AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

S. HRG. 111–146

TREASURY SECRETARY TIMOTHY F. GEITHNER

HEARING

BEFORE THE

CONGRESSIONAL OVERSIGHT PANEL

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

SEPTEMBER 10, 2009

Printed for the use of the Congressional Oversight Panel

TREASURY SECRETARY TIMOTHY F. GEITHNER

S. HRG. 111–146

TREASURY SECRETARY TIMOTHY F. GEITHNER

HEARING

BEFORE THE

CONGRESSIONAL OVERSIGHT PANEL

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

SEPTEMBER 10, 2009

Printed for the use of the Congressional Oversight Panel

U.S. GOVERNMENT PRINTING OFFICE

53–177 WASHINGTON : 2009

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

CONGRESSIONAL OVERSIGHT PANEL

PANEL MEMBERS

ELIZABETH WARREN, *Chair*

REP. JEB HENSARLING

PAUL S. ATKINS

RICHARD H. NEIMAN

DAMON SILVERS

CONTENTS

	Page
Opening Statement of Elizabeth Warren, Chair, Congressional Oversight Panel	1
Statement of Hon. Jeb Hensarling, Member, Congressional Oversight Panel, U.S. Representative from Texas	4
Statement of Damon Silvers, Member, Congressional Oversight Panel	5
Statement of Paul Atkins, Member, Congressional Oversight Panel	9
Statement of Richard Neiman, Member, Congressional Oversight Panel	13
Statement of Hon. Timothy F. Geithner, U.S. Secretary of the Treasury	15

HEARING WITH TREASURY SECRETARY TIMOTHY GEITHNER

THURSDAY, SEPTEMBER 10, 2009

U.S. CONGRESS,
CONGRESSIONAL OVERSIGHT PANEL,
Washington, DC.

The Panel met, pursuant to notice, at 1:23 p.m. in Room SD–419, Dirksen Senate Office Building, Elizabeth Warren, Chair of the Panel, presiding.

Present: Elizabeth Warren, Representative Jeb Hensarling, Richard Neiman, Paul Atkins, and Damon Silvers.

OPENING STATEMENT OF ELIZABETH WARREN, CHAIR, CONGRESSIONAL OVERSIGHT PANEL

Chair WARREN. This hearing is called to order.

Thank you for being here today, Mr. Secretary.

I also want to welcome Paul Atkins, who is the newest member of the Congressional Oversight Panel, and we are glad to have you with us here today. Thank you.

I also want to say, as we get started here, the panel has agreed to keep their opening statements very short so that we can focus on the questions, and we appreciate that you have agreed to do the same, Mr. Secretary. So, thank you for being here.

This hearing offers an important opportunity to hear directly from you about the $700 billion investment that taxpayers have made in the financial system. Almost exactly a year ago, Secretary Paulson told Congress that the country was in a dire state. Americans were alarmed. To restore confidence, Congress quickly passed the laws that created the Troubled Asset Relief Program, TARP.

Since that time, public fear has turned into anger. Savings have evaporated, jobs have disappeared, and mortgage foreclosures are now measured in the millions of families and the billions of dollars. Taxpayers question what TARP accomplished when, on an individual level, their financial circumstances seem more precarious than ever. They feel like they got stuck with the bill for this bailout, but they didn't get the benefits.

In granting Treasury such enormous discretion with TARP money, Congress expected an equal measure of transparency and accountability. Taxpayers have a right to understand clearly what Treasury is doing and why it is doing it.

Each month, the Congressional Oversight Panel has issued a detailed report. In June, we evaluated the stress tests. In July, we examined the repayment of TARP funds. And after we reported that the first 11 banks had repurchased their warrants from Treas-

ury at a price that we believed was only 66 percent of their estimated value, the next round of banks repurchased their warrants at prices that were much closer to our estimated value. In August, the panel examined the impact of the decision to leave troubled assets on the books of the banks and how much risk that leaves in the banking system.

Yesterday, the panel released a report examining the use of TARP funds in the domestic auto industry and recommended that taxpayers, who now own substantial amounts of both Chrysler and GM, might be better protected if Treasury would put its shares in a trust so that someone not in Government could actively manage them and make decisions about the best time to sell.

Of course, taxpayers are now stakeholders in hundreds of financial institutions as well. Taxpayers still want to know how their money has been used and what difference their enormous investment has made. Have these companies been cleansed of toxic assets—the reason TARP was passed? Are these companies better run today than they were a year ago? Do they treat consumers better now than they did last year? And the fear that no one wants to have to think about—what are the chances these financial institutions will stumble again? Or to put it more directly, are we going to change the rules that got us into this mess before it happens again?

[The prepared statement of Chair Warren follows:]

Room E-320
Washington, DC 20401

Congress of the United States

CONGRESSIONAL OVERSIGHT PANEL

Opening Statement of Elizabeth Warren

Congressional Oversight Panel Hearing with Treasury Secretary Timothy Geithner

September 10, 2009

Thank you for being here today, Mr. Secretary. This hearing offers an important opportunity to hear directly from you about the $700 billion dollar investment that taxpayers have made in the financial system.

Almost exactly a year ago, Secretary Paulson told Congress that the country was in a dire state. Americans were alarmed. To restore confidence, Congress quickly passed the laws that created the Troubled Asset Relief Program (TARP).

Since that time, initial public fear has turned into anger. Savings have evaporated, jobs have disappeared, and mortgage foreclosures are now measured in millions of homeowners and billions of dollars. Taxpayers question what TARP accomplished when, on an individual level, their financial circumstances are more precarious than ever. They feel like they got stuck with the bill for this bailout, but they didn't get the benefits.

In granting Treasury such enormous discretion with TARP money, Congress expected an equal measure of transparency and accountability. Taxpayers have a right to understand clearly what Treasury is doing, why it is doing it, what it will accomplish, and how success will be measured.

Each month, the Congressional Oversight Panel has released a detailed report. In June, we evaluated the stress tests. In July, we examined the repayment of TARP funds. After we reported that the first eleven banks had repurchased their warrants from Treasury at a price that was only 66 percent of their estimated value, the next round of banks repurchased their warrants at prices that were much closer to our best estimate of value. In August, the Panel examined the impact of the decision to leave troubled assets on the books of the banks—and how much risk that leaves in the banking system.

Yesterday, the Panel released a report examining the use of TARP funds in the domestic auto industry and recommended that taxpayers, who now own substantial amounts of both Chrysler and GM, might be better protected if Treasury would put its shares in a trust so that someone not in government can actively manage them and make decisions about the best time to sell.

Of course, taxpayers are now stakeholders in hundreds of financial institutions as well. Taxpayers still want to know how their money has been used and what difference their enormous investment has made. Have these companies been cleansed of toxic assets—the reason TARP was passed? Are these companies better run today than they were a year ago? Do they treat consumers better today than they did last year? And the fear no one wants to have to think about: what are the chances these financial institutions will stumble again—or, to put it more directly, are we going to change the rules that got us into this mess before it happens again?

Again, thank you for coming. We look forward to hearing from you.

Again, thank you for coming, Mr. Secretary. We look forward to hearing from you.

Congressman Hensarling.

STATEMENT OF HON. JEB HENSARLING, MEMBER, CONGRESSIONAL OVERSIGHT PANEL, U.S. REPRESENTATIVE FROM TEXAS

Mr. HENSARLING. Thank you, Madam Chair.

On occasion, I suspect we will disagree in the future, but I do want to thank you for your public service at a time of great challenge in our Nation's history.

I would note that this is your second appearance before the Congressional Oversight Panel since the President was sworn in in January. It is now September. I believe you have agreed now to appear before this panel at least on a quarterly basis. I would ask you once again to potentially reconsider appearing on a monthly basis. Given that the President has made a commitment that his administration would be the most transparent and accountable administration ever, I would think that would comport with that goal a little better.

We are clearly coming up on the 1-year anniversary of the EESA legislation. TARP has never really been as advertised. As we know, a toxic asset removal program became a capital infusion program. I am not here at this point to continue the debate on whether or not it was wise legislation at the time. I think there are smart people on both sides of that debate. Historians will one day record it. But I must admit almost 1 year later, I continue to be concerned and am curious as to what TARP has evolved into as of today.

I think that many Americans share a fear that I have that an emergency piece of legislation that was meant for economic stability has now morphed into essentially a $700 billion revolving bailout fund for the administration. I am concerned that the previous administration crossed a line in investing in GM and Chrysler, something that this administration continued to do. I fear that this administration crossed another statutory line in favoring members of the UAW in those reorganizations over similarly situated creditors and secured creditors.

I feel like the administration crossed another statutory line in giving Fiat 20 percent of Chrysler, up to 35 percent—a company that I understand was not owed one dime—and they will receive this if they produce a car capable of making 40 miles per gallon. I am having trouble somehow rectifying this with the charge of taxpayer protection and of financial stability.

I continue to be concerned about the issue of taxpayer protection, although certainly not all of it. I need not tell you that we have the first trillion-dollar deficit in our Nation's history. I need not tell you that recently OMB had to change their debt outlook. They missed their figure by about a third. They were looking at $7 trillion of debt instead of $9 trillion.

Part of this is TARP. Recently, the CBO came out with their report that they expect $40 billion more of loss in the Chrysler and GM programs. So that continues to be a concern, and I look forward to hearing from you, Mr. Secretary, particularly after the President announced last night that your administration has saved

us from the brink of economic ruin—and I paraphrase. I don't have the quote in front of me.

If that is true, why do we continue to need this TARP statute that many of us believe is no longer about financial stability? So I look forward to hearing your testimony.

I yield back, Madam Chair.

Chair WARREN. Thank you, Congressman.

Mr. Silvers.

STATEMENT OF DAMON SILVERS, DEPUTY CHAIR, CONGRESSIONAL OVERSIGHT PANEL

Mr. SILVERS. Yes, thank you, Madam Chair.

Good afternoon, Mr. Secretary. Like my colleagues, I very much appreciate your presence here with us today. As was noted, this is the second time you have appeared, and we are grateful.

I also wish to express my appreciation to you for the support you have given to Herb Allison as head of the Office of Financial Stability. Mr. Allison is an outstanding business leader, and it has been a pleasure to work with him these last few months.

I believe Congress and the American people should ask really three basic questions about the Troubled Asset Relief Program. First, is TARP and the associated programs of the Fed and the FDIC preventing and/or calming acute crises in our financial markets? Secondly, is TARP leading to the private financial system once again playing its appropriate role as provider of capital to the real economy? And finally, is the public, as provider of funds to the financial system through TARP and these other programs, receiving fair terms?

When you last appeared before us, I focused on the question of whether the public was being treated fairly. I remain deeply concerned about whether inappropriate subsidies are being extended in areas such as transactions with weak banks such as Citigroup, credit enhancements in the PPIP, and the repurchases of warrants from banks that have repaid Capital Purchase Plan investments.

However, I believe that you and Mr. Allison have made progress in these areas around the issue of fairness, as evidenced, for example, by the price Treasury ultimately received for Goldman Sach's warrants, a price very close to this panel's estimate of their value in our July report.

Today, I hope to discuss with you the question of whether TARP strategy is leading to the revival of the private credit system with particular reference to the continued weakness of three of our four largest banks, a subject addressed in some detail in this panel's August report. This question is tied to the important question of what Treasury, the Fed, and the FDIC strategy is for ultimately withdrawing public support for the financial system. And you addressed these matters in some detail in your written testimony today.

Looming over this conversation is the precedent of Japan's lost decade, in which you are quite expert, and the current talk of W- and L-shaped recoveries. Despite optimistic statements of the kind that we saw from the regional Fed banks yesterday, the numbers that we see tell a tale of rising unemployment, of rising foreclosures, a growing crisis in commercial real estate, which has been

addressed in this panel's earlier reports, rising small bank failures, and falling bank business lending.

Together, this data warns of the danger of a vicious circle that could overwhelm both the stimulus and Treasury's apparent strategy of hoping the banks earn themselves back to health. I believe the Treasury, the Federal Reserve, and the FDIC, under this administration and the prior administration, can take credit for calming the acute crisis of last fall, another matter you address in your written remarks.

I also believe that the decision to infuse capital rather than to buy troubled assets that Secretary Paulson made, and which I think you have largely carried forward, was the correct decision and has borne substantial fruit for our country and the world. I also believe the stimulus package is a critical part of the recovery plan that is intertwined with these matters, although it is not really proper subject for today.

The question now is, are we addressing the fundamental financial weakness in our banking system? Or are we hoping that if we close our eyes, it will go away?

I look forward to your thoughts on these matters. Thank you.

[The prepared statement of Mr. Silvers follows:]

Congress of the United States
CONGRESSIONAL OVERSIGHT PANEL

Opening Statement of Damon Silvers

Congressional Oversight Panel Hearing with Treasury Secretary Timothy Geithner

September 10, 2009

Good afternoon, Mr. Secretary. Like my colleagues, I very much appreciate your presence here today. I also wish to express my appreciation to you for the support you have given Herb Allison as head of the Office of Financial Stability. Mr. Allison is an outstanding business leader who has been a pleasure to work with these past few months.

I believe Congress and the American people should ask three basic questions about the Troubled Asset Relief Program.

Are TARP and associated programs of the Federal Reserve and the FDIC preventing or calming acute crises in our financial markets?

Are TARP and other government action leading to the private financial system once again playing its appropriate role as provider of capital to the real economy, and finally

Is the public as provider of funds to the financial system through TARP receiving fair terms?

When you last appeared before us, I focused on the question of whether the public was being treated fairly. I remain deeply concerned about whether inappropriate subsidies are being extended in areas such as: transactions with weak banks such as Citigroup, the credit enhancements in the PPIP, and in the repurchases of warrants from banks that have repaid Capital Purchase Plan investments. However, I believe that you and Mr. Allison have made progress in these areas, as evidenced for example by the price Treasury ultimately received for Goldman, Sachs' warrants, a price very close to this Panel's estimate of their value in our July report.

Today, I hope to discuss with you the question of whether TARP's strategy is leading to the revival of the private credit system with particular reference to the continued weakness of three of our four largest banks, a subject addressed in some detail in this Panel's August report. This question is tied to the important question of what Treasury, the Fed and the FDIC's strategy is for ultimately withdrawing public support from the private financial system.

Looming over this conversation is the precedent of Japan's lost decade, and current talk of W and L shaped recoveries. Despite optimistic statements of the kind we saw from the regional Fed banks yesterday, the numbers tell a tale of rising unemployment, rising foreclosures, a growing crisis in commercial real estate, rising small bank failures and falling bank business lending—which together warn of the danger of a vicious circle that could overwhelm both the stimulus and Treasury's apparent strategy of hoping the banks earn themselves back to health.

Congressional Oversight Panel

I believe Treasury, the Federal Reserve and the FDIC can take credit for calming the acute crisis of last fall. The question now is, are we addressing the fundamental financial weakness in our banking system or are we hoping that if we close our eyes, it will go away. I look forward to your thoughts on these matters.

Chair WARREN. Thank you.
Commissioner Atkins.

STATEMENT OF PAUL ATKINS, MEMBER, CONGRESSIONAL OVERSIGHT PANEL

Mr. ATKINS. Thank you, Madam Chairman.

Good afternoon, and I join my colleagues on the panel in welcoming Secretary Geithner, and it is a privilege to be here today. And thank you very much for appearing today in what I understand is the meeting for the third quarter of 2009.

It is a privilege for me to be here today to serve the American taxpayers on this panel in our oversight role over the Troubled Asset Relief Program. In the context of the current Federal budget and the talk today in Washington of programs costing trillions of dollars, TARP's size of $700 billion seems almost quaint.

Since we are in the building named after him, I am reminded of Senator Everett Dirksen's famous tongue-in-cheek line about the Federal Government's spending habits. "A billion here and a billion there, and pretty soon you are talking about real money."

TARP is large. And frankly, the slush fund aspect of it invites potential problems. Thus, Congress has set up this robust oversight framework with a special inspector general, a separate audit under GAAP and GAAS, not Government accounting rules, and of course, this panel.

I take this accountability and transparency mandate from Congress very seriously. Press reports indicate that you and Mr. Barofsky have resolved any ambiguities in his reporting relationship to the Treasury in favor of independence. I think that is an appropriate result of the unusual nature of the program.

I also understand that the information-sharing relationship between Treasury and this panel has been problematic in the past and perhaps can be improved. There is now a special liaison, I understand, in Treasury assigned to work with this panel. So I look forward very much to working with you all and experiencing for myself the state of interaction.

We are approaching the 1-year anniversary of the passage of the EESA, as Representative Hensarling said, that set up TARP. Since its passage, Treasury has created an alphabet soup of programs under TARP, and that does not include the other programs of the Fed, the FDIC, and other banking agencies.

Several questions arise. How effective has each of these programs been? Have some been more effective than others? Has TARP achieved its original purpose and mission? What are the costs, not just in terms of out-of-pocket expenses, but also of the real, if latent, costs such as moral hazard?

The authority under EESA expires on the 31st of this year. The Treasury Secretary, of course, has the authority under EESA to extend TARP until October of 2010. Will TARP be extended? Has that decision already been made? If not, what criteria will be used in making the decision? What are the conditions under which you might make the decision?

The statute provides only vague guidelines. For example, it requires a quantification of the expected cost to taxpayers of an extension, and that cost cannot be quantified without a rigorous eco-

nomic analysis, including direct and indirect costs. And that includes the moral hazard that I mentioned.

So, with that, Madam Chairman, I yield my time, and I look forward to the testimony of the Secretary.

[The prepared statement of Mr. Atkins follows:]

CHAIRMAN ELIZABETH WARREN
SEN. JOHN E. SUNUNU
REP. JEB HENSARLING
RICHARD H. NEIMAN
SIMON S. JOHNSON

732 North Capitol Street, NW
Room C-320
Washington, DC 20401

Congress of the United States

CONGRESSIONAL OVERSIGHT PANEL

Opening Statement of Paul Atkins

Congressional Oversight Panel Hearing with Treasury Secretary Timothy Geithner

September 10, 2009

Good afternoon. I join my colleagues on the Panel in welcoming Secretary Geithner. Thank you for appearing today in your meeting for the third quarter of 2009.

It is a privilege for me to be able to serve the American taxpayers on this Panel in our oversight role over the Troubled Asset Relief Program. In the context of the current federal budget and the talk today in Washington of programs costing trillions of dollars, TARP's size of $700 billion seems almost quaint. Since we are in the building named after him, I am reminded of Senator Everett Dirksen's famous tongue-in-cheek line about the federal government's spending habits: "A billion here and a billion there, and soon you are talking about real money." TARP is large, and the slush-fund aspect of it invites potential problems. Thus, Congress set up a more robust oversight framework, with a special inspector general, a separate audit under GAAP and GAAS (not government accounting rules), and this Panel.

I take this accountability and transparency mandate from Congress very seriously. Press reports indicate that you and Mr. Barofsky have resolved any ambiguities in his reporting relationship to the Treasury secretary in favor of independence. That is an appropriate result in light of the unusual nature of this program. I also understand that the information-sharing relationship between Treasury and this Panel has been problematic and can be improved. There is now a special liaison in Treasury assigned to work with this Panel. I look forward to working with you all and experiencing for myself the state of interaction.

We are approaching the one-year anniversary of the passage of the Emergency Economic Stabilization Act that set up TARP. Since its passage, Treasury has created an alphabet soup of programs under TARP, and that does not include the other programs of the Federal Reserve, the FDIC, and other banking agencies. Several questions arise: How effective have each of these programs been? Have some been more effective than others? Has TARP achieved its original purpose and mission? What are the costs, not just in terms of out-of-pocket expenses, but also other real, if latent, costs such as moral hazard?

The authority under EESA expires on December 31st. The Treasury Secretary has the authority to extend TARP until October of 2010. Will TARP be extended? Has that decision already been made? If not, what criteria will be used in making this decision? What are the conditions under which the Treasury Secretary will make his decision? The statute provides very vague guidelines, but as vague as they are, they need to be taken seriously. For example, the statute requires a quantification of the expected cost to the taxpayers of an extension. This cost cannot be quantified without a rigorous economic analysis, including direct and indirect costs. That includes the moral hazard that I mentioned earlier.

Congressional Oversight Panel

This Panel has addressed the moral hazard issue in the context of pricing of warrants that the US Government obtained in making capital injections under TARP. This Panel has found that these warrants have been underpriced and I look forward to reviewing the analyses of this panel and others. If warrants are underpriced, it not only short-changes the taxpayer, who took huge risks at the time, but it also increases the moral hazard of the program. The warrants should be priced very high, so that there is a disincentive for future government hand-outs. The taxpayers expect and demand no less.

With that, Madame Chairman, I yield my time and look forward to the testimony of the Secretary.

Chair WARREN. Thank you, Commissioner Atkins.

Now, Superintendent of Banking for the State of New York, Superintendent Neiman.

STATEMENT OF RICHARD NEIMAN, MEMBER, CONGRESSIONAL OVERSIGHT PANEL

Mr. NEIMAN. Thank you, Madam Chair.

Mr. Secretary, thank you very much for being here today. And I will keep my comments brief as well to maximize the time for questions.

First, I do want to acknowledge Treasury's responsiveness to the panel's inquiries on behalf of taxpayers. When we first met with you 5 months ago, you pledged that you and your staff would be available to us and maintain open lines of communication. From our public hearings over the summer with Ron Bloom and Herb Allison, to the many conference calls and face-to-face meetings we have had with other members of your staff, I thank you for your level of cooperation and for supporting our oversight work.

You also responded to nearly 30 questions that I put to you directly from members of the public, some of which were very tough and candid. These questions and responses are now posted on the Internet to serve as a resource for all concerned Americans.

Second, although financial stability has not yet been fully achieved, you deserve credit for making substantial progress. We are by no means out of the crisis, but there are positive signs, such as decreasing credit spreads and the revival in areas of the securitization markets.

Nevertheless, our gains in financial stability remain fragile. Addressing the millions of homeowners facing foreclosures is key to breaking the downward cycle and achieving sustainable results. The Home Affordable Modification Program is integral to this effort, but initial results have been mixed.

I intend to explore several of these issues with you during my time here, including issues around delays in servicer participation and uneven servicer performance, borrower frustrations around eligibility standards and access to account information, and the need to complement the HAM program with additional initiatives to address foreclosures stemming from job loss and recession.

Finally, with Congress returning this week, it is widely expected that your regulatory reform proposals will experience significant movement and debate. I will be asking about your vision for developing a regulatory architecture that best supports consumer protection and long-term financial stability.

I look forward to your testimony.

[The prepared statement of Mr. Neiman follows:]

[illegible]
[illegible]
[illegible]
[illegible]

[illegible] NW
Room [illegible]
Washington DC 20401

Congress of the United States

CONGRESSIONAL OVERSIGHT PANEL

Opening Statement of Richard H. Neiman

Congressional Oversight Panel Hearing with Treasury Secretary Timothy Geithner

September 10, 2009

Mr. Secretary, thank you for being here today. I will keep my comments brief, as I would like to maximize the amount of time for you to respond to our questions.

First, I want to acknowledge Treasury's responsiveness to the Panel's inquiries on behalf of taxpayers. When we first met with you 5 months ago, you pledged that you and your staff would be available to us and maintain open lines of communication. From our public hearings over the summer with Ron Bloom and Herb Allison to the many conference calls and face-to-face meetings we have had with other members of your staff, I thank you for your level of cooperation and for supporting our oversight work.

You also responded to nearly 30 questions that I put to you directly from members of the public, some of which were very tough and candid. These questions and responses are now posted on the internet, to serve as a resource for all concerned Americans..

Second, although financial stability has not been fully achieved yet, you deserve credit for making substantial progress. We are by no means out of this crisis, but there are positive signs, such as decreasing credit spreads, the slowing rate of housing price declines, and revival in areas of the securitization markets.

Nevertheless, our gains in financial stability remain fragile. Addressing the millions of homeowners facing foreclosures is key to breaking the downward cycle and achieving sustainable results. The Home Affordable Modification Program is integral to this effort, but initial results have been mixed. There are outstanding issues that the Panel will continue to address and that I would like to explore more fully in the course of today's hearing, including-

- Delays in servicer participation and uneven servicer performance;
- Borrower frustrations around eligibility standards and access to account information, and;
- The need to complement HAMP with additional initiatives to address foreclosures stemming from job loss and the recession.

Finally, Congress returned this week and it is widely expected that your regulatory reform proposals will experience significant movement and debate. I will be asking about your vision for developing a regulatory architecture that best supports consumer protection and long term financial stability.

I look forward to your testimony.

Chair WARREN. Thank you, Commissioner.

Mr. Secretary, we received your remarks this morning. Thank you very much. They will, of course, be part of the record.

So that we will have more time to be able to question you and hear your answers, I am going to ask that you keep your oral remarks to five minutes. Of course, anything else that you wish may be entered in the record.

Mr. Secretary.

STATEMENT OF HON. TIMOTHY F. GEITHNER, U.S. SECRETARY OF THE TREASURY

Secretary GEITHNER. It is a pleasure to be here again. Let me just begin by saying this is my 16th time testifying before the Congress of the United States and the oversight panel this year. Glad to hear you still want to see more of me. Happy to come and try to do it again, and I think this is an important part of the process.

And Congress, when it acted last fall, didn't just give the executive branch unprecedented authority to try to resolve this crisis, it created an unprecedented level of oversight not just with the Congressional Oversight Panel, but with the establishment of the SIGTARP and, of course, giving the GAO its usual mandate for oversight.

We take that process very seriously. We have examined carefully everything you have written, recommendations you have made, adopted many, many of the recommendations of the oversight panels, and I think they have made our programs more effective than they would have been. So I welcome that role and compliment you for the thoughtfulness and seriousness of your approach.

I also want to thank you particularly, Mr. Silvers, for what you said about Herb Allison and just say that I have the privilege of working with just exceptionally talented, dedicated people at the Treasury. It is a good thing about our country that people are willing to come, work in Government at a time of crisis, and bring great expertise and talent. You want to have working for the American people, people with the greatest sophistication about financial markets and these things, so that they can drive a hard bargain in the interest of the taxpayer. And I think that the team at Treasury is doing a good job of that.

Just a few initial remarks. Last September, of course, we faced the risk of catastrophic financial failure and the risk of a great depression. And today, I believe because of comprehensive policy actions put in place since then, we are back from the edge of the abyss. The consensus among private forecasters now is that the U.S. economy is now growing again. The financial system is showing very important signs of repair. Cost of credit has fallen dramatically not just for homeowners, for households, but for businesses as well.

Because of these signs of progress, we are now in a position to start to adjust our strategy, moving from crisis response, from the emergency response to recovery, from rescuing the economy to repairing and rebuilding the financial system, to repairing and rebuilding the foundations for future growth. And as we enter this new phase, we have to begin winding down in programs that are

no longer necessary and that, by design, are less needed, less important as the economy recovers.

Let me just highlight a few things that underscore this transition we are in the midst of now. Earlier this year, we put a reserve fund in the President's budget, recognizing the possibility we might need additional $750 billion of authority to fix this problem. Today, we believe that money is unlikely to be necessary. We have removed it from the budget projections. We are borrowing less already than we expected to resolve this crisis.

Later this month, the Treasury's money market guarantee fund will be allowed to expire, earning more than $1 billion in income, no cost to the taxpayer. The FDIC's program to guarantee senior debt, which has generated more than $9 billion in fees, has seen very, very dramatic declines in usage. The suite of facilities the Federal Reserve put in place to provide liquidity to markets, to provide broad support to credit markets, have seen dramatic reduction in usage.

So we are now at a point where reliance on these facilities is down 80 to 90 percent from their peak, from swap lines for foreign central banks to a backstop for the commercial paper market, et cetera. The details are in my testimony.

When I took this job, the Government had outstanding commitments in terms of capital to the U.S. banking system in the range of $240 billion. Today, we have $180 billion outstanding. So that is a dramatic reduction in the scale of our exposure, direct exposure in terms of capital to the financial system, due in large part, to the success of our efforts to force a greater level of disclosure and to make it more possible for private capital to come in and recapitalize this damaged financial system.

The dividends paid on those investments and the warrants you have received now total $12 billion. And for the 23 banks that have fully repaid, Treasury has earned an annualized average return of roughly 17 percent.

Now, all these steps underscore our commitment to unwind these extraordinary programs put in place during the crisis as soon as conditions permit. At the same time, though, we have to recognize that we have to continue to reinforce this process of repair and recovery until it is truly self-sustaining, led by private demand. The classic errors of policy during crises once that governments not only act too late with insufficient force, but they put on the brakes too early. We are not going to repeat those mistakes because to do so would increase the ultimate cost of this crisis not just to taxpayers directly, but in terms of the damage it causes to the fabric of the American economy.

Now, millions of Americans are still suffering deeply from this crisis, still facing probably the most challenging economic and financial environment we have seen in generations. Unemployment is still unacceptably high. The mortgage market, outside what is supported directly by Fannie, Freddie, FHA, is still significantly impaired. Commercial real estate financing remains strained. Small businesses, in part because they are more dependent on banks, have less options to access credit in this difficult environment. And of course, among——

Chair WARREN. Mr. Secretary, we are at 5 minutes. So——

Secretary GEITHNER. I am winding it up. And foreclosures are rising significantly because of the high rate of unemployment we are seeing as a country.

Because of those challenges, we need to make it clear that we are going to keep those programs that are necessary for recovery as long as conditions require. There is a lot of concern that as things have improved, that we are going to let the market go back to the conditions it enjoyed before the crisis, and we are not going to let that happen.

We have seen dramatic restructuring in our financial system already. If you look at the list of the top 20 firms in the country 2 years ago, a substantial fraction of those firms no longer exist today as independent entities. The financial system is going to be smaller, but it is going to be stronger, and that is a fundamentally healthy, desirable thing for our economy. But for that to happen, the Congress of the United States need to come join with us in passing comprehensive financial reforms so we have much stronger rules of the road and constraints in place to prevent this from ever happening again.

I look forward to your questions.

[The prepared statement of Secretary Geithner follows:]

Secretary Timothy F. Geithner
Written Testimony
Congressional Oversight Panel
September 10, 2009

Chair Warren, Representative Hensarling, members Neiman, Silvers and Atkins, thank you for the opportunity to testify today. Mr. Atkins, the last time I appeared before this panel you had not yet joined, so let me first say welcome and thank you for your continued public service.

On October 3, 2008, confronting a financial system on the verge of collapse, Congress gave the Treasury Department unprecedented authority to stabilize the U.S. economy. In doing so, Congress also created an unprecedented framework of oversight to protect taxpayer interests.

The Treasury Department welcomes this oversight and we have adopted a broad range of recommendations made by the Congressional Oversight Panel, the Special Inspector General for the Troubled Asset Relief Program and the Government Accountability Office.

Our nation has traveled a great distance over the past year.

The emerging confidence and stability of September 2009 is a far cry from the crippling fear and panic of September 2008. Back then, the United States was living through one of the worst periods in our financial history. Fannie Mae and Freddie Mac were taken into federal conservatorship; Lehman Brothers went bankrupt and AIG nearly followed; Wachovia, Washington Mutual and Merrill Lynch were sold in distress; and weakness at a prominent mutual fund sparked a dangerous "run" on money market mutual funds.

Policy interventions at the end of last year succeeded in achieving the vital, but narrow, objective of preventing a catastrophic systemic meltdown. But by the time President Obama took office, the financial system remained extremely fragile and the new Administration faced a rapidly evolving set of grave challenges.

In the financial sector the flow of credit to businesses and families had frozen; the issuance of new asset-backed securities (ABS) had essentially come to a halt; and liquidity in a broader range of securities markets had fallen sharply.

In addition, the broader economy was in a free fall. In January we lost 741,000 jobs, the largest single month decline in 60 years; our GDP contracted at a rate not seen in more than 50 years; American families had lost $10 trillion in household wealth; and there was increasing concern we were headed towards a second Great Depression.

Today, thankfully, that is no longer the case.

The consensus among private forecasters is that our economy is now growing; the financial system is showing signs of repair; and the cost of credit has fallen dramatically.

For example, American families are spending less each month on mortgage payments. Because of near historically low interest rates, a family with an average 30-year mortgage is saving around $1,200 each year.

And for businesses, the cost of long-term investment grade borrowing has fallen from a peak of roughly 400 basis points to about 135 basis points today, when viewed as a spread over Treasuries.

Credit is now more readily available. Issuance of corporate bonds has surged, more than offsetting a modest decline in lending by the banking system.

For state and local governments, improved conditions in the municipal bond market have allowed for lower-cost financing to help them through this recession. Last December, higher-rated municipalities – which have historically borrowed at rates lower than the rates on U.S. Treasury securities – were facing interest rates nearly twice the Treasury rate. Since then, the cost of borrowing has again fallen below the Treasury rate, and state and local governments have been able to issue debt at levels in line with recent years.

We still have a long way to go before true recovery takes hold. This Administration will keep at it until that happens. We know that millions of ordinary Americans are suffering through no fault of their own and their well being is the driving force behind every policy we enact and every dollar we spend.

But, a year on from that moment of crisis, it is clear that we have stepped back from the brink and that, as the President recently said, we are pointed in the right direction. It is also clear that such a turn-around was not inevitable, nor was it an accident. It happened because the Obama Administration and Congress put in place a comprehensive strategy that was unprecedented in size and scope.

Our response included the most sweeping economic recovery package in our nation's history, meant to address the dramatic contraction in demand. And it included a Financial Stability Plan designed to recapitalize our financial system with as much private capital and as little taxpayer funding as possible; to repair the institutions and markets that provide credit to American families and businesses; and to stabilize the spiraling housing crisis.

On each front we are seeing progress.

First, since the "stress test" results were released in early May, banks have raised over $80 billion in common equity and $40 billion in non-guaranteed debt. Importantly, that has meant that more than 30 firms have repaid $70 billion in Treasury investments, with the taxpayers earning a double-digit return on these equity investments. It's worth noting that when we first announced that our largest banks would be subjected to the most comprehensive, forward looking examination ever undertaken, the banks were resistant and the markets were skeptical. But the extraordinary level of transparency attached to the tests generated increased credibility and confidence.

Second, the Term Asset-Backed Securities Loan Facility program is helping restart critical channels of credit to American households and businesses. Since March, the TALF program has backed nearly $62 billion of consumer and small business credit; over 2.7 million consumer and small business loans and leases; and over 200 million active credit card accounts.

Since the peak of the crisis, spreads for the asset classes backed by the program have come down from between 50 to 85 percent. Spreads on credit card and auto loans have fallen from a peak of 600 basis points to approximately 100 basis points over the benchmark, the same levels that existed before Lehman Brothers went bankrupt in September 2008. In addition, investors are gaining confidence in the market without the need for government support. In March approximately 60% of new ABS issuance was purchased with the support of our program. This month that is down to 40%.

Third, to help clean up the balance sheets of major financial institutions and re-liquefy key markets for financial assets, we proposed the creation of a public-private investment program for the purchasing of legacy loans and securities. Since the announcement of the program, non-agency mortgage-backed securities have gone up substantially in price. Prime fixed rate securities issued in 2006 that traded as low as $60 in March have increased in value by over 40 percent as liquidity has come back to the markets. That improvement in financial market conditions has created the positive backdrop to proceed with the program at a scale smaller than initially envisioned.

Fourth, the Administration attacked the housing crisis across multiple fronts using various authorities. We boosted demand by implementing a new homebuyer's tax credit in the Recovery Act, which over 314,000 Americans have used to date. We supported historically low mortgage rates by strengthening confidence in Fannie Mae and Freddie Mac, including through a $200 billion increase in stock purchase agreements, enabling American families to reduce the cost of their monthly mortgage payments by refinancing. Given that many Americans were unable to refinance because their loan to value ratio was above 80, we expanded our refinancing program to include borrowers with loan to value ratios up to 125, providing the opportunity for more underwater homeowners to refinance. And we created a $75 billion loan modification program, including $50 billion in Troubled Asset Relief Program funds, designed to allow 3 to 4 million families the chance to stay in their homes.

To date, over forty-five servicers have signed up for our Making Home Affordable Modification Program, including the five largest. Between loans covered by these servicers and loans owned or guaranteed by the government sponsored entities, more than 85% of loans in the country are now covered by the program. In addition, these participating servicers have extended offers on over 500,000 trial modifications and over 360,000 trial modifications are currently underway.

Finally, I would like to provide an update on our support for the auto industry. The New General Motors and the New Chrysler recently emerged from expedited bankruptcies and are operating as independent companies. The government's support in that process has prevented substantial job losses, led to an orderly restructuring, and stabilized economic and financial markets. In

exchange, the taxpayer received equity stakes, warrants, and direct loans in each company, along with a government commitment to manage that investment commercially and exit its position as quickly as is practicable.

The government is a reluctant, careful shareholder in General Motors and Chrysler. It committed tax dollars on the strict condition that these companies and their stakeholders were willing to fundamentally transform, address prior bad business decisions, and chart a path toward long-term financial viability without ongoing government assistance. Throughout the restructuring process, the Auto Task Force has refrained from intervening in the day-to-day decisions of these companies. Such intervention could seriously undermine the companies' long-term viability and, consequently, their ability to repay the taxpayer for its investment.

The termination of the Auto Warranty Commitment Program demonstrates the government's prudent use of taxpayer funds and commitment to exit. The government invested $641 million in the Warranty Program to give confidence to GM's and Chrysler's customers during a period of substantial uncertainty. Following the companies' emergence from bankruptcy, the money invested in the program has been returned, along with interest payments from New Chrysler.

Because of these early signs of progress in each area, we are now in a position to evolve our strategy as we move from crisis response to recovery, from rescuing the economy to repairing and rebuilding the foundation for future growth.

As we enter this new phase we must begin winding down some of the extraordinary support we put in place for the financial system.

Earlier this year, we added a contingency fund to the President's budget to provide for the possibility that we might need another $750 billion in stabilization funds. Today, we believe that money is unlikely to be necessary and we have removed it from budget projections, lowering this year's deficit.

Later this month, Treasury's guarantee program for money market mutual funds, which, at its peak, covered over $3 trillion of combined fund assets, will end. While the program had no direct cost to taxpayers, it earned more than $1 billion in income.

The FDIC's program to guarantee senior debt (TLGP), which has generated more than $9 billion in income, has seen significant declines in usage as private sector alternatives become more economic.

Many of the programs to provide liquidity were designed to phase down as markets improved and government guarantees became more expensive. That planned phase down has taken place, dropping usage of the Federal Reserve's Commercial Paper Funding Facility (CPFF) by 87 percent, the Asset-Backed Commercial Paper Money Market Fund Liquidity Facility (AMLF) by 99 percent, the Term Auction Facility (TAF) by 57 percent, and the Federal Reserve's program on currency swaps by 90 percent. Financial institutions paid to use each of these programs, and they generated considerable income for the taxpayers with no significant losses.

Over the past eight months, support needed for the banking sector has decreased significantly. When I took on this job, the government had outstanding commitments of $239 billion to banks. Since then we have invested $11 billion through the Capital Purchase Program in more than 350 financial institutions, while banks have repaid more than $70 billion, reducing the total size of the government's capital investments in the banking system to $180 billion. We now estimate that banks will repay another $50 billion over the next 12 to 18 months.

The dividends paid on those investments and the repurchases of warrants we received for those investments now total about $12 billion. For the 23 banks that have fully repaid, Treasury has earned an annualized average return of roughly 17 percent.

These are all important steps towards recovery. But we must remember that it took years for this crisis to take hold. Given the extent of damage done to the financial system, the loss of wealth for families and the necessary adjustments after a long period of excessive borrowing around the world, it is realistic to assume recovery will be gradual, with more than the usual ups and downs.

Going forward, we must continue reinforcing recovery until it is self-sustaining and led by private demand. The classic errors of economic policy during crises are to act late with insufficient force and then put the brakes on too early. We are not going to repeat those mistakes.

Unemployment is still unacceptably high; the mortgage market, outside those covered by Fannie Mae and Freddie Mac, is still significantly impaired; commercial real estate financing remains extremely strained; small businesses are still grappling with unusually tight credit in part because they have few alternatives to banks for loans; and as job losses continue, families are finding it increasingly difficult to meet their mortgage payments causing foreclosures to rise.

We are going to do everything necessary, for as long as is necessary, to make sure American families and small businesses see sustained, material improvement in their lives.

In addition, the critical imperative we face as a country is making sure that the same vulnerabilities in our system which gave rise to this recession are not allowed to trigger another. To do that, we must pass comprehensive regulatory reform legislation by the end of the year.

The Administration's proposals are focused on three key areas: protecting consumers, making the financial system more stable, and creating better tools to respond to financial stress in large, interconnected institutions.

There is broad agreement that consumer protection needs to be stronger. Achieving this objective requires mission focus, market-wide coverage and consolidated authority, none of which exist in today's system. That is why we are proposing a Consumer Financial Protection Agency to make sure that responsible Americans receive the protection they deserve and access to fair and transparent mortgages and credit cards.

The need is undeniable. With 78 percent of American families using credit cards and 44 percent carrying a balance, deceptive terms and practices affect nearly every family. More than half of the high cost loans at the center of the mortgage crisis were made to middle class families and in middle class communities. And yet there was no federal regulator dedicated to consumer protection.

To make the system more stable, we have proposed requiring financial institutions to hold more capital and manage liquidity risk more effectively; closing loopholes in regulation; requiring stronger federal supervision of all major financial firms; putting the market for over-the-counter derivatives under a comprehensive system of regulation; evolving the Federal Reserve's authority to create a single point of accountability for the consolidated supervision of all large, interconnected firms; and creating a Financial Stability Oversight Council to bring together all regulators to identify emerging risks and coordinate responses.

And to provide the government better tools to respond to future crises, the Administration has proposed new resolution authority. The Administration's proposal gives the government a legal mechanism, similar to the authority that the FDIC already has for managing the closure of insured depository institutions, to more effectively manage the wind down of large non-bank financial institutions in a way that protects taxpayers.

We have come a long way since this panel was first created. While significant challenges remain, and while a great deal of work still needs to be done, it is important to remember that a year ago our financial system stood at the verge of collapse. We remember that because where we stand today is testament not just to the President, not just to Congress but to the resilience of the American people.

This is a moment of great challenge and consequence. But as our nation has done time and again, we will not simply recover from this crisis, we will rebuild and emerge stronger than before.

Chair WARREN. Thank you, Mr. Secretary.

Secretary GEITHNER. I was only about 6 minutes.

Chair WARREN. And 19 seconds.

[Laughter.]

Chair WARREN. A year ago, Secretary Paulson told us that we were in a financial crisis because of toxic assets on the banks' books. In fact, he came to Congress and explained that Congress needed to give $700 billion to the Treasury Department to deploy in order to remove those toxic assets, and we have had a year to get rid of them.

Does Treasury know how many toxic assets remain on the books of the banks? Do you have a dollar figure for that?

Secretary GEITHNER. Given the stress tests we put the U.S. banking system through, you now have an unprecedented level of disclosure for the 20 largest banks in the country about exactly what loans and securities they hold, with a pretty careful estimate of the potential losses on those exposures you might face in a worse economic environment. That gives a much better picture today.

But the critical thing to recognize is and the reason we care about these toxic assets and their losses is because they require capital. And we came into this crisis with a banking system that did not have enough capital to cover losses in a deep recession, and that is what helped produce the worst financial crisis in generations.

Because we put the system through this incredibly exacting set of stress tests with much more disclosure, the banking system today has much more capital in it, and that makes it much less likely that the financial system is going to be a source of headwinds, a constraint on future recovery.

Chair WARREN. I understand——

Secretary GEITHNER. Now, if they had not been able to raise private capital, if they were still left with too little capital against potential losses, then we would be facing a much greater challenge. But the problems posed by those assets are substantially addressed by the dramatic improvement in capitalization of the financial system.

Chair WARREN. So let me see if I can just pin this down, though. You say for the 20 largest banks for which we have stress tests, you believe we have a sense of how much is left in the way of toxic assets on their books?

Secretary GEITHNER. Absolutely.

Chair WARREN. Do we have a dollar figure for that?

Secretary GEITHNER. Well, again, I would be happy to——

Chair WARREN. For the 20?

Secretary GEITHNER [continuing]. Summarize for you or have the Fed summarize for you. They put out a lot of detail on exactly very detailed composition of exposures by those banks.

Chair WARREN. And for all the banks for which a stress test was not run, do we have any sense of how much remains in the way of toxic assets in the banks, in these books?

Secretary GEITHNER. My compliments to you for highlighting this question. We are a country of 9,000 banks, not just 20 banks.

Chair WARREN. Yes. That is right, although fewer every day.

Secretary GEITHNER. Fewer every day, but that is sort of a necessary process of repair and restructuring that we are going through. But many of those banks came into this crisis with more capital than the big banks held, but many of them also had more concentrated exposure to commercial real estate, other real estate investments. So there are challenges ahead for the financial system as a whole.

Now, we decided not to put the rest of the U.S. banking system through the kind of exacting stress tests that we applied to the biggest institutions. A lot of complicated judgments went into that, and so you are right to point out that we are left today with somewhat less disclosure of that.

But the supervisors of the country are spending a lot of care and attention looking at those risks in those institutions, helping them work through that. But you are right to highlight this is a significant challenge ahead.

Chair WARREN. Okay. So when——

Secretary GEITHNER. But it is important to recognize that those remaining 9,000 banks together account for between a quarter and a third of the U.S. banking system.

Chair WARREN. All right.

Secretary GEITHNER. Or a much smaller share. So we are probably likely as a country to be able to manage and withstand those remaining pressures, and we can do so with much greater confidence because of the actions we took to stabilize the rest of the system.

Chair WARREN. So when the Washington Post this morning summarized yesterday's Federal Reserve report, the Beige Book, they summarized it by saying the banking sector remains a mess. Would you take issue with that characterization?

Secretary GEITHNER. I guess I would say it this way. I think the U.S. financial system today is in substantially stronger shape than it was 3 months ago, 6 months ago, 9 months ago, and on the eve of this recession. There is, again, more capital, greater recognition of losses, and we are in a better position to get through this.

But remember, this is just the first quarter. We are just starting to see signs of growth. It is very early, and we did a lot of damage to the financial system of this country, and it is going to take a while to get through this. And it is going to take longer to do it because we are going to do it right.

So I would not want anyone to be left with the impression that we are not still facing really substantial challenges throughout the U.S. financial system. And where there has been improvement, it has been dramatic, much more than I would have expected at this stage in the crisis. But a lot of that has come through the direct effects of policies—to put capital in banks and to provide support for the markets that were most damaged.

We do not have a mortgage market today except for that directly supported by the Government, and that sort of underscores the basic fact that we have got a lot of challenges ahead.

Chair WARREN. Okay. Thank you, Mr. Secretary.

Congressman Hensarling.

Mr. HENSARLING. Thank you, Madam Chair.

Mr. Secretary, under the EESA statute, how do you define financial institution?

Secretary GEITHNER. I was looking forward to this discussion, and I think I understand where you are going. The statute was written, as you implied in your opening statement, really quite broadly. And as you also said in your opening statement, my predecessor—the previous administration—made a judgment not just that it was in the economic interest of the country to provide support for the automobile industry, but that it was legal and appropriate to do so using the EESA legislation.

Mr. HENSARLING. And you concurred in that opinion?

Secretary GEITHNER. And obviously, we would not have spent a penny of taxpayers' money using that authority if we did not concur in both those judgments.

Mr. HENSARLING. If you concur, then clearly, you believe that Chrysler and GM are financial institutions. Is AT&T a financial institution?

Secretary GEITHNER. If you look at the plain facts of what I inherited in terms of judgments like this, I understand why it might be hard to explain why an automobile industry is a financial institution. But again, that was the judgment made by my predecessor and under——

Mr. HENSARLING. I understand that, Mr. Secretary. But you voluntarily chose to continue the practice——

Secretary GEITHNER. Only——

Mr. HENSARLING [continuing]. And I am still trying to figure out your legal interpretation of the EESA statute. And so, clearly, I assume you don't believe you are breaking the law. So you believe that Chrysler and GM meet the statutory definition of a financial institution. So we have a number of——

Secretary GEITHNER. As the law was written.

Mr. HENSARLING. Well, of course. So, again, the question is, is AT&T a financial institution? Is American Airlines a financial institution? Is Walmart——

Secretary GEITHNER. No and no.

Mr. HENSARLING. No and no.

Secretary GEITHNER. But Congressman, I think it is important to recognize two important things. One is that I did not design this statute. I was not in office when it was written into legislation.

Mr. HENSARLING. I assure you I didn't either, Mr. Secretary.

Secretary GEITHNER. But it did what was necessary for the country, which is to give the executive branch of the United States broad authority and discretion to fix this. And the fact that we waited so long to make that authority available made this crisis more damaging and worse.

One important fact—In a crisis of this severity, a recession this deep, we have things that we would never want to do.

Mr. HENSARLING. Mr. Secretary, I understand that. As you well know, Congress had—the House had legislation that dealt specifically with the automotive industry. So there were at least some members of the House who clearly did not believe that Chrysler and GM came within that statutory limit.

So what I hear is Chrysler and GM, yes, are financial institutions. AT&T, American Airlines—happen to be two Dallas-based

companies—are not. So, is there any additional clarity—and I believe one of the things the markets continue to demand is clarity of public policy.

Who will you bail out? Who will you not bail out? And so, I again ask you for some clarity on what is a financial institution?

Secretary GEITHNER. Congressman, I don't think we are going to be able to take this further.

Mr. HENSARLING. Okay.

Secretary GEITHNER. But I want to revise slightly how I responded to your question about AT&T and American Airlines. I would say it slightly differently, which is I do not believe you can read the statute today to justify action beyond the scope of the actions we have taken in this context.

Mr. HENSARLING. Well, I personally——

Secretary GEITHNER. Now, things might change in that case.

Mr. HENSARLING [continuing]. Hope, Mr. Secretary, that the legal interpretation of a statute doesn't change with the passage of a handful of months.

In the remaining time I have on this question——

Secretary GEITHNER. No. That is clarity in the sense that we have to pass two tests to use this authority. One test is does the law give us the authority to act? And the other is, are those actions necessary and prudent in the interest of fixing this mess, restoring financial stability?

It is not the simple test of what——

Mr. HENSARLING. Mr. Secretary, forgive me. Unfortunately, our time is constrained, and I may have time for one more question here. Leaving the question of the definition of a financial institution, there are roughly, I don't know, six, eight major programs under TARP now. And I am curious, having been serving on this panel for almost a year, I think with perhaps one exception, I am having trouble discovering where Treasury has identified any particular metrics of success beyond financial stability——

Secretary GEITHNER. I would be happy to help you on that.

Mr. HENSARLING. Well, I look at the Capital Purchase Program. Its purpose is to stabilize the financial system, the automotive program, prevent significant disruption of the automobile industry that could pose systemic risk to the financial market stability——

Chair WARREN. I am going to have to stop—I am going to have to stop you there, Congressman. I am going to be disciplined about time.

Secretary GEITHNER. But could I say I think that——

Chair WARREN. I will give you 20 seconds.

Secretary GEITHNER. Okay. You can look at each of these programs, and this is the great virtue of the markets, and you can see almost day-to-day evidence of whether they are having an effect in lowering borrowing costs, improving confidence in the stability of the system.

For example, you can look at the cost of borrowing for businesses and families, the cost of mortgages, confidence in financial institutions, price advantage. Those things are a good day-to-day indication of where these programs are having effect, and you can see a big impact——

Chair WARREN. Thank you, Mr. Secretary.

Mr. Silvers.

Mr. SILVERS. Yes, Mr. Secretary, I want to pick up, I think, on the threads of your testimony, which I think flow very nicely into the real issues facing the country right now, which do include the question of the unemployment rate.

A couple of weeks ago, in two parallel stories in the Washington Post, the following statement was made on the front page. The wounded U.S. economy, and I quote, "has shown signs of improvement in recent weeks, but many economists are accentuating the negative, bracing for headwinds"—you mentioned headwinds—"that could cause the recovery to be weak. Huge swaths of the financial system have been damaged, which could lock consumers and businesses out of loans for years to come."

Next to that story was another story about Asia. You are smiling. You probably read the same papers I do. And that story says the Asian recovery was—I won't quote it, but to the effect of the Asian recovery has been far more robust than ours, and a key factor in that has been the relative strength of Asian banks.

Now, do you agree with this characterization that appeared in The Post of the circumstances we find ourselves in?

Secretary GEITHNER. There are several important points to start with. In the best of times, we grow roughly an average of 2.5 percent a year. For an emerging market economy, in China, India, Brazil, Mexico——

Mr. SILVERS. Mr. Secretary, I think Japan was the—Japan was the comparative here.

Secretary GEITHNER. Yes, I doubt that you are going to see a more robust recovery there than here. But I would say, again, you need to think about that relative comparison. I think that we are in a position where it is much less likely today that weakness in the banking system or in the rest of the financial sector proves to be a substantial constraint on the pace of recovery here.

The dominant constraint on pace of recovery here is the basic reality that as a country we borrow too much, save too little, live within our means, and the process of correcting that pattern of behavior is going to necessarily produce a slower recovery for the United States.

Mr. SILVERS. Mr. Secretary, why is it, in your view, that the weakness of the banking system, and particularly the three out of the four largest banks, whom you are, I believe, correctly not allowing to repay TARP money—in light of your comments about the fact that, to take an example, the mortgage market is a creature right now of your efforts, and secondly, as you noted in your written testimony that business lending—not just small business lending, but business lending by banks is going the wrong direction quite seriously, why is that not a problem?

Secretary GEITHNER. I think it is a problem, and I said we are in a much better position today than we have been and we could have expected to be. So it is much less likely today that it will be a constraint.

But just a few observations. Bank lending, as you point out correctly, is declining, but it's declining much, much less than it has in past recessions and much less than the decline in economic activity in part because we have been, again, relatively effective in

restoring some confidence and stability. The decline in bank lending has been more than offset by the increase in borrowing in the securities markets.

So, overall, what we are seeing is a reduction in demand for credit. Again, as people improve their balance sheets, save more, spend less, there is less evidence of a substantial contraction in the supply of credit. But it is still early. Largely because of the forceful actions we took and the support we will continue to provide, it would not be appropriate or prudent for us to infer from that sign of progress that we are at the point where we can wind it back completely.

Mr. SILVERS. Just to come back to that one sentence in your written testimony, which I found by far the most interesting—no offense to the rest of it—is that is it really a good thing that essentially credit provision has moved away from the banking system to the extent that it is going on, particularly with respect to the fact that most employers, most creators of jobs, can't access the bond market?

Secretary GEITHNER. It is an interesting question. But remember, our banking system took on too much leverage.

Mr. SILVERS. Unquestionably.

Secretary GEITHNER. So, inevitably, the banking system leverage was going to have to come down. That was a necessary. The consequence is that you are going to see less growth in lending by banks. I think it is important to the future stability of our system, that there are alternatives to banks in the capital markets that actually work.

So if there is weakness in banks, there is an offsetting source of strength, and vice versa. So part of the reform process we are all committed to is not just to make sure there is stronger capital in banks, much stronger shock absorbers in banks, much better capacity to absorb future risk, but that the securities markets, asset backed and others, have a stronger, more robust framework because that will make our system more stable in the future.

Mr. SILVERS. My time has expired. I will come back to you next round.

Chair WARREN. Thank you.

Commissioner Atkins.

Mr. ATKINS. Thank you, Madam Chair.

I wanted to start out by looking ahead, I guess, if we could. Because as I said before, the authority under EESA expires at the end of this year, and you have the authority to certify that it should be extended with appropriate justifications under the statute. And no one would be happier than I to see it meet its end.

But according to the statute, your certification should include a justification why the extension is necessary to assist American families and stabilize financial markets, as well as the expected cost to the taxpayers for such an extension. So I guess my first question is, have you made a decision yet one way or the other?

Secretary GEITHNER. No. I have not yet decided. We are going to think through that carefully.

Mr. ATKINS. Well, and that is what I wanted to explore because this is rather for a statute—no offense to the congressman here who didn't vote for it anyway—but it is very squishy, and it is real-

ly questionable to me what it means, for example, to stabilize financial markets. You just said that you have been relatively effective in restoring stability.

So when you determine that the markets have been stabilized, are you comparing it to a year ago, in which case they are much more stable; 3 years ago, in which case they might not be? What kind of markets would you look at—U.S. stock market, commodities, international markets, the dollar? I mean, I think all of these things need to be carefully looked at, but I don't know if you have started this process.

Secretary GEITHNER. I completely agree with you, and I think you listed a range of important factors. You want to look at, again, what is the capacity of the financial system to live on its own now without these exceptional supports? How likely is it that you are going to see enough repair and strength in the securities markets, not just in the banking system, for us to withdraw that support?

I think that some of these programs realistically are going to take a longer time for them to work. For example, the expected path of foreclosures in the United States is going to last for a long time. So it is very, very unlikely that we are going to be at the point in the next few months to have said that the housing market is at a point where we can be confident that we can withdraw these exceptional actions.

There are parts of the credit markets in asset-backed securities where there has been very substantial improvement, but a lot of that has come on the strength of the basic backstop we have provided. So we want to look at a broad set of measures of basic health in the system, and we want to make sure that people are confident that we are going to get the economy on a strong foundation before we withdraw it.

Because as I said, again, I think the classic mistake people make is that they declare victory too soon. They put on the brakes too early. They withdraw support and then the system has to go back and build more insurance against the risk of a bad outcome, which could intensify the recession or reignite——

Mr. ATKINS. Well, but contrary wise, too, you can also make a mistake of leaving the crutch on too long, and the patient then gets too dependent on that.

Secretary GEITHNER. You are exactly right.

Mr. ATKINS. And we are talking about moral hazard, which I hope that as you all do your cost analysis here, you have to take that into account because I think that is a huge usually undermining factor of our financial system.

Secretary GEITHNER. I completely agree with you, and I think you said it exactly right. But let me just point out one thing that is helpful on that front.

Largely, these programs are designed so that they will be expensive when things normalize. And that is why you have seen use of these programs dramatically decline as conditions have improved. This helps mitigate the risk that people rely on these programs too long.

Mr. ATKINS. But I think you could argue that, for example, the warrants are, even now, relatively under priced. I mean, sure, the taxpayer is making a nominal profit. But query whether or not in

relationship to the humongous risk that the taxpayer took a year ago, is that recoupment commensurate with the risk that was taken?

Secretary GEITHNER. I like the way you frame it. I think we need to look at two things in measuring the effectiveness of these programs. One is what was the direct measured benefit to the taxpayer in terms of the return on the risk we took? But that is not sufficient.

The best way to measure the effect of these programs is to take a broader view of what you did to help get this economy out of crisis into recovery. And that is a harder thing to measure.

Mr. ATKINS. Right.

Secretary GEITHNER. But still, if you look at almost any measure of cost of credit—confidence in the financial system, availability of credit, concern about risk—all of those measures are dramatically lower, and that is the fair way to capture the return on these investments, not just the 18 percent return on average we have gotten on our investments and warrants.

Mr. ATKINS. So that argues in a way for ending the program——

Secretary GEITHNER. No, I don't think it does because, again, I think the art of this—and there is no science to it. The art in this is if you commit to do enough and you make that credible to people, you are not going to be behind always chasing a crisis, and you are more likely to solve it at lower cost.

If you prematurely pull it back, you are going to live with too much risk. It is going to be more expensive in the future. That is the basic central design of effective strategy in financial crises.

Chair WARREN. Thank you, Mr. Secretary.

Superintendent Neiman.

Mr. NEIMAN. Thank you.

Mr. Secretary, the new Treasury servicer report on mortgage modifications represents, I think, an important step in data access and accountability. But it also confirms in the report just issued this week that there are wide disparities among the rates of modifications. Some firms, as you well know, have not started any trial modifications, while many more firms have started rates in the low single digits.

You held an important meeting with servicers on July 28th to discuss these very issues. I was also encouraged yesterday to hear Assistant Secretary Barr's House testimony with respect to new commitments that have been made in key areas such as the speed of implementation, data collection, and borrower outreach.

Now the report that was just issued shows that there are trial modifications started, and the number is around 360,000. These would indicate only about 12 percent of estimated eligible borrowers. Secretary Barr indicated that servicers have committed to increase that number to a total of around 500,000 trial modifications by November 1.

Based on that, your benchmark of reaching 3 million to 4 million homeowners who are at risk, are you satisfied we are on that track? Have we set realistic expectations? And even more importantly, is the real risk and challenge in converting those trial mods to permanent sustainable modification?

Secretary GEITHNER. You describe the facts and the progress and the challenges absolutely right. It is not enough just to have sent out $1.8 million of solicitations to participate in modification, which is the numbers we have approached now, or almost that level. It is not enough that you have close to 500,000 offers extended, it is not enough that you have more than 350,000 households now benefiting from substantial reductions in mortgage interest rates. You need to make sure these modifications are going to work over time, and we are very focused on making sure this program reaches as many eligible homeowners as possible.

Two important points. It is very helpful to put in the public domain every month detailed numbers that allow the American people to see the number of people these banks are reaching. And I am quite confident that will produce much, much faster modifications much more quickly because institutions do not want to live with the consequences of being so far behind the curve of what is possible in helping families get through this exceptional set of problems.

We also want to make sure that we are going in after the fact and looking at whether people are denying eligible homeowners access to modification. So there is a so-called second look program. That is a softer form of what it actually is, which is a program of auditing to make sure that they are not denying eligible homeowners the chance to participate.

So I think this is going to reach a substantial share of people that are eligible. But it is important to recognize that this was just one part of a set of actions we took to help stabilize the housing market, to bring down mortgage interest rates. And those actions when viewed in total, have helped bring down mortgage interest rates to very low levels, and it helped bring a measure of stability to housing markets, housing prices, housing activity faster than many economists had forecasted.

And it is that broader measure that should be the ultimate test of this program.

Mr. NEIMAN. I think I would be interested in your comments about the continued obstacles to effective and increasing the effectiveness of servicer participation. I will do that in a follow-up QFR.

But what we are hearing in talking to servicers is there is still concern about outreach, getting documentation back from servicers. Some creative approaches that I have heard from servicers are, because people are not responding, to going out physically and visit. I would like your thoughts on other creative approaches.

I have suggested in the past possibly even letters from yourself or ideally, the President of the United States to assure that people are opening their mail, realizing that this is not just another creditor notification, but a real response and involvement from the Government.

Secretary GEITHNER. We welcome those suggestions. And of course, we are very pragmatic. We want this to work, and we will take and act on any reasonable suggestion.

I think you are right to point out for this to work, people need to take some initiative, to ensure they get help. But, 350,000 families today have seen a dramatic reduction in the cost of carrying

their mortgage, there is more money in their hands at a time when they are going through an enormous challenge.

Chair WARREN. That is our time.

Mr. NEIMAN. In my 10 seconds I have left, I just want to—we will be holding a hearing on September 24th in Philadelphia on this very issue, and we would look for support from your office to assure that we have representatives from the Treasury and Fannie Mae and Freddie to go over those very programs that you reference, particularly the second look.

Chair WARREN. A good use of your extra 20 seconds there.

Mr. NEIMAN. Thank you.

Chair WARREN. Thank you, Superintendent Neiman.

So I would like to return, Secretary Geithner, to a point you raised, and that is that the stress tests are effectively the tool by which we have measured the strength of the 20 largest financial institutions, and that is what gives you confidence both that we understand the risk of exposure on the toxic assets and the overall projections on how stable these institutions are.

But the worst-case scenario under the stress test for 2009 projected average unemployment for the year at 8.9 percent. As you know, the current unemployment rate is 9.7 percent. The average for the year has now reached 8.9 percent. So the panel has recommended that under those circumstances, the stress tests be repeated for these financial institutions. Does Treasury plan to do that?

Secretary GEITHNER. It is important to start determining whether this was a conservative enough stress test, and the measure of the forecast for growth in employment that was framed as part of that scenario is not significant. The most important thing to observe was the loss rates that were assumed in the worst-case scenario. And if you look carefully, as you have done, at what the Fed designed and produced, the loss rates that were assumed in the stress scenario were worse than peak losses experienced by this country in the Great Depression.

So they assumed roughly loss rates in the stress test could rise as much as 9 percent. We are now more in the 2 to 3 percent range. Over the last quarter, losses are running well below that level and in earnings are running substantially above the assumptions. So——

Chair WARREN. Mr. Secretary, I am sorry. Let me stop there because you are the one who put out what the appropriate details were in the stress test.

Secretary GEITHNER. Actually, the Fed designed it, as you would expect, and they are the ones who put it out.

Chair WARREN. That is right. The Fed designed. But you are the one who advanced it and said we could rely on it. And one of the featured elements was unemployment, and we all know that unemployment relates very closely to the level of foreclosures, which, in turn, relates very closely to the value of the toxic asset, the declining value.

Secretary GEITHNER. But the framing constraint in the stress test was the loss estimates that were applied and the earning estimates that were constrained. Those did not relate to the unemployment forecast. So, again, what matters——

Chair WARREN. Is not what you advertise?

Secretary GEITHNER. No, we put in the public domain for everyone to see and assess for themselves what the loss rates were.

Chair WARREN. You know, Mr. Secretary——

Secretary GEITHNER. So people can judge on their own.

Chair WARREN [continuing]. That raises the question. We would like to be able to rerun the stress tests, and I understood from conversations with you that we would have enough information about how the stress test is composed that reasonable people could sit down, build in other assumptions, and see how the stress test would come out with these major banks. And in fact, we don't have the risk model, and we don't have the data inputs——

Secretary GEITHNER. Again, I would be happy to——

Chair WARREN [continuing]. That make it necessary to repeat them.

Secretary GEITHNER. I would be happy to remedy that. And I would be happy to spend as much time as you would like going through this.

Chair WARREN. That is—I will take yes for an answer.

Secretary GEITHNER. But I need to slightly change the way you framed it. These were an important improvement in the market's capacity to assess risk in these institutions. And on the strength of that improved capacity, you have seen a substantial amount of private capital come into the U.S. financial system.

Now, we never said it was sufficient. There is no certainty in life. Things could change going forward. But I think we have a basis for people to independently assess whether these assumptions were rigorous enough and whether they need to be revisited.

Chair WARREN. And so, let me ask the other half of that, and that is we also asked the question about expanding the stress test to mid-size banks and perhaps even smaller banks in a somewhat modified form. Is Treasury willing to do that?

Secretary GEITHNER. Well, as I said, we said publicly—and I am not going to change this view—at the time of the stress test results that were not going to conduct a similar exercise, bank by bank, across the 9,000 other banks in the country. But what supervisors have done——

Chair WARREN. How about the next 100?

Secretary GEITHNER. Well, again, let me explain what the supervisors have done because this is their job. What they have done is apply a carefully structured framework through the supervisory process to the rest of those institutions. Then, we can have a better sense for making judgments about the rest of the strength of the remaining system. But it is not realistic or feasible for the Fed and the supervisors to conduct the level of detailed assessment required for this to be credible for a banking system that has 9,000 additional banks.

Chair WARREN. Thank you, Mr. Secretary.

Congressman Hensarling.

Mr. HENSARLING. Thank you, Madam Chair.

Mr. Secretary, I don't want to replow the old ground on financial institutions. I agree with you we have probably made about as much headway between ourselves as we are going to make on that.

Secretary GEITHNER. We could try.

Mr. HENSARLING. But I certainly think it is reasonable for anyone to conclude that there is a fair amount of subjective power that is assumed by Treasury in deciding who will receive bailout or economic recovery funds under EESA. I do want to start replowing some old ground in my earlier line of questioning because I am concerned the American people need to know what are we getting for our $700 billion today?

And again, having been on this panel, I started reading from Treasury's Website on the purpose of these programs. And frankly, with the exception of the Foreclosure Mitigation Program, where you offer the goal of assisting 7 million to 9 million homeowners—I think today we stand at roughly 350,000, if my records are correct—I can find no demonstrable metric of success by the administration. So can you enlighten me as you——

Secretary GEITHNER. Again, I would be happy to walk you through, like I do a Murton testimony and the substantial reports the Fed and the Financial Stability Oversight Board have provided. But I just don't think what you are saying is fair.

With these programs, you can see directly not just how much money we are spending, where we are spending it, but what is actually happening to borrowing conditions in those markets because—I will give you an example. One of the most important things we did with the Fed was this program called the Term Asset-Backed Lending Facility, which was designed to provide a backstop of support to the lending markets critical for small businesses, for auto finance, for student loan finance, for credit card receivables, et cetera.

And you can see in detail how much issuance has come with this program, what has happened to the cost of issuance, how much has been directly funded by these programs rather than indirectly supported by it. In the banking——

Mr. HENSARLING. Mr. Secretary, what you are asking us to do, though, is draw, in essence, the cause and effect. Happy to look at the statistics in the economy, but again, coming from an oversight panel here, it is hard not to conclude that essentially you have the subjective power to invest $700 billion on a revolving basis on any institution you deem is a financial institution and that any program will be judged as a success if you deem it a success after the fact. All I am saying is that——

Secretary GEITHNER. No, I don't agree with that.

Mr. HENSARLING [continuing]. I can't find——

Secretary GEITHNER. And I would never claim that. I would just remind you of two things. The Congress of the United States designed the authority Treasury was provided. We are using that authority——

Mr. HENSARLING. And Mr. Secretary, you have the ability under the programs that you design to say here are the metrics for success.

Secretary GEITHNER. Right. However, the great virtue of this program is that you can see not just the return we are getting when people repay, the price we are getting relative to the market, but you can see directly, program by program, what is happening to credit conditions, which is the ultimate test of what we are trying to do.

In fact, you can do better than that——

Mr. HENSARLING. Well, Mr. Secretary, let me ask, if what is happening in the credit markets is the ultimate test—and again, we can question cause and effect—clearly, the LIBOR–OIS spreads 1 month were incredible back in the crisis in September of '08. By the time your administration took office, they went down from 300 basis points to 20 basis points.

Now since your administration has come into power, apparently they are down to 10 basis points. So, certainly, that is an improvement. But it sounds like a lot of this happened on the previous watch.

Secretary GEITHNER. Well, hold on.

Mr. HENSARLING. And again, I don't know what the cause and effect relationship is.

Secretary GEITHNER. Cause and effect is difficult in economics and finance, but it is much easier and more clear in these programs than in these markets where we try to measure the effects of economic policy. And you are right to point out that the actions taken by my predecessor, which, of course, I was part of, did have an important effect in breaking the panic in the fall of 2008. But it is also true that almost any measure of financial health for this country, in January of this year, was still in signs of emergency. And——

Mr. HENSARLING. But Mr. Secretary, again, the question is what is the taxpayer getting for their money today? We can debate what purpose it served a year ago.

Secretary GEITHNER. I will tell you what the taxpayer is getting. You have a financial system that is more stable. Credit is more available. People can borrow at much lower cost. And the taxpayer of the United States can observe the returns in the investments we have made in the banking system in terms of actual billions of dollars.

Mr. HENSARLING. Well——

Secretary GEITHNER. There is no better measure than the return of these programs, and I would be happy to——

Mr. HENSARLING. How about an additional 2.5 million jobs lost, the highest unemployment rate that we have seen in 25 years, mortgage delinquencies and foreclosures up? Mr. Secretary, it is a mixed report card at best.

I see my time is up.

Secretary GEITHNER. But Congressman, no one is going to——

Chair WARREN. Our time is up.

Secretary GEITHNER. I was very clear in my statement. It is only now we are seeing positive growth for the first time. Unemployment is still very high and could stay high for some period of time. We are not close to being through this. But on the clearest, direct measures of the program we were tasked with executing, we have made more progress than I think people reasonably expected. Not enough yet, though. And we are going to keep at it.

Chair WARREN. Thank you, Mr. Secretary.

Mr. Silvers.

Mr. SILVERS. Mr. Secretary, I want to take this up from a sort of different angle. I think one of your achievements—clearly yours, not the prior administration's—in the stress tests was to put an

end to the fiction that all banks were equally healthy. I understand why that fiction was indulged originally. I don't think it was done out of bad faith or for anything other than the best of reasons, but it was important to put an end to it.

However, I think many of the characterizations of success that you have just indulged in with my colleague are due to unwinding funds that were given to strong banks. And when they paid them back, they paid them back at a profit, and that was never where the risk was embedded anyway. I mean, there was always some risk, but the big risks were not there.

So I want to turn to weak banks. And I hope you will indulge me in what may seem a little peculiar sort of questioning. Can you explain to me and to the listening public what is a "zombie bank," and why is it so dangerous?

Secretary GEITHNER. I don't ever use that term myself because I don't think it helps anything. I think the risk in any financial crisis is if you have a banking system that doesn't have enough capital, they will have to reduce lending. And viable businesses or families will not have access to credit, and therefore, they will be forced to shrink or go out of business or delay a college education for their children.

That is why the health of the banking system matters, and that is why it is a good use of policy and financial resources to try to make sure you bring capital in. So you are not living with a set of institutions that are too weak to lend.

Mr. SILVERS. Too weak to lend. Is it fair to say that those people who like the term "zombie bank" mean by it the walking dead, meaning an institution that is not in receivership or insolvent, but is too weak to lend? Is that a fair characterization of that term?

Secretary GEITHNER. I think I just said it. Again, I don't——

Mr. SILVERS. You know——

Secretary GEITHNER. I am being less graphic than you, but I think you have got the right concept.

Mr. SILVERS. Okay.

Secretary GEITHNER. Where are you going with this?

Mr. SILVERS. Well, I thought I got to ask the questions.

[Laughter.]

Mr. SILVERS. Where I am going with this is whether or not you like graphic terms, graphic terms sometimes have the ability to clarify things that otherwise seem very mysterious. Whether or not you like graphic terms and whether you use the terms I just used or the terms you used, in your view, is Citigroup such an institution today?

Secretary GEITHNER. No.

Mr. SILVERS. Why?

Secretary GEITHNER. This won't satisfy you, Mr. Silvers. I can't talk in this context, and I will never talk in this context about the detailed outlook for individual institutions in our country, no matter which they are in this case. So I want to return to where I began, which is that the best test of whether these programs are working is whether you are seeing private investors in this country and around the world willing to come in and provide capital to those institutions, to provide funding for them.

And one of the great virtues of the stress test was it gave them a chance to make that choice, and they basically voted with——

Mr. SILVERS. Mr. Secretary, how can you be sure? And I recognize the cause and effect issues that you mentioned earlier are real in these areas. But how can you be certain that what you didn't really do in the stress test was signal that you, the Treasury Department and the Fed, were not going to further hammer the capital structures of these banks and that they could be invested in because there was an implicit guarantee behind them, even though they remain at their core not really functioning institutions or, to use the graphic term, zombies?

Secretary GEITHNER. Again, you are right to point out that we did a range of other things besides just making it possible for private capital to come into these banks. Part of that included the set of guarantees, liquidity facilities that the Government and the Fed provided together. Those were important and necessary and have been helpful in restoring confidence.

But again, I think, by any measure, you have the system that we have today, which is in a smaller, but stronger capacity to support the economy going forward. That is the ultimate test of what we are trying to do.

Mr. SILVERS. Mr. Secretary, I am going to refrain because I think folks at Citigroup may feel I am picking on them. I was going to ask you about Bank of America and Wells in order. I am not going to spend the time doing that because you are not going to answer, and I appreciate why you feel it would be inappropriate for you to be specific with respect to particular institutions.

Those three institutions are a macroeconomic problem, right? And they go directly to jobs. As this panel has gone through the country talking to people who are trying to create jobs, we hear over and over again that in various ways—whether it is agriculture or with commercial real estate or large firms or small firms—we hear over and over again that the system is weak, and the large institutions are not stepping up.

Chair WARREN. Mr. Silvers, that is our time.

Mr. SILVERS. I am done.

Chair WARREN. Commissioner Atkins.

Mr. ATKINS. Thank you, Madam Chairman.

I wanted to go back to the statute a bit because one of the other provisions of the statute regarding TARP is that the Government Accountability Office is to do an audit, and I think, significantly, it is not under Government accounting rules, but under GAAP and GAAS, which will be, I think, interesting. So they are going to have to get to some of these issues if they are going to do a balance sheet and a P&L statement and all that sort of thing. They are going to have to look at cost and what not.

So I guess my question is, first of all, has this been scoped out yet as far as the audit goes? Where does that stand?

Secretary GEITHNER. I don't think I can do adequate justice to that today, but I would be happy to get back to you in writing with exactly where that process stands.

Mr. ATKINS. Okay.

Secretary GEITHNER. I know that we have a response to put out in terms of a broad financial statement of the Government, which

will include some estimates of those measures. But in terms of the GAO process itself, I don't know the details of that right now.

Mr. ATKINS. Okay. So as far as when it might be public?

Secretary GEITHNER. I just can't tell you, but I would be happy to have them get back to you or we can do it ourselves directly.

Mr. ATKINS. Okay. Another issue, and you brought this up in your opening statement, is regulatory changes that you all have proposed to Congress. And I guess having come from an independent agency, I value that sort of tradition of independence from the administration.

And earlier this year, there were reports in the press about I guess I would term it as maybe excessive pressure from the administration, especially the Treasury Secretary, with respect to your colleagues on the President's working group and elsewhere. So I wonder where that stands as far as you are concerned, as far as dealing with others as independent agencies that are not part of the administration, of course, and how you view your interaction?

Secretary GEITHNER. I actually believe that, just by what you read, that there is a lot of agreement across those agencies on the core things we try to achieve. And I think on the broad structure—that is, the framework for protection of derivatives and on resolution authority for dealing with failed institutions in the future. This is evident by the core provisions on capital you heard us outline a couple of weeks ago. There is a broad base of agreement across those agencies on the core parts of reforms.

There are some areas, though, where they would prefer that we leave the existing authority they have. And so, the focus of their concerns have been on taking authority from them and putting it in a different place, most conspicuously in the area of consumer credit protection, where I think by any measure, it failed.

And our belief is to put in place a stronger system. You had to put in a single entity, both the authority to write rules and to enforce them. But that is, I think, where there is still disagreement across these institutions. And you would expect to have disagreement. There is nothing surprising in that.

Mr. ATKINS. Well, people have vested interests and everything else. But I guess we can—we will have another chance to talk about these particulars later on.

With respect to the programs under TARP, do you have any expectation of expanding the list that you have now?

Secretary GEITHNER. Again, what we tried to do earlier in the year was to lay out a broad framework to recapitalize the system and to provide targeted support for the credit markets that are necessary for recovery. And as many of you said, we put out a broad framework of programs in that area. It was our best judgment at the time.

We want to have some capacity to modify and adapt those over time to make sure they are doing what they need to do and to wind them down and redeploy capital as necessary.

At this stage, we don't have any specific plans to substantially expand the scope of the entities into areas we would target, but it is possible that——

Mr. ATKINS. Well, if——

Secretary GEITHNER [continuing]. Looking at the damage in the system remaining, we might make that judgment. But we would want to set a very high bar for doing so because we want to be able to demonstrate an appropriate use of taxpayers' money, measured by returns we are going to get.

Mr. ATKINS. Well, speaking of which, one of the issues I think that is still in question is whether or not TARP is a revolving type of arrangement, whether the monies that are paid back are then available for the future? Do you have any legal analysis of this?

Secretary GEITHNER. Yes, in previous testimony, we provided extensive responses to the Congress on how that authority was drafted. And I actually think there is broad acceptance in the Congress by the architects of that legislation that the process works as follows:

If a dollar comes back—and, of course, as I said, billions of dollars have come back to the Treasury from the financial system—that goes directly to the general fund to reduce debt outstanding.

Chair WARREN. I am sorry——

Secretary GEITHNER. But the law is designed——

Chair WARREN. Mr. Secretary.

Secretary GEITHNER [continuing]. To still give us the authority to use that if we think we need to do it to help protect the system.

Mr. ATKINS. Well, I guess I would like to see the legal analysis.

Secretary GEITHNER. Happy to do that.

Chair WARREN. Thank you.

Superintendent Neiman.

Mr. NEIMAN. Thank you.

A major aspect of regulatory reform is the streamlining and modernizing of our regulatory structure. Your proposal includes merger of the OCC and the OTS, and I support that change. Some, including our Nation's largest banks, however, propose going further to create a single monolithic Federal bank regulator, which raises, in my opinion, serious concerns. Creating a single regulator as a means of improving financial regulation relies, in my opinion, on the faulty assumption that regulatory consolidation leads to a stronger and safer banking system in itself.

In my opinion, the opposite is true. Such a proposal would increase the fragility of the system by increasing industry consolidation, by eliminating needed checks and balances, and subordinating the interests of the consumer to the business goals of a handful of mega banks. In my experience, multiple regulators yield better results for consumers and for financial stability, much like multiple judges are used in the Olympics to arrive at the right score.

What are your concerns about the proposals to create a single monolithic regulator? And how important was it for you, in drafting your proposals, that the FDIC and the Federal Reserve retain examination authority to better inform their respective missions of deposit insurance and lender of last resort?

Secretary GEITHNER. Thank you for raising that question, and I think you have framed the choices thoughtfully.

One of the most important things we decided that we had to do was to eliminate the weakest parts of supervision in the system and eliminate the opportunity for people to take advantage of

weaker supervision by flipping their charter or shifting risk to those parts of the system.

One of the principal examples of that, unfortunately, was in the difference between the standards applied to thrifts and applied to banks. So we thought eliminating that was a necessary, essential condition for reform.

If you look beyond that, there is less evidence that having two entities responsible for different types of State-chartered banks alongside a single Federal supervisor, would create really meaningful risk of arbitrage in the future. In fact, if you look at the standards applied by our bank supervisors, in general, they were more evenly applied and more effectively enforced.

So we don't think it was necessary or desirable to try to force all of that into one new entity, partly because of the concerns about concentrated power and partly because we are asking the Congress to do a lot in a very short period of time. And a guiding principle that affected our choices was to say we want to make sure they are focusing on the things that are essential to do. It should not be on those that might be desirable to some people, but would not offer a benefit that was proportionate to the political difficulty or the practical difficulty of doing it. Further dramatic consolidation of bank supervisors we didn't think met that test.

But of course, we are open to suggestions, and if there is the desire in the Congress and the interest in going further in terms of consolidation, we would, of course, be happy to support that. But I think you have to balance the factors that you laid out in your comments.

Mr. NEIMAN. And you would share my concerns over the role of the checks and balances that I often use as an example, the role of the independent FDIC in raising issues of the importance of the leverage ratio—is it an important check and balance in the regulatory scheme?

Secretary GEITHNER. I think you are right that there is virtue in multiple pairs of eyes looking at these institutions. But on the other hand, competition across regulators creates risk, too. We didn't get that balance right. We thought we had to propose how to fix the weakest parts of the problem, the greatest opportunities for evasion of arbitrage. But of course, we will be open to suggestions about how to get that balanced better.

Mr. NEIMAN. Thank you.

I yield my time. I am going to pick up regulatory reform in the next round.

Chair WARREN. Thank you.

Mr. NEIMAN. Assuming we are going to have a next round?

Chair WARREN. I hope so.

Mr. NEIMAN. Right.

Chair WARREN. Thank you.

So AIG has received about $70 billion in TARP money, about $100 billion in loans from the Fed. Do you know where the money went?

Secretary GEITHNER. Absolutely. I am happy to provide any detail that you would like to see on this. The money helped prevent default and helped to stabilize a very damaged institution that

would have posed, we think, very substantial risk of systemic failure——

Chair WARREN. Well, maybe I should ask it with more specificity. Was Treasury aware of who the counterparties were that were going to receive payment in full on the credit default swaps when $170 billion went to AIG?

Secretary GEITHNER. They have hundreds, maybe thousands of counterparties. I am sure that the supervisor is involved and the Fed would have access to detailed information.

Chair WARREN. So they knew who was going to get the money, the counterparties?

Secretary GEITHNER. Well, I think they could have known. Now, whether they knew at the time, I am not sure they knew. But of course, they would have access to that.

Chair WARREN. Do you know if they spoke with any of the counterparties?

Secretary GEITHNER. In what sense?

Chair WARREN. In any sense.

Secretary GEITHNER. About what?

Chair WARREN. About the fact that they were——

Secretary GEITHNER. Remember, many of the counterparties are institutions that are supervised all the time. So I suspect they were talking at all times.

Chair WARREN. They were holding pieces of paper from an entity that was clearly insolvent, and the question of the Government infusion of dollars there was going to make the difference between whether they got paid off in full or they ended up with nothing.

Secretary GEITHNER. Right. But maybe I should let you finish. So where are you going? What would you like to know?

Chair WARREN. I just want to know.

Secretary GEITHNER. What?

Chair WARREN. Did Treasury have conversations with any of the counterparties——

Secretary GEITHNER. And I don't——

Chair WARREN [continuing]. Who ultimately profited from this infusion of cash?

Secretary GEITHNER. I was not Secretary of the Treasury at that time of the initial investment, but I was the president of the New York Fed. And of course, I was central to the basic judgment we reached together to prevent default by AIG. I am sure that was the right judgment at the time. You are right to point out that that action did help make the system more salient and did have broad benefits to the stability of the system, including the counterparties.

But more importantly, the reason why AIG posed systemic risk was not principally because of the direct exposure of those institutions, those counterparties. The biggest risk to the system was in the damage it would have done to both retail people who bought insurance protection, saving protections from AIG and systemic risk. So it was a more complicated picture——

Chair WARREN. So let me then follow up. I understand your point and the distinction you are drawing. We just finished our auto report, and Chrysler and GM, insolvent company. AIG, insolvent company. Chrysler and GM have bondholders, unsecured creditors, secured creditors, and employees, and they all took big haircuts.

AIG had people holding credit default swaps, and they took no haircut at all.

Secretary GEITHNER. AIG had——

Chair WARREN. They ended up with money from the Federal Government 100 cents on the dollar, and I am trying to understand why those two are different from each other.

Secretary GEITHNER. This is the tragic failure about the regime we came in with because we did not have the legal capacity to manage the orderly unwinding of a large, complex financial institution. We do have the capability to unwind small banks and thrifts, but did not have it for an entity like AIG. And that forced us to do things that we would not ever want to do.

But as an——

Chair WARREN. Are you saying that you couldn't find a way to pay less than 100 cents on the dollar there, but since you could find a way in the auto industry, you did?

Secretary GEITHNER. Of course not. I mean, we would have done that immediately if we could have done that. But in deciding that a default by AIG would have presented the risk of further systemic damage to a very fragile system, we made the judgment to prevent this. By preventing default, we helped AIG meet its financial obligations not just to people that bought insurance protection, savings protection products, but to its broad counterparties. That is the consequence of that decision. And if you think through——

Chair WARREN. But not the same for the auto industry?

Secretary GEITHNER. Completely different situation, you are right. But if you think through what happens when you let default happen, consider the trauma caused by Lehman's default to get a sense of the damage that can result. And then, again, that is why we moved so quickly to propose broad resolution authority to give us better tools for dealing with these in the future.

Chair WARREN. And I appreciate that. Let me ask one quick question, if I can slip it in before we run out of time, and that is a year ago, we were worried about banks that were too big to fail. But in the last year, big banks have gotten bigger, while 84 small banks have been allowed to fail. And some experts are estimating that 1,000 smaller and mid-size banks could disappear before this crisis is over.

I just want to know, are we more at risk on the question of concentration than we were a year ago?

Secretary GEITHNER. You know, I don't think so. But it depends largely on what Congress ultimately decides to do in terms of financial reform. The only way to deal effectively with the moral hazard risk created by the consequences of this crisis and by the too big to fail problem is to make sure there is a set of reforms in place that make us better able to withstand the failure of large institutions so we don't have to intervene to put taxpayers' money at risk to prevent them from or to provide for more orderly resolution.

And that requires resolution authority, stronger capital, better derivatives protection, a whole set of cushions and safeguards to limit the risk of contagion spreading, and that is why, again, reform is so important. And that is the only way, I think, to make the system safer——

Chair WARREN. Thank you, Mr. Secretary.

Secretary GEITHNER [continuing]. From future failure.

Chair WARREN. Thank you.

Congressman Hensarling.

Mr. HENSARLING. Thank you, Madam Chair.

Mr. Secretary, I continue to be concerned over the precedent being set for the taxpayer and our financial markets with the Chrysler and GM intervention. You are well acquainted with the facts since it was your team that helped put together the reorganizations. And GM bondholders were asked to swap $27 billion in debt for initially 10 percent common equity. The UAW agreed to swap $20 billion for 17.5 percent of common equity, $9 billion in preferred stock, and the UAW, through their VEBA, ended up with 55 percent of Chrysler. They ended up with 17.5 percent of GM.

When you talk about the success of your administration in stabilizing the financial markets, I am just very concerned about how when senior secured bondholders are treated less equally than those who are unsecured and equally unsecured creditors, still we see the UAW receives preferential treatment. Warren Buffett, perhaps the most famous investor in America, has said, "If priorities don't mean anything, that is going to disrupt lending practices. Abandoning that principle would have a whole lot of consequences."

The Wall Street Journal, some would say I guess the investor journal, wrote an op-ed back in May. "By stepping over the bright line between the rule of law and the arbitrary behavior of men, President Obama may have created 1,000 new failing businesses. That is businesses that might have received financing before, but now will not since lenders face the potential of future Government confiscation."

Investors Business Daily. "This undermines the reason for buying a bond at all. Accepting the lower returns in exchange for legal guarantees, that, in turn, will reduce the willingness to buy bonds."

Now I must admit it is somewhat anecdotal, but when I speak to investors, I believe there are hundreds of billions of dollars that are sitting on the sidelines because investors are concerned about what the Government policy is, concerned about the potential to confiscate their investment. I have small businesses, at least throughout the 5th District of Texas, that tell me they can't get lines of credit. So I know there was a huge stabilization by the time your administration took office. I am not sure I have seen a lot of improvement since then.

And I simply question what precedent have you set, and what is the impact for financial stability in treating the UAW so differently than senior creditors of those who are equal?

Secretary GEITHNER. Panel members had a lot of time to look at this carefully. Your report provides a pretty thoughtful discussion of the choices we faced in that context and the outcomes. I know you have had testimony on this before. And I understand the concerns you are raising. As you said, many people have raised those concerns for some time.

But this was a process overseen by a bankruptcy judge. That bankruptcy judge looked at the terms of the agreement and reached a judgment about whether that was acceptable. That is a great strength of our system, and that really is the ultimate test——

Mr. HENSARLING. Well, it was a plan, though. It was a plan financed with taxpayer money under TARP.

Secretary GEITHNER. Yes, it was, and I think you know—you don't agree with it. You opposed this action, which I understand, for thoughtful, principled reasons. But we took this action because we thought it was important and effective to do in the face of this crisis and recession. And I think this will be judged as an exceptionally well-designed, dramatic restructuring.

The scale of the restructuring designed and approved through this process went well beyond what is contemplated by many people in this Congress, including on your side of the aisle——

Mr. HENSARLING. Well, and in the time I have remaining, Mr. Secretary—I am sorry. We have limited time here.

But another aspect of this that I simply don't understand is how Fiat is brought into the deal—20 percent, I believe, of Chrysler. Up to 35 percent if they produce cars that receive 40 miles per the gallon. I know the President and the administration is passionate about their global warming agenda. We can have that debate. But under EESA, I am having trouble finding out why Fiat, who wasn't owed a dime, who I don't believe put a dime into the deal, what having them use TARP money—U.S. taxpayer money to produce these cars sometime in the future has anything to do with taxpayer protection or financial stability. I just don't get it.

Secretary GEITHNER. Congressman, again, I don't think I am going to talk you out of your concern, and I respect why you have opposed what we did and what my predecessor did in the automobile industry. But we made a set of judgments that we thought was in the interest of the country, and I think we are much better off today because those companies were not forced to go into liquidation. And I think that was a prudent, sensible use of the authority that Congress gave us.

Chair WARREN. Thank you, Mr. Secretary.

Mr. Silvers.

Mr. SILVERS. Mr. Secretary, my colleague seems to be under the misapprehension that you are a bankruptcy judge. Are you a bankruptcy judge?

Secretary GEITHNER. Last time you asked me if I was an investment banker, and I said no then. But I have also never been a bankruptcy judge. You are right.

Mr. SILVERS. Although I did recall after our previous exchange about your resume that the term "banker" does seem to apply to the Federal Reserve Bank of New York when last I——

Secretary GEITHNER. That would be stretching the definition.

Mr. SILVERS. It is not a bank?

[Laughter.]

Mr. SILVERS. Anyway, but you are not a bankruptcy judge, are you?

Secretary GEITHNER. No.

Mr. SILVERS. And the role of the TARP in respect to any bankrupt entity is as a provider of debtor-in-possession financing, is it not?

Secretary GEITHNER. In that context, yes.

Mr. SILVERS. And then a provider of such financing makes strategic decisions about how they want their money to be used, right?

Mr. Buffett would, if he was a debtor-in-possession financer. I assume the Treasury would as well.

Secretary GEITHNER. We did. And we did so on what we thought were the best financial terms for the taxpayer and for the country. But again, those judgments were overseen by a bankruptcy judge.

Mr. SILVERS. All right. Let me move on. You have made some references in your testimony to regulatory reform. One criticism of a program, which I personally believe is a pretty serious and positive program that the administration has put out, is the criticism that it doesn't really deal with what structurally went wrong in our banking system and financial markets in that it doesn't deal with the combination and risks associated with investment banking, in particular proprietary trading combined with commercial banking and insured deposits.

I am particularly concerned about this problem because of, to go back to my prior questioning, essentially the zombie bank problem. If you have very weak financial institutions, particularly ones that think they have an explicit or implicit guarantee, they have not been resolved. They are really very weak. The temptation to gamble is almost irresistible.

Can you comment on your views as to how this problem should be addressed and will be addressed under the administration's program?

Secretary GEITHNER. Again, most important is to make sure the institutions hold more capital and a higher quality form of capital against the risks they might face in the future. You know, capital is sort of like a rainy day fund. It is the resources they can draw on if things don't turn out so well.

It is probably the most important protection we have against the risk of future crisis. While constraining future leverage and risk taking, it will make the system better able to withstand the stress that might come if one institution faces the risk of failure, and that is the centerpiece of reform. We laid out, last week, a comprehensive set of proposals for reforming capital standards.

The banks would be required to hold more capital against the risk they take in whatever form. It is probably the most important thing we can do against the risk you are framing. Now if we had adopted a strategy, Mr. Silvers, of just simply guaranteeing the liabilities of the financial system, not forcing recapitalization, not conditioning our assistance on the kind of pretty dramatic restructuring, then I would be more worried about the risks that you refer to. But that is not the strategy that we adopted.

Mr. SILVERS. Is it your view, that allowing an aggressive proprietary trading desk as part of a holding company that has significant insured deposits is a wise form of public policy?

Secretary GEITHNER. I think it is very important to make sure that institutions will hold a lot of capital against all the risks they take. Now if you look at this crisis—and of course, we will be looking at this for a long time—most of the losses that were material, for both the weak and strong institutions, did not come from those activities. They came overwhelmingly from what I think you can fairly describe as classic extensions of credit, particularly where they are backed by real estate.

And those basic choices, which are classic banking types of decisions—is the sort of the tragedy of this crisis——

Mr. SILVERS. Well, Mr. Secretary, I am not so sure about that. I think if you look at where the big holes came in the major commercial banks, they were substantially—I give one example. I had this very interesting conversation with one large bank where they said, you know, "We didn't make any subprime loans." And so, I said, "Well, how did you get into so much trouble?" And they said, "We had something called a capital markets desk."

And they were in the business of repackaging other people's subprime loans and putting them in off balance sheet vehicles. Do you disagree with that as a characterization of how we got here?

Secretary GEITHNER. Maybe we are agreeing rather than disagreeing.

Mr. SILVERS. Right.

Secretary GEITHNER. And what you may call trading, I would call the extension of credit. And these were extensions of credit. But in any case, the basic point I agree with is that——

Mr. SILVERS. Underwriting——

Secretary GEITHNER [continuing]. You want to make sure that if firms aren't forced to hold capital against the risky things they do, we will be vulnerable again to a repetition of this crisis, and we are not going to let that happen.

Chair WARREN. Thank you, Mr. Secretary.

Mr. SILVERS. Thank you.

Chair WARREN. Commissioner Atkins.

Mr. ATKINS. Mr. Secretary, I am glad that you have a lot of confidence in capital, but I think even the capital levels that you are talking about would not have prevented what went on last year. And so, some of it is a bit of flying by the seat of the pants, I think, ultimately.

Secretary GEITHNER. Well, no, I think you are right. It is necessary, but not sufficient.

Mr. ATKINS. Exactly.

Secretary GEITHNER. But it is central.

Mr. ATKINS. And one of the central things is really predictability because as you were talking with the chair about AIG, I think if you go back last year—and this is a debate for another time. But when you track Fannie Mae, Freddie Mac, and then what happened there, and then allowing Lehman to go, but then turning around with AIG, I think that freezes up the marketplace more because people were uncertain than anything else.

But I wanted to get to PPIP, the Public-Private Investment Program, to find out where that stands. There are two basic programs under it—the legacy securities program, of course, and then the loan program. The legacy securities program is the only one that is really up and going, and I was wondering where that stands, how many purchases have been made? Do you view these as viable in this grand, great scheme of instruments that are out there?

Secretary GEITHNER. I think at the end of this month, you are going to see the asset managers we selected to raise capital to help launch these programs close on their capital raising. All indications are that they are raising a lot of capital.

Soon after that happens, they will be in the market buying securities. But when the details of the program were announced, there was a pretty significant effect on prices in those securities since the prospect of financing capital coming in did help restore and improve liquidity in those markets. So you are seeing some positive effect.

As I have said many times before in public, we expect there to be less demand for these facilities than was initially expected in part because liquidity has improved and partly because more capital came into the financial system. But I still think that they are valuable enough, worth going ahead with. And if we think there is a high return to the taxpayer and to the overall economy from expanding them, we will be open to expanding them further.

Mr. ATKINS. Okay. Well, I think we can probably save that for another day. I know your time is short. I wanted to give Mr. Neiman an opportunity as well.

Chair WARREN. Thank you, Commissioner Atkins.

Secretary GEITHNER. Madam Chair, could I just very briefly?

Chair WARREN. Of course.

Secretary GEITHNER. You are very right to say that if you look back over the arc of this crisis, one thing that was very damaging to confidence was the lack of clarity about whether the Government was going to step in and decisively stabilize the system.

But just to be fair to my predecessors and the other people who have been living with this crisis, that was——

Mr. ATKINS. We were there, too.

Secretary GEITHNER. Largely, that was the consequence of the fact that until Congress acted to pass the EESA, the Government of the United States did not have the authority to step in and provide capital, and it was only with that authority and the subsequent actions by the Congress and the President to make sure the additional resources were available that we really had the broad set of tools that were necessary to help stabilize this financial crisis.

But I think you are right to say that clarity about strategy, matched by resources in authority, is central to confidence. And this crisis was more damaging, more prolonged in part because of the absence of authority and the constraints that were put on the capacity of the Government to escalate, and that is something we have to fix.

We can't put the country in the position where we enter the next crisis with a limited set of tools. That is why resolution authority is so important.

Mr. ATKINS. Well, then I will take back my time a little bit just to respond. I am not sure that your proposals will do that, actually, and I think they also raise other very dangerous issues, especially with this systemic type of regulator and what not.

So we can debate the authority issue from last year another time. But anyway, I will yield my time.

Secretary GEITHNER. Again, we welcome a chance to talk about this in more detail, and we don't claim to have a monopoly of wisdom on these things. We expect our proposals to be refined and improved as they work their way through the Congress. But it is important to recognize that we can't let the system or the country go

back to where things were with that much risk and so few tools to help contain the damage.

Chair WARREN. Mr. Secretary, we are down to our last questions.

Superintendent Neiman.

Mr. NEIMAN. Thank you.

Mr. Secretary, I applaud the administration for taking the long overdue steps to make consumer protection a national priority with respect to financial services. I share this commitment to consumer protection and have seen firsthand the impact of predatory lending. And I strongly agree with your proposal to empower States and consumer protection, particularly by guaranteeing that any Federal standards would serve as a floor and not a ceiling.

Yet I have some serious reservations about another aspect of the proposal. First, I have a fundamental concern about any agency restructuring that separates consumer protection from safety and soundness. These are not conflicting missions. Isn't one of the primary lessons learned from the current crisis that a loan that is unfair to consumers when made is not a safe and sound loan? Doesn't that lesson argue for greater integration of the two disciplines into a holistic approach to supervision rather than further segregation?

So I would also question whether it is absolutely necessary to create a new and separate agency with all the start-up and unintended consequences it would bring or whether expanding the mission of an existing agency like the Federal Trade Commission, which has a strong consumer protection track record, may have a better ability to achieve the goals of regulatory reform without creating new bureaucracies, inefficiencies, and cost?

So my question to you is what thought, if any, was given to alternatives such as expanding the mission of the Federal Reserve Board or increasing the jurisdiction of an agency like the FTC that may better protect consumers and not create a new bureaucracy?

Secretary GEITHNER. We looked at a lot of models and thought carefully through the concerns, many of which you expressed. But let me just say it starkly. We have been living as a country with a system where we gave bank supervisors primary responsibility for writing rules and enforcing those rules for consumer protection. And how did that turn out for the country?

It did not serve us well enough. It is not a system that worked. It failed in its most basic mission. The reasons for that failure were complicated, but I think we had a test of the viability of the model that combined the authority for prudential supervision and consumer protection. And the judgment we reached was based on that record of experience over many decades, several recessions, past crises. That is, you need to put rule-writing authority and primary enforcement authority in a single place with the resources and expertise necessary to do that job well.

Now, by clarifying where enforcement authority is, we are not going to be adding to the overall burden of the system. FTC does a great job. They have a lot to do, and the specific challenges of getting consumer protection right, particularly in credit, is, as we have seen, very, very hard.

So, again, this represents in our view, looking at a range of alternatives, what we thought was the best path forward. But I understand why many supervisors look at the prospect of a different

model, and many banks are uncomfortable with the implications of that change.

But I think separating rule writing from enforcement would not be a sensible strategy. I think the rules would be at risk of being poorly written. And if you——

Mr. NEIMAN. Would you not, though, acknowledge that the Federal Reserve, though late to the game, did take strong action with respect to mortgages and credit card issues?

Secretary GEITHNER. I completely agree with you, and they provided a set of reforms and regulation that became the body of important credit card and mortgage legislation passed by Congress. But you asked when did those rules come?

Mr. NEIMAN. But if Federal Reserve was directed to, statutorily, report to Congress, to have a governor on the board with consumer responsibilities and experience, would that not be an alternative?

Secretary GEITHNER. There are many alternatives, but we have to make a judgment together with the Congress about what is going to be most effective. And again, we have had a painful experience about the limits of effectiveness of the system we had, which gave those entities responsibility for the rules and the enforcement. And the system failed.

Now, some of the most damaging things have happened outside banks. The standards were worse outside banks, and part of the failure of the system was not to provide greater protections in place for nonbanks, and that is a centerpiece of what we are proposing. That should be helpful for banks, not just bank supervisors.

Mr. NEIMAN. Let me move on to another area that has arguably not gotten as much attention as the creation of a new agency to protect consumers, and that is product suitability and effective disclosures. Consumers and investors need effective disclosures, not just more pages of print. For example, it may be a suggestion of a nationally recognized rating system could clearly communicate product safety and complexity, perhaps along with a one-page or two-page summary of key terms.

I often compare this rating system to the rating system used on ski slopes. I am a poor skier. When I get up to the top of a mountain, I could not imagine skiing without a green, red, or double diamond. Don't consumers deserve the same level of protection? Is this something that you would consider?

Secretary GEITHNER. I agree with you. Better disclosure, that kind of differentiation is central to the basic strategy recommendations we made, and of course we are open to suggestions about how to get it better.

Mr. NEIMAN. And then my last question——

Chair WARREN. Excuse me. We are out of time.

Mr. NEIMAN [continuing]. I did not get an agreement with our September 24th hearing.

Secretary GEITHNER. We will try to respond appropriately.

Mr. NEIMAN. So your cooperation with respect to participation of Treasury and Fannie and Freddie would be very, very welcome.

Secretary GEITHNER. We will do as much as we can to make sure you have good representation there.

Mr. NEIMAN. Thank you.

Chair WARREN. Thank you very much, Mr. Secretary. We appreciate your being here. We appreciate your very detailed answers to our questions, and we look forward to seeing you again soon.

Secretary GEITHNER. Happy to do so again. Thank you.

Chair WARREN. This hearing is concluded.

[Whereupon, at 3:06 p.m., the hearing was adjourned.]

QUESTIONS FOR THE RECORD

FOR US DEPARTMENT OF THE TREASURY

SECRETARY TIMOTHY GEITHNER

CONGRESSIONAL OVERSIGHT PANEL

September 23, 2009

Questions for the Record from Panel Chair Elizabeth Warren

1. **Given the proportion of whole loans to total assets held by small banks, and Treasury's shelving of the legacy loans portion of PPIP, what is Treasury doing to prevent large numbers of failures of small banks? What is Treasury doing to help small banks that are part of the growing "troubled list" get off this list?**

   Treasury is focused on the needs of small and community banks throughout the country. Since January, the Administration has invested $11 billion through the Capital Purchase Program in more than 350 financial institutions, many of which are community banks. In addition, we announced the CPP expansion for Small Banks Program in May, which allows viable banks with total assets under $500 million to receive CPP funds up to 5% of risk-weighted assets (versus the 3% limit for all other banks). Injecting capital through these programs can improve banks health, allowing them to keep their overall supervisory ratings high and supports greater lending.

   Only viable institutions, as determined by each institution's primary regulator, are eligible for CPP funds, reflecting Treasury's continued interest in protecting the taxpayer while working towards continued improvement in financial stability. While the Federal Deposit Insurance Corporation's (FDIC) "problem list" has been growing, it is important to note that many more financial institutions would likely have been at risk had the Administration not made these programs available.

   What is Treasury's plan with respect to the legacy loans program going forward? Does Treasury expect the eventual roll out of the legacy loans program as originally planned? If so, can you please provide a timetable?

   The Public-Private Investment Program (PPIP) was announced in March by the Secretary of the Treasury, the Federal Reserve, and the FDIC, and is being developed to help restart the market for loans and securities and to help banks remove troubled loans and other assets from their balance sheets. Reviving the market for these assets will enable banks to raise new capital and be better positioned to lend to further the recovery of the U.S. economy. In June, the FDIC announced that it would develop the Legacy Loan Program ("LLP") by testing the mechanism on a pilot basis through the sale of receivership assets. On September 16th, the FDIC announced that it had signed a bid confirmation letter with a private investor in a pilot sale of receivership assets to test this funding mechanism. The results of this test sale will be analyzed to determine whether the LLP can be used to remove troubled assets from the balance sheets of open banks, and in turn spur lending to further support the credit needs of the economy. The FDIC has indicated that it will publish additional details about the sale after the closing later this month.

Has Treasury considered a "matching program" that would direct TARP funds to troubled small banks by contributing government aid in equal amount to what small banks raise in the private markets?

The Treasury Department has a keen interest in attracting private capital to the banking system. We continue to explore additional ways to achieve this goal. It is important to note that viable small banks are currently eligible under the CPP expansion for the Small Banks Program, subject to a maximum TARP investment of 5% of risk weighted assets without any matching requirement. These firms are not restricted by TARP from raising capital in the private sector.

2. **Some small banks that are denied TARP funds allege that they are held to a different standard from large banks. They claim that that while large banks received CPP funds when they were in financial trouble, small banks that need the funds to remain solvent are denied. Does Treasury apply different standards when evaluating big banks versus small banks?**

   All institutions are evaluated under the same standards. The primary test is that any institution, regardless of size, must be found to be viable without TARP funds by its primary regulator.

3. **The FDIC's level of reserves has reportedly fallen to about $20 billion, and it currently guarantees billions of dollars in bank loans and parts of a pool of Citibank assets. If the FDIC's purpose is to protect insured depositors, how are these commitments consistent with that purpose? Why has the burden of handling the crisis been shifted to this extent to the FDIC, given the amount of TARP funds unspent and the Treasury's position that it is running a revolving fund to permit new money to be expended as TARP funds are repaid? The FDIC can borrow from its line of credit with the Treasury if necessary to support the costs of its responsibilities. Does such borrowing simply shift the costs borne by the taxpayer from one Treasury budget category to another?**

   Although many aspects of this question would be best addressed to the FDIC directly, it is clear that the FDIC has the resources and necessary tools to protect insured depositors and resolve failed banks. According to the FDIC, its total reserves were $42.4 billion as of June 30. To further bolster their position, Congress expanded the borrowing capacity of the Insurance Fund from $30bn to $100bn, with the potential to expand to $500 billion through December 31, 2010 with approval of 2/3 of FDIC Board, 2/3 of Federal Reserve Board of Governors, and approval of the Treasury Secretary, in consultation with the President. Throughout the FDIC's 75-year history, no depositor has ever lost a penny of insured deposits. While deposits insured by the FDIC are backed by the full faith and credit of the United States Government, the FDIC is funded not with taxpayer money, but with deposit insurance premiums imposed on banks. These assessments on banks both in the near term and the future are the source of funds to repay any Treasury borrowings and replenish the fund. In this manner, the costs

of FDIC action are ultimately borne by the bank industry itself, not the taxpayer. In addition, the FDIC has received fees in exchange for its asset guarantees and the TLGP program. These programs have been important components of the government's overall financial stability initiatives.

4. **Bank of America and the U.S. government have an unconsummated agreement for a $118 billion guarantee. What is the status of this transaction? Should Bank of America be required to pay for the implied benefits of a guarantee it never signed?**

   On September 21, 2009, Treasury, the Federal Reserve and the FDIC entered into a Termination Agreement with Bank of America regarding the Asset Guarantee Transaction originally announced on January 16, 2009. In connection with the termination of the guarantee contemplated by the Term Sheet dated January 15, 2009, Bank of America agreed to pay in cash a total fee of $425 million, consisting of $276 million to UST, $57 million to the Federal Reserve, and $92 million to the FDIC.

   The Term Sheet contemplated that the US government would bear the risk of the loss on the pool from January 15, 2009, to May 6, 2009, the date that Bank of America notified the US government parties of its desire to terminate guarantee negotiations. From and after the date of the Term Sheet, Bank of America benefited from (i) the USG parties' support of the guarantee, and shared losses on the pool of assets and (ii) the related effect on restoration of market confidence in Bank of America. The fee was appropriate, for the benefit Bank of America received over period from the date of the term sheet to the date of notification of termination.

5. **AIG used some of its TARP funds to pay its credit default swap counter-parties 100 cents on the dollar. Did Treasury know who AIG's counter-parties were before it provided these funds? Did Treasury or the FRBNY consider other options that would have permitted the counter-parties to share the financial loss with the U.S. taxpayer? Did Treasury or the FRBNY approach the AIG counter-parties to discuss whether any such arrangement would be possible?**

   AIG's obligation to post billions of dollars of cash collateral to its derivatives counterparties in mid-September of 2008 was triggered by the downgrade of AIG's credit rating in early September. TARP did not exist at that time so it was the Federal Reserve that provided AIG with an $85 billion credit facility to meet those obligations. After the creation of TARP in October, Treasury's first investment into AIG was made in November 2008 as a preferred stock investment. The investment proceeds were used to pay down $40 billion of the $85 billion outstanding under the Fed credit facility so as to reduce AIG's total indebtedness and thereby avoid a threatened further ratings downgrade that could have triggered additional collateral calls from its derivative counterparties. Treasury was consulted by the Federal Reserve in connection with its decision to

provide AIG a credit facility in September to meet its collateral posting obligations and other liquidity needs triggered by its ratings downgrade.

The rationale at that time for providing AIG sufficient liquidity to meet its collateral posting requirements and other liquidity needs in full derived from the interplay between those obligations and AIG's other indebtedness. Under the contracts governing most of AIGFP's derivatives trades, the failure to meet a collateral posting obligation in full would constitute an event of default, giving rise to the right of AIGFP's counterparty immediately to terminate the affected trade and to assert potentially even greater claims against AIGFP upon such termination. In turn, AIGFP's failure to honor the payments required to be made by it under any particular trade would constitute a default under all of its other trades, permitting its over 1000 counterparties to terminate the almost 50,000 trades they had with AIGFP. Further, AIG had guaranteed AIGFP's obligations under most of its derivative contracts. If AIGFP defaulted on its obligations to its counterparties and then AIG failed to honor its guaranty of AIGFP's obligations, that failure would have constituted a default under the contracts and indentures governing most of AIG's own indebtedness. The result could potentially have accelerated of in excess of $50 billion of third party indebtedness against AIG, which would have almost certainly required AIG to seek relief under Chapter 11 of the United States Bankruptcy Code.

On the second day following the commencement of the Lehman Brothers bankruptcy, the decision was made that the risk that any one of AIG's counterparties would refuse to accept anything less than 100 cents on the dollar, declare a default and trigger a cascading series of cross defaults across AIG's complex capital structure was too great to take. The already fragile financial system would likely not withstand the shock of the immediate bankruptcy of AIG, yet another large financial institution. Therefore, AIG was provided with sufficient funding to meet its obligations in full.

6. **The Panel's September 15, 2009, letter to you asked about your statement that the indicative loss rates that were used to estimate losses in the more adverse stress test scenario were set higher than those seen during the Great Depression. Since the Great Depression, banking and market regulation has changed fundamentally to prevent a repeat of the banking crises that occurred during 1929-32. These changes included the creation of the FDIC and the SEC, and substantial changes in the structure and terms for supervision of financial institutions. Please explain the relationship between the choice of indicative loss rates and the strength of the present regulatory process. Please discuss whether the loss rates reflect a buffer to guard again faulty risk assessment by the regulatory agencies.**

   Economic statistics indicate that, while the nation is enduring the most severe economic reversal since the end of World War II, if not since the Great Depression, the recession is still far less serious than the Depression. Does

the Treasury believe that the seriousness of the recession may increase to the point that economic reality draws closer to the indicative loss rates?

As indicated in the Federal Reserve's May 7, 2009 release of the SCAP results, the total loan loss rate of 9.1% assumed under the SCAP's more adverse scenario exceeds all two year loan loss rates that have been observed for U.S. commercial banks from 1921 to present, including the Great Depression. This reference point indicates the severity of the adverse scenario assumed in the stress tests. As you point out, the U.S. banking industry has evolved significantly since the 1920s and regulations have evolved alongside, in some cases in response to industry developments and past crises. The assumed loss rates were designed to capture potential losses in a deeper and more protracted economic downturn than was anticipated in spring of 2009. To guide estimation, the banking supervisors provided firms with a common set of indicative loss rate ranges for specific loan categories under the baseline and "more adverse" economic scenarios. These indicative loss rate ranges were derived using a variety of methods for predicting loan losses, including analysis of historical loss experience at large bank holding companies and quantitative models relating the performance of loans or groups of loans to macroeconomic variables.

We cannot let the beginning signs of normalcy lead to complacency. The Administration has proposed a plan to address the core regulatory failures and weaknesses that directly contributed to the crisis, and the dangers that could lead to the next one.

7. **The amount of the capital buffer required for ten of the stress-tested bank holding companies was reduced by first quarter 2009 operating results. There have been a number of media reports that those results reflected significant accounting changes rather than economic performance. For each of the 19 stress-tested bank holding companies, please describe in detail the extent to which accounting changes increased operating income in the first and second quarters of 2009.**

   Please explain the extent to which accounting changes were factored into the computation of projected earned income by the stress-tested bank holding companies, on a forward-looking basis, for 2009 and 2010.

   Questions on the precise methodology used to conduct the stress tests are best addressed to the Federal Reserve and any questions on specific institutions would be best addressed to the institutions themselves or their primary supervisor. However, a number of high level observations could be helpful. At the time of the stress test, there was some public discussion of FAS 115-2 and FAS 124-2 which addressed the recognition of an other-than-temporary-impairment ("OTTI") on debt securities held in the available-for-sale ("AFS") or held-to-maturity ("HTM") accounts. The guidance provided some additional flexibility to companies, assuming certain conditions were met, to recognize only the credit loss component of the OTTI in earnings rather than the full amount of the OTTI

(which would include any liquidity discount or other factors) than was previously the case.

As you note, the supervisors did use an adjustment in the SCAP for Q1 results. But, as noted in the paper released with the SCAP results, less than $20 billion of the $110 billion adjustment in the required capital buffer was due to pre-tax, pre-provision net revenues ("PPNR") for the first quarter exceeding the SCAP estimates. Further, the accounting changes referenced above, as they relate to loss recognition, would have no impact on the PPNR adjustment. For conservatism, it is important to note that in the consideration of losses in the adverse scenario, no credit was given to banks' forward-looking estimates of the impact of these changes to the OTTI amounts. The stress test assumed that the full amount of OTTI would be realized on applicable debt securities.

Supervisors did make efforts to incorporate likely changes to accounting rules into the SCAP. For example, the SCAP papers make clear that supervisors did take into account the expected impact of FAS 166 and 167 which amended FAS 140 and FIN 46(R) with respect to the on-boarding of off-balance sheet assets likely to occur in the first quarter of 2010. Further adjustments were made by supervisors to take into account the change in the characterization of income resulting from these changes from securitization-related income to net interest income. Further, while not related to an accounting change, supervisors did not give any credit either in the Q1 adjustment or in the estimates of PPNR for any fair value gain banks had recorded on their own liabilities. While it would have been impossible for those conducting the assessments to incorporate all conceivable changes to accounting rules, supervisors did attempt to address the changes that were most likely to be adopted.

8. **In what ways does Treasury oversee contractors, especially contractors who are themselves responsible for program oversight? In what ways are contractors held accountable for their performance? Does Treasury directly tie contractors' pay to performance? Please elaborate with specific examples.**

Treasury contractors provide vital support to the Troubled Asset Relief Program (TARP). However, the responsibility for managing and overseeing programs rests squarely with government personnel.
Treasury has a robust process for overseeing performance of all contractors. The oversight process starts during the requirements planning phase and carries through inspection and acceptance of goods and services to closing out a completed contract. The Office of Financial Stability (OFS) uses a number of mechanisms to ensure that contractors fulfill the operational, financial and compliance requirements of their contracts. The operational activities of contractors are tracked through the regular submission of activity reports to OFS personnel charged with oversight. Contractors are required to submit monthly cost accrual and invoices that are reviewed by OFS to ensure appropriate costs control.

The OFS has created a Contract Administration Manager position to oversee long-range requirements planning and provide leadership and guidance to staff overseeing contractors. Each contract is managed by a certified Contracting Officer Technical Representative (COTR) who assesses and reports contractor cost, schedule and quality, inspects and accepts deliverables, audits contractor records, provides appropriate technical direction, and performs periodic quality assurance reviews. Contractor performance information is presented regularly to an executive Contract Review Board. Treasury contractors are paid based on performance. Less than satisfactory performance may result in termination of the contract, reduced payments, or loss of follow-on work. Treasury has withheld and reduced payments on contracts where cost submitted were considered unallowable or unsupported by contract requirements. In other cases, performance information was considered in the decision to not award follow-on work.

Treasury mitigates financial and performance risk through selection of the most effective contract type for the required work. Fixed price arrangements are negotiated where the contract deliverables can be reasonably anticipated and fairly priced into the contractors' proposals. Treasury facilitates competition to select the contractors offering the best value, and where appropriate enters into multiple-award contracts to maintain competitive pressures over the contract period of performance. Treasury continually seeks to improve its oversight of contractor performance through in-line review of procurement actions for consistency and adoption of best practices, verification and validation of contract information to ensure accuracy and integrity, periodic re-assessment of effectiveness of systems and procedures, and a built-in feedback loop through regular COTR Roundtables, a Contract Review Board, and intra- and inter-agency exchanges.

In addition to using contractors, Treasury may use its statutory authority to designate Financial Agents as third party service providers. Treasury has currently designated seven Financial Agents to provide vital program support under EESA. The services to be provided under EESA include custodial support, asset management and program administration under the Government's home preservation programs. Financial Agents are governed by a separate authority from contractors, stemming from the National Bank Acts of 1863/1864, and are not subject to the Federal Acquisition Regulation. Financial agents are generally considered to be acting in the Treasury's stead for the stated purpose of the Financial Agency Agreement (FAA) rather than serving at an arm's-length capacity.

The financial agents supporting TARP are managed by a dedicated Office of Financial Agents (OFA). OFA has primary responsibility for ensuring that the financial agents are fulfilling the terms and requirements of their respective FAAs. OFA works closely with the other offices within OFS to ensure that the

financial agents are meeting the needs of the programs. The operational activities of the financial agents are tracked through close working relationships between the financial agents, OFA, and OFS program offices, the submission of regular reports and detailed maintenance of internal control documentation. OFS also receives compliance certifications such as an annual certification of a financial agent's representations and warranties and quarterly certifications regarding conflicts of interest from the financial agents. Further, each FAA contains requirements for financial agents to complete assessments of their IT systems and an evaluation of their internal controls such as a SAS 70 Type II. In addition, each of the financial agents is subject to annual or ad hoc reviews by the OFA or other OFS offices, including OFS's internal controls division, and outside auditors including GAO and SIGTARP.

Regarding accountability, Treasury has significant unilateral authority under a FAA, among other things, to terminate the FAA, reduce the scope of services provided by the financial agent, or to place a financial agent on probation and withhold payment if it is not fulfilling the responsibilities of the FAA, or if it is deemed necessary to protect the interests of the United States.

Treasury has implemented procedures to oversee conflict of interest situations that may arise in connection with contractors and financial agents, based on our administration of the Conflict of Interest Interim Final Regulation 31 CRF Part 31. The Interim Final Regulation requires the contractor or financial agent to disclose potential, perceived or actual conflicts and to provide a mitigation plan to Treasury during the lifecycle of the procurement process including new contract task orders or new work under an FAA. The conflicts of interest team within OFS's Chief Risk and Compliance Office (CRCO) will perform a review of the conflicts disclosed and the mitigation plan. The CRCO will work with OFA, PSD, COTR, and, in some instances, the business sponsors to understand the facts and circumstances in determining if the conflicts disclosed are complete and the associated mitigation plan is appropriate. Factors that are considered in CRCO's review include, but are not limited to, the kinds of the conflicts disclosed, the type and nature of the contractor's / financial agent's business activities, and the scope of services the contractor / financial agent is performing for Treasury.

In addition, OFS and PSD remain in close contact with contractors and financial agents, and make regular inquiries, to discover conflict of interest situations that may not have been reported to OFS.

OFS also receives, tracks, and reviews conflict of interest compliance certifications from contractors and financial agents, regarding organizational and personal conflicts of interest. Certifications are required at the time of award of a new contract / agreement, the beginning of a new task order, and periodically based on the nature of the work performed for Treasury. For example, the financial agents generally have a quarterly certification requirement whereas contractors may have an annual certification requirement. If a contractor or

financial agent fails to timely provide an acceptable conflict of interest certification, OFS identifies the gap, informs OFA / PSD / COTR, contacts the contractor or financial agent, and focuses on bringing the contractor or financial agent into compliance.

Finally, each contractor and financial agent is subject to annual or ad hoc reviews of their conflicts of interest procedures and compliance by CRCO.

Questions for the Record from Panelist Congressman Jeb Hensarling

1. **Will you agree to provide the Panel with a formal written legal opinion justifying the:**

   (i) use of TARP funds to support Old Chrysler and Old GM prior to their bankruptcies;*

   (ii) use of TARP funds in the Chrysler and GM bankruptcies;*

   (iii) transfer of the equity interests acquired by the United States government in New Chrysler and New GM to the UAW/VEBAs; and**

   (iv) delivery of notes and other credit support* by New Chrysler and New GM for the benefit of the UAW/VEBAs?**

*** A plain reading of EESA would necessarily preclude the employment of TARP funds for the benefit of the auto industry because, among other reasons, neither Chrysler nor GM qualifies as a "financial institution." Further, a funding bill specifically aimed at assisting the auto industry was not approved by Congress. Nevertheless, the Administration orchestrated the Chrysler and GM bankruptcies which resulted in an investment of over $81 billion in the auto industry.**

**** Since the acquisitions of the equity interests were financed with TARP funds, the transfer of the equity interests to the UAW/VEBAs constitutes a use of TARP funds.**

***** The promissory notes issued to the UAW/VEBAs are senior to the TARP financed equity issued to the United States government. Since the United States government controlled New Chrysler and New GM at the time the notes were issued, the government directly or indirectly orchestrated the subordination of the TARP financed equity issued to the government to claims held by the UAW/VEBAs.**

We believe the Secretary had the authority under the Emergency Economic Stabilization Act (EESA) to make the investments in the auto industry, both with respect to old Chrysler and old GM and in connection with the new companies that acquired their assets.

The purpose of EESA was to provide the Secretary of Treasury with the flexibility to take the actions necessary to restore U.S. financial stability. Congress provided the Secretary broad authority by including broad definitions of "troubled" assets and "financial institution." Providing assistance to the auto companies at the time the determinations were made was consistent with both the language and intent of the statute. The auto companies were and are interrelated with entities extending credit to consumers and dealers and because of the effects a disruption in the industry would have had at such time to financial stability, employment and the market as a whole.

The GAO noted in testimony before the Senate Banking Committee last December that the authority was sufficient to permit the purchase of troubled assets from the auto companies.
In answer to the specific factual questions asked above (iii and iv), we provide the following information:

The interests received by other stakeholders of Chrysler and GM, including the United Auto Worker (UAW)/ Voluntary Employee Beneficiary's Association (VEBAs), resulted from negotiations between all stakeholders as described in detail by Ron Bloom and Harry Wilson in their depositions in the bankruptcy cases, transcripts of which have been provided to the Congressional Oversight Panel (COP).

The terms of the purchase agreements relating to the sales under section 363 of the Bankruptcy Code by Chrysler and GM set forth the interests each party would receive either as equity or debt. Treasury's equity in the new Chrysler was part of the consideration for its loan to new Chrysler. Treasury's equity in the new GM was part of the consideration Treasury received for credit bidding certain loans in the 363 Sale. There was no transfer of interests from Treasury to the UAW/VEBA of either of the new operating companies. Further, Treasury retained $7.1 billion of senior debt in new GM. Since valuable claims of the UAW/VEBA under existing labor agreements were extinguished in the bankruptcies, the debt and equity it negotiated to receive was the basis for it agreeing to enter new labor agreements. Without these concessions and agreements, neither operating company would have been able to continue operations.

2. **Will you agree to provide the Panel with:**

   (i) **the criteria the Administration will use to determine which "non-financial institution" may be allowed to receive assistance through TARP; and**

   (ii) **a formal written legal opinion justifying the use of TARP funds for any such non-financial institutions?**

Treasury has used funds under the EESA only in accordance with the purpose and specific requirements of the statute. EESA authorizes the Secretary of the Treasury (the "Secretary") to establish the TARP to "...[p]urchase troubled assets from any financial institution".

Section 3 of EESA defines "financial institution" broadly to mean "[a]ny institution, including, *but not limited to*, any bank, savings association, credit union, security broker or dealer, or insurance company, established and regulated under the laws of the United States...and having significant operations in the United States, but excluding any central bank of, or institution owned by, a foreign government" (emphasis added).

3. **Will you agree to provide the Panel with a formal written legal opinion justifying the treatment of TARP as a revolving facility?**

   The Treasury Department does not treat TARP as a revolving fund. When financial institutions repay financial assistance they have received under the TARP, Treasury does not re-use funds from the repayments to provide new TARP financial assistance. Treasury deposits the proceeds of repayments into the Treasury general fund for reduction of the public debt, as required by section 106 (b) of the Emergency Economic Stabilization Act of 2008, as amended. Such repayments do, however, reduce the amount of outstanding troubled assets that count against the maximum amount of troubled assets that Treasury is authorized to purchase under the TARP (i.e., the "statutory cap"). Further, Treasury has authority through the statutory termination date to enter into new commitments to purchase troubled assets up to the statutory cap and continuing authority to fund such purchases if committed before the termination date.

4. **In just three months, TARP's $700 billion authorization will expire. When will you decide whether or not to extend TARP beyond December 31, 2009?**

   Upon what specific criteria will you base your decision?

   The Administration is evaluating the necessity, efficacy, and cost of its financial policies, including programs implemented under TARP. Our financial policies have had four key objectives. First, we have been unequivocally committed to preserving financial stability. Second, we have sought to ensure that the financial system has adequate capital. We have done this in two ways: by reducing uncertainty and by mobilizing private sources of new capital. Third, we have sought to restart key non-bank channels for private credit. Finally, we have sought to moderate the impact of the adjustment in the real estate sector on households.

   As the Administration's policies have taken hold, and the economy and financial markets have started to recover, many of the policies put in place to contain the crisis are being wound down. In the August Midsession Review (MSR), the Administration dropped the "placeholder" that was included in the President's Budget to support an additional $750 billion in total activity to stabilize financial markets if necessary. As a result, we lowered the projected deficit for Fiscal Year 2009 by $250 billion. The Money Market Mutual Fund Guarantee Program, which Treasury established at the height of the crisis one year ago, expired on September 18. The program stopped a run on money market mutual funds, incurred no losses, and generated $1.2 billion in revenue for taxpayers. Due to market improvements, the FDIC anticipates that the last day that banks can issue debt guaranteed through its Temporary Liquidity Guarantee Program (TLGP) will be October 31, 2009. These are signs of our commitment to roll back government support as soon as practicable.

   The financial results suggest that these programs have been implemented responsibly. Following the successful conclusion of the large bank "stress tests"

initiated as part of the Obama Administration's Financial Stability Plan, banks were able to raise a substantial amount of new private capital. As a result, banks have repaid more $70 billion in TARP capital, allowing us to reduce the projected national debt by a similar amount. When President Obama took office the U.S. government had invested in financial institutions holding almost 90 percent of all banking system assets. With repayments in recent months, that number has fallen to about 55 percent. While it is difficult to project the ultimate return to taxpayers for TARP investments, in those cases where the banks have repaid and any remaining government stake in these banks has been sold completely, taxpayers have earned a 17 percent return.

In spite of the progress achieved to date, the normalization of financial markets is partial and fragile, and the economic recovery is, at best, in its very early stages. The housing market has not established a firm bottom and foreclosures continue to rise across all classes of mortgages, with prime mortgages now leading the way. The restructuring process for the commercial real estate market has only recently begun. The pace of bank failures has increased, and it is expected to remain elevated for some time. During this difficult period of adjustment, the financial system could be sensitive to future economic and market events.

In this context, it is important to maintain financial initiatives in three key areas, even while other programs are winding down. First, some programs remain critical for rebuilding the supply of credit to households and businesses. Second, some programs continue to contribute to financial stability even if they are not being utilized heavily. Finally, we still need to be able to respond to unforeseen financial developments. Maintaining such capacity provides critical insurance for the financial system and may, by bolstering confidence, actually reduce the chances that we will have to use such capacity.

In addition, we must address the structural weaknesses in our financial system that this crisis revealed. That requires a significant overhaul of our financial regulatory system. The Administration has put forward specific proposals for such reform, which should reduce the risk of another episode of financial upheaval and create conditions for financial stability and sustainable economic growth.

History suggests that both waiting too long to address a financial crisis as well as exiting too soon from policies designed to contain a financial crisis can significantly prolong an economic downturn. We have tried to learn from this history. We must not waver in our resolve to ensure the stability of the financial system and to support the nascent recovery that the Administration and Congress have worked so hard to achieve.

At the same time, we must work together to set our country on a fiscally sustainable path, an objective the Administration has pursued despite the overwhelming needs for public intervention that it inherited. We continue to attempt to minimize the potential costs of our financial and economic policies to taxpayers, while meeting our critical objectives.

I will weigh the circumstances and factors outlined above as I consider whether to extend my authority under the EESA beyond December 31, 2009.

5. **Should you extend the program's authorization, does the Administration plan to ask Congress to extend TARP past October 2010?**

   Upon what specific criteria will you base your decision?

   EESA does not provide for an extension of Treasury authority to purchase, to make and fund commitments to purchase, or to guarantee assets under Sections 101(a), 101(a)(3), and 102 beyond October 2010. However, if financial and economic conditions warrant an extension, the Administration will work with Congress to provide Treasury with adequate authority. In doing so, the Administration will be guided by the circumstances and factors outlined above in my response to question 4.

6. **TARP was enacted to provide "financial stability," and the recent Stimulus Package was enacted to provide "economic stimulus." Do you agree that the Administration is now using the TARP to promote "economic stimulus" instead of "financial stability"?**

   If TARP is not being used for "economic stimulus," then how else may you explain the $81 billion "investment" in Chrysler and GM, neither of which is a "financial institution"?

   The purpose of EESA was to give the Treasury the authorities necessary to "restore liquidity and stability to the financial system of the United States." I have consistently used TARP for this purpose. The auto companies are financial institutions within the definition provided under EESA.

   This term is defined broadly in EESA to include "any institution" and is specifically not limited to banks, brokers, etc. A plain reading of the definition supports providing funds to the auto companies if it was necessary to promote financial stability. The outright failure of GM and Chrysler would likely have resulted in disruptions to the financial system and the economy as whole.

   The broad authority of the Secretary to interpret terms in EESA supports the determinations by me and my predecessor that financial instruments purchased from the auto companies qualify as troubled assets, the purchase of which was necessary to promote financial market stability.

   GAO noted in testimony before the Senate Banking Committee last December that the authority provided under EESA was sufficient to permit the purchase of troubled assets from the auto companies.

7. **According to Treasury's TARP *Transactions Report* for the period ending September 11, 2009, over $22 billion out of a possible $50 billion in TARP funding has been allocated towards incentive payments for the *Home Affordable Modification Program* (HAMP), which is over 40% of the total commitment. Also according to Treasury data, about 360,000 trial modifications have started. When the program was announced in March, Treasury estimated that HAMP would reach 3 to 4 million homeowners.**

   (i) **Will Treasury extend the commitment size of HAMP beyond $75 billion in order to reach the goal of carrying out loan modifications for 3 to 4 million homeowners? If so, through what authority will HAMP be extended, *Emergency Economic Stabilization Act* (P.L. 110-343), Housing and *Economic Recovery Act* (P.L. 110-289), or other?**

   Treasury believes that it has sufficient resources under current authorities to reach the stated goal of the Home Affordable Modification Program to provide assistance to up to 3 to 4 million borrowers over 3 years. $22 billion represents the total amount that has been allocated to all servicers currently participating in the program under the "caps" that are calculated for each servicer, based on their eligible loans and other factors. It does not represent funds actually paid as incentives. We are currently starting about 20,000 to 25,000 trial modifications per week, and are on pace to meet the stated goal of helping up to 3 to 4 million borrowers over 3 years.

   What is the expected all-in cost to the taxpayers of HAMP and any such expansion of HAMP, either using EESA or other authority?

   The cost of the HAMP program is not expected to exceed the allocated amount of $75 billion, $50 billion from TARP authority and $25 billion from HERA authority.

   (ii) **Does Treasury anticipate that it may introduce any additional foreclosure mitigation programs, including, without limitation, any refinancing, modification, second lien and other programs?**

   The Home Affordable Modification Program is one element of the Administration's comprehensive efforts to foster stability in the housing market and help American homeowners. On Feb. 18, the Administration announced Making Home Affordable, which includes: (1) the $75 billion Home Affordable Modification Plan to provide an opportunity for 3 to 4 million Americans to reduce their monthly mortgage payments to affordable levels; (2) increased refinancing flexibilities for the GSEs, including the Home Affordable Refinancing Plan which provides new refinancing opportunities to borrowers whose homes have lost value; and (3) increased support for the GSEs, including a $200B increase in the Senior Preferred Stock Purchase Agreements to help keep mortgage rates low and support mortgage affordability across the market.

In addition to the Making Home Affordable Plan, the Administration has worked with Congress to enact a number of housing market programs as part of the American Recovery and Reinvestment Act (ARRA), which included: (1) raising the loan limits for GSE loans, from a previous maximum of $625,500 per loan to $729,750, thus supporting conforming loans even in high-cost markets, (2) implementing an $8,000 first-time home buyer credit, (3) Neighborhood Stabilization grants, and (4) the Tax -Credit Assistance Program (TCAP) and the Low Income Housing Tax Credit Exchange. ARRA expenditures for the neighborhood and affordable housing programs total nearly $12 billion. In addition, in conjunction with the Fed's MBS purchase program, the Administration has taken actions to support mortgage financing generally and support market liquidity. Helping to keep mortgage rates low has provided the opportunity for over 2.9 million Americans with GSE loans to refinance since February.

On second liens specifically, we have developed a program to require modification of second liens as part of the Home Affordable Modification Program for servicers participating in the Second Lien Program. Details of the Second Lien Program were announced on April 28.

If so, what is the anticipated all-in cost to the taxpayers of such programs, either using EESA or other authority?

The total cost of the Home Affordable Modification Program, including the Second Lien Program and Foreclosures Alternatives Plan falls within the $50 billion under EESA and $25 billion under HERA that has been allocated to the program.

(iii) How many HAMP modifications have been started for borrowers with home loans owned or guaranteed by Fannie Mae and Freddie Mac? How many HAMP modifications have been started for borrowers with "private label" (non-agency) home loans?

We reported on September 9 that 360,000 trial modifications were underway. Of that number about 210,000 are loans owned or guaranteed by Fannie Mae or Freddie Mac. The balance are non-agency loans.

(iv) How much funding has been committed to the *Home Affordable Refinance Program* for homeowners with loans owned or guaranteed by Fannie Mae and Freddie Mac, either using EESA or other authority? How much funding has been committed to the *Home Affordable Modification Program* for homeowners with loans owned or guaranteed by Fannie Mae and Freddie Mac, either using EESA or other authority? Both programs were announced as separate initiatives in the Administration's *Updated Detailed Program Description* released on March 4, 2009.

There is no direct allocation of funds for the Home Affordable Refinance Program. The Home Affordable Refinance Program is an increase in refinancing capabilities for the GSEs, but has no funding associated with the program.

$25 billion under HERA authority is allocated to incentive payments for modification of mortgages owned or guaranteed by Fannie Mae or Freddie Mac as part of the Home Affordable Modification Program.

What is the anticipated all-in cost to the taxpayers of such programs, either using EESA or other authority?

The all-in allocation of funds for the Home Affordable Modification Program is $75 billion, $50 billion from TARP and $25 billion from HERA. There is no funding allocated to the Home Affordable Refinance Program.

(v) What is the anticipated all-in costs of the programs described in (i)-(iv) above to the holders of the mortgages?

Servicers are required to run all loans through a net present value (NPV) test developed for the program, and modifications are required to be offered when loans test positive under the NPV test. The result of the NPV test is positive when the expected future cash flows from a modification are greater than the expected future cash flows from not modifying the loan. This means that modifications under our program occur when the modifications are expected to yield a net benefit to the mortgage holder.

In addition, the Home Affordable Modification Program requires lenders or investors to pay the full amount to reduce a borrower's payment to 38 percent of gross monthly income. Once the lender or investor reduces the monthly payment to 38 percent DTI, HAMP matches reductions in monthly payments dollar-for-dollar with the lender/investor from 38 percent to 31 percent DTI.

(vi) Why do the MHA programs not include a "shared appreciation" or "equity kicker" feature where the mortgage holder and Treasury share in any post-workout appreciation in the fair market value of each home with the homeowner? In other words, why should the homeowner receive all of the benefit from any subsequent appreciation in fair market value even though the mortgage holder and Treasury assisted the homeowner by reducing interest and/or principal payments and making payments to the mortgage servicer for the benefit of the homeowner?

In designing MHA we explored a wide variety of program designs and balanced many competing factors. Shared appreciation specifically

includes substantial administrative costs and complexities, which would have to be offset against any potential benefit to taxpayers. Such a program would also be difficult for servicers, trustees, mortgage holders and others to assess and implement. Costs would be substantial because the government would have to design operational systems to price, acquire, track and ultimately collect shared appreciation. We would also have to manage ownership interests in properties across the nation on an ongoing basis. We have considered this option and concluded that the costs outweighed the benefits.

We are focused on getting as many families as possible who are struggling with their mortgages into a mortgage that they can afford. The program we have designed gets the borrower's interest rates and monthly payments down to a level they can afford in a way that is most cost effective for taxpayers.

8. **Will Treasury announce any new TARP programs or expand the size of any existing programs?**

Treasury continues to monitor the progress we are making in returning to a stable and strong financial system and will continue to consider the best ways to achieve that objective. The normalization of financial markets achieved to date is partial, and the economic recovery is, at best, in its very early stages. Key parts of the financial system are still substantially impaired, and the system as a whole remains somewhat fragile. In those markets where conditions have improved, it is unclear whether improvements achieved to date will persist without a period of continued government support. The restructuring process for the commercial real estate market has only recently begun. Credit losses in some parts of the system are still increasing and bank failures, which tend to lag economic cycles, are still on the rise.

Treasury must balance the desire to exit its investments in private sector entities as quickly as is practicable with the need to ensure that such a withdrawal does not put the progress that the Obama Administration has made in restoring financial stability at risk. To that end, Treasury will continue to provide support where it is necessary to sustain confidence in the financial system and to support critical channels of credit to households and businesses.

9. **So far in 2009, there have been over 90 bank failures and there are now 416 banks on the FDIC's "at-risk" list. Is Treasury considering any new TARP program for small- or medium-sized financial institutions to handle losses that may be forthcoming for commercial-mortgage holdings or any other types of losses?**

The Treasury Department is constantly monitoring markets and institutions to inform policy response. Treasury is particularly focused on the challenges faced by small and community banks because of the important role that these institutions play in lending to small businesses, families and consumers across the

country. In May, we announced the CPP expansion for Small Banks Program, which allows viable banks with total assets under $500 million to receive CPP funds up to 5% of risk-weighted assets (versus the 3% limit for all other banks). This program has helped smaller financial institutions withstand the current economic circumstances and continue to lend.

As you note, the commercial real estate market is experiencing stress due to declining macroeconomic fundamentals and an adverse economic financing environment. Because of the important role commercial real estate plays in our economy, Treasury has undertaken a number of programs in response to this stress in this industry.

In March 2009, Treasury launched two liquidity initiatives targeted at commercial real estate. The Term Asset-Backed Securities Loan Facility (TALF) and the Public-Private Investment Program (PPIP) have both been successful in helping to reduce spreads for commercial real estate borrowing and attracting private capital to the commercial real estate lending sector. Since the announcement of the program, spreads on CMBS have fallen by approximately 50% from their peak.

Further, on September 15, 2009 tax guidance was issued clarifying the circumstances in which CMBS securitization vehicles that elected treatment as real estate mortgage investment conduits (REMICs) may modify commercial loans held by those vehicles without jeopardizing the REMIC status of the vehicles.

The guidance clarifies a number of issues regarding the REMIC rules, including (1) that SPVs with REMIC elections and borrowers may discuss loan modifications at any time; (2) that a loan need not already be in default for default to be reasonably foreseeable; and (3) that a loan may be modified whenever default is reasonably foreseeable based on relevant facts and circumstances. The guidance also contains an example in which a performing loan may be modified 12 months before it is due if, based on all facts and circumstances, default is reasonably foreseeable at that time.

Treasury will continue to closely monitor both the health of the sector as well as the impact of our recent initiatives.

10. Over the past few years Chrysler was owned by Daimler AG. Daimler AG could not fix Chrysler. Next, Chrysler was owned by Cerberus Capital. Cerberus Capital could not fix Chrysler. Given this recent and painful history why do you think the United States government--at an enormous cost to the taxpayers--can fix Chrysler?

The US government provided assistance to Chrysler last December because of the risks that the conditions in the industry posed to the stability of financial markets and the economy as a whole. That assistance was provided on the condition (among others) that Chrysler develop a restructuring plan. After an initial plan was rejected, the President made a viability determination regarding Chrysler's

return to profitability and from that platform he directed the Auