>16</sup>

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<sup>14</sup>GAO-10-531 and Congressional Oversight Panel, *May Oversight Report: The Small Business Credit Crunch and the Impact of the TARP* (Washington, D.C., May 13, 2010).

<sup>15</sup>Federal law also has varying definitions of small business for different purposes. The Small Business Act defines “small business concern” for the purpose of federal small business programs as one that is independently owned and operated and is not dominant in its field of operation. 15 U.S.C. § 632(a)(1). The act authorizes SBA to establish size standards that further define small business for the purpose of these programs by such criteria as industry, number of employees, and annual receipts. 15 U.S.C. § 632(a)(2); 13 C.F.R. Part 121. However, the U.S. bankruptcy code defines “small business debtor” as a person engaged in commercial or business activities with liquidated secured and unsecured debts not exceeding \$2,000,000. 11 U.S.C. § 101(51C).

<sup>16</sup>This table represents the major sources of small business data but is not exhaustive of all publicly available small business data.

**Table 12: Advantages and Limitations of Selected Small Business Data Sources**

Data source	Source description	Source advantages	Source limitations
Call report data— Federal Deposit Insurance Corporation (banks), National Credit Union Association (credit unions), and Office of Thrift Supervision (thrifts)	Outstanding loan balances for commercial real estate loans and commercial and industrial loans under \$1 million for banks and thrifts, and member loans more than \$50,000 for credit unions	<ul style="list-style-type: none"> <li>• Commercial loan size is used as a proxy for loans to small businesses, making reporting consistent among institutions</li> <li>• Effective the first quarter 2010 Treasury requested small loans be reported quarterly rather than annually</li> </ul>	<ul style="list-style-type: none"> <li>• Does not track whether a small business receives the loan, and may include certain small loans to large businesses</li> <li>• Proxies do not account for loans to small businesses that are larger than these established thresholds</li> <li>• Decreases in loan balances may not represent a decrease in credit to small businesses but could reflect realized losses on these loans and loan repayments.<sup>a</sup></li> </ul>
SLOOS	Surveys approximately 60 large domestic banks, which hold two-thirds of all business loans	<ul style="list-style-type: none"> <li>• The most recent version of the survey dates to 1990 and is generally conducted quarterly</li> <li>• Reflects supply and demand trends</li> </ul>	<ul style="list-style-type: none"> <li>• Small firms are categorized as having less than \$50 million in revenue regardless of industry</li> <li>• Survey includes only banks with more than \$1 billion in assets, though smaller banks also provide a significant amount of credit to small businesses</li> </ul>
Federal Reserve Survey of Terms of Business Lending (STBL, E.2)	Surveys interest rates and other terms on business loans during the first business week in the middle month of each quarter over the federal funds rate on C&I loans originated during the survey week at a sample of large and small commercial banks and branches and agencies of foreign banks	<ul style="list-style-type: none"> <li>• Spreads indicate the risk banks perceive in making loans</li> <li>• The survey has a consistent panel with a high response rate</li> </ul>	<ul style="list-style-type: none"> <li>• Spreads for small loans may not represent small business loans and may instead be small amounts drawn on larger loans. For example, a small \$900,000 loan could be a draw off a \$50 million credit line</li> <li>• According to a Federal Reserve official, the survey is a poor indicator of the volume of bank lending because it does not distinguish between multiple loans of short maturities or a single loan with a long maturity</li> </ul>

**Appendix II: Small Business Credit**

<b>Data source</b>	<b>Source description</b>	<b>Source advantages</b>	<b>Source limitations</b>
NFIB surveys	<ul style="list-style-type: none"> <li>Monthly survey addresses a range of questions to participating NFIB members.</li> <li>Conducted a recent study of a nationally representative sample of small employers entitled Small Business Credit In A Deep Recession</li> </ul>	<ul style="list-style-type: none"> <li>Survey dates to 1970s and is conducted monthly</li> <li>Captures supply and demand side credit trends</li> </ul>	<ul style="list-style-type: none"> <li>The monthly survey over-represents some industries, including manufacturing and construction, while under-representing some skilled service industries. As such, respondents may not be representative of the credit experiences of all firms in the economy.<sup>b</sup></li> <li>Some surveys are periodic and not collected over time, limiting the analysis of historical trends</li> </ul>
National Small Business Association (NSBA) Surveys	Periodically surveys members to show conditions of small businesses	Provides information on the types of credit used by small businesses	Responses are limited to members who tend to be older firms
Federal Reserve Flow of Funds Account (Z.1)	A quarterly account that tracks the flow of money within various sectors of an economy. The account analyzes economic data on borrowing, lending, and investment	Loans to non-corporate, nonfinancial businesses are a proxy for credit to small businesses	Presents net flows, which do not isolate loan originations
Federal Reserve Assets and Liabilities of Commercial Banks in the United States (H.8)	Estimates weekly balance sheet data for all commercial banks with a breakdown for large and small domestic commercial banks	Source for high frequency bank balance sheet data	Small banks are defined as those not included in the top 25 commercial banks, which may overstate the impact of lending by small banks
Federal Reserve Survey of Small Business Finances (SSBF)	Series of four surveys on the use of bank credit and other means of financing by small businesses	Comprehensive, historical survey reflecting multiple credit sources for small businesses	<ul style="list-style-type: none"> <li>Survey was last published in 2006 based on 1998-2003 data.</li> <li>The survey was discontinued because of its cost and the data collection burden placed on small businesses</li> </ul>
Federal Reserve Survey of Consumer Finances	Beginning April 2010, this triennial survey will provide questions on households' small businesses	Soon to include an in-depth look at small business access to credit	Summary results of the addition will not be published until 2012

**Appendix II: Small Business Credit**

<b>Data source</b>	<b>Source description</b>	<b>Source advantages</b>	<b>Source limitations</b>
SBA 7(a) and 504 loan approval and secondary market volumesc	Monthly gross value of loan approvals and value of 7(a) guaranteed portions sold by lenders in the secondary market	<ul style="list-style-type: none"> <li>• Comprehensive measure of loan originations for SBA applicants</li> <li>• Comprehensive state of secondary market trends</li> </ul>	<ul style="list-style-type: none"> <li>• SBA loans represent only about four percent of small business financing overall.<sup>d</sup></li> <li>• Because the profile of SBA borrowers differs from other small business borrowers, trends in SBA loan originations do not necessarily provide information on overall trends in small business loan originations</li> </ul>

Source: GAO analysis of data sources and interviews with Treasury and Federal Reserve officials.

<sup>a</sup>GAO-10-531.

<sup>c</sup>The 7(a) program is the SBA’s primary program used for working capital and other business needs, while the 504 program is typically used for purchasing long-term, fixed assets.

<sup>d</sup>In a previous report, we estimated the percent of SBA loans to total small business loans at about 4 percent. See GAO, *Small Business Administration, Additional Measures Needed to Assess 7(a) Loan Program’s Performance*, [GAO-07-769](#) (Washington, D.C.: July 2007).

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# Appendix III: Econometric Analysis of the TED Spread

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We conducted an econometric analysis to assess the impact of the early end of the Department of Treasury's (Treasury) authority to incur new obligations under the Troubled Asset Relief Program (TARP) (for brevity we denote this "the early end of TARP") and the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) on the TED spread, an indicator of risk in the interbank lending market.<sup>1</sup> Our multivariate econometric model uses an event study design (with elements of a difference-in-difference model) using daily data on the TED spread. In lieu of relying on graphing and identifying trends in the data before and after the announcement, the goal of this exercise was to determine whether the decline in the TED spread in the near term after the deal to end TARP early and pass financial regulatory reform was statistically significant when other important variables were also considered, in particular, other measures of short term credit risk. Economic theory offers no unified or straightforward predictions about the impact of such a simultaneous change in policy. The early end of TARP could, in isolation, (1) increase perceptions of risk in lending to banks as Treasury would lose the ability to use TARP funds to respond new threats to financial stability or (2) have no effect if the market perceived financial institutions had built up adequate capital and liquidity to weather a new shock to the financial system. Alternatively, if markets took the early end of TARP as a signal that the government believed that financial institutions were sound, it could reduce perceptions of risk in the interbank market. The passage of regulatory reform could reduce perceptions of risk in the interbank market to the extent that it implies increases in capital and liquidity at financial institutions or otherwise enhances financial stability, or increase perceptions of risk if, for example, a new "orderly liquidation authority" reduced the necessity to bail out creditors in systemically important financial institutions. In short, the multitude of potential theoretical channels for the early end of TARP and passage of regulatory reform imply that their ultimate impact is an empirical question.

The primary regressions model changes in the 3-month TED spread as a function of contemporaneous changes in the spread between 90-day nonfinancial commercial paper and 3-month Treasury bonds. The nonfinancial commercial paper spread should have favorable properties as a control variable: it has the same maturity as the TED spread, and is likely to capture general credit risk in the economy but does not cover financial firms and thus is less apt to be confounded by (although is not fully

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<sup>1</sup>Pub. L. No. 111-203, 124 Stat. 1376 (2010).

insulated from) reverse causality.<sup>2</sup> Other control variables we used were daily changes in the S&P 500 and the term spread (measured as the difference between the 10-year and 3-month Treasury bonds). We used a dummy variable to indicate news of the deal to end TARP early and pass financial regulatory reform. To carry out the exercise as validly as possible, we conducted tests to ensure the stationarity of the variables in the model, used heteroskedasticity and autocorrelation-consistent standard errors, and conducted sensitivity analysis.<sup>3</sup> To help ensure that our results were not sensitive to the main specification we chose, we ran the model with a number of variations, including

- a variety of event start dates, including June 29, 2010, when news of the likely passage of financial regulatory reform was reported; June 30, 2010, one day after (when the conference report passed in the House of Representatives); June 22, 2010, one week before (to address the possibility that information became available to market participants before media reports of the deal); and July 15, 2010, (when the conference report passed in the Senate),
- two different nonfinancial commercial paper rates, AA and the higher credit risk A2/P2 rate,
- longer maturity (6-month and 12-month) TED spreads,
- a time trend, and
- an autoregressive model where changes in the TED spread were modeled as a function of lagged values of itself rather than control variables.

In numerous specifications we found that news of the early end of TARP and likely passage of financial regulatory reform did not have a statistically significant impact on the TED spread. The effect is also economically inconsequential, less than *four-tenths of a basis point* (itself

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<sup>2</sup>This makes the analysis quite similar to a difference-in-difference approach. Changes in the TED spread also reflected in changes in the nonfinancial commercial paper spread are more likely to represent shocks specific to the banking system rather than systemic shocks to short term credit risk in the overall economy.

<sup>3</sup>Carrying out an HAC adjustment in an event study context with dichotomous event variables (pulse dummies) can result in inconsistent standard errors and spurious findings under certain conditions. For example, see T. Fromby and J. Murfin, "Inconsistency of HAC Standard Errors in Event Studies with i.i.d. errors," *Applied Financial Letters*, vol. 1 (2005). Our results were not sensitive to this adjustment.

one one hundredth of a percent) deterioration in the TED spread (per day) in our primary specification.<sup>4</sup> Whether the muted response to news of the early end of TARP is because market participants did not view it as a meaningful event, or because the simultaneous increase in the likelihood of financial regulatory reform counteracted any effect, is unknown. Because we may not have captured all important factors that might explain movements in the TED spread, omitted variable bias remains a possibility. Furthermore, this test assesses market participants' initial expectations and not the ultimate impact of the early end of TARP and passage of financial regulatory reform. In addition, ending TARP less than 3 months early, along with previous announcements related to TARP exits beginning in late 2009, could have limited informational content relevant for interbank markets in the June 29, 2010, announcement. Finally, because we use contemporaneous variables, in particular the nonfinancial commercial paper spread, it is possible that reverse causation would result in our model being misspecified.

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<sup>4</sup>In one specification the announcement effect was marginally significant but remains economically quite small.



# Appendix IV: Department of the Treasury Comment Letter



ASSISTANT SECRETARY

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

January 10, 2011

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

Dear Mr. McCool:

The Department of the Treasury (Treasury) appreciates the opportunity to review the GAO's latest draft report on Treasury's Troubled Asset Relief Program (TARP), titled *Status of Programs and Implementation of GAO Recommendations* (Draft Report).

While we recognize that the economic recovery is not complete, Treasury is pleased that the GAO's report acknowledges the success of TARP and other government actions taken to stabilize the financial system and the economy. Thanks to our comprehensive and careful strategy to address the financial crisis, the financial system is much better capitalized today, credit markets have improved, confidence has been restored, economic growth has resumed, and the projected cost of TARP and other actions is much lower than originally anticipated.

As stated in the Draft Report, Treasury has addressed or has taken steps to address many of the GAO's previous recommendations. Although Appendix I indicates that we have fully or partially implemented 40 of the 56 recommendations to Treasury, our review indicates that Treasury has fully or partially implemented 53 – or approximately 95% - of the recommendations and the only open recommendations are those issued within approximately the last six months. We will continue to meet with GAO staff to reconcile the data.

The GAO's sole new recommendation is that "OFS should finalize a plan for addressing how it will manage its workforce, in particular term-appointed employees and key SES positions, including plans for various staffing scenarios." As stated in the Draft Report, Treasury has a human capital strategy for OFS and has undertaken succession planning management. OFS continues to refine those and other staffing initiatives as it manages its workforce during TARP's continued evolution.

We look forward to continuing to work with you and your team in our ongoing efforts to stabilize the financial system.

Sincerely,

A handwritten signature in black ink, appearing to read "Tim Massad".

Timothy G. Massad  
Acting Assistant Secretary for Financial Stability

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# Appendix V: GAO Contacts and Staff Acknowledgments

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## Staff Acknowledgments

In addition to the contacts named above, A. Nicole Clowers, Gary Engel, Mathew J. Scirè, and William T. Woods (lead Directors); Lawrance Evans, Jr., Dan Garcia-Diaz, Lynda Downing, Carolyn Kirby, Kay Kuhlman, Harry Medina, Joseph O'Neill, Raymond Sendejas, and Karen Tremba (lead Assistant Directors); Kevin Averyt; Ken Bombara; Tania Calhoun; Emily Chalmers; William Chatlos; Rachel DeMarcus; Sharon Dyer; Sarah Farkas; John Forrester; Michael Hoffman; Christine Houle; Joe Hunter; Karen Jarzynka; Elizabeth Jimenez; Charles Jones; John Karikari; Tory Klepacz; Heather Krause; Damian Kudelka; Robert Lee; Grant Mallie; Karine McClosky; Tim Mooney; Susan Michal-Smith; Daniel Newman; Lauren Nunnally; Anna Maria Ortiz; Jared Sippel; Winnie Tsen; Jim Vitarello; Letisha Watson; and Chris Yfantis have made significant contributions to this report.

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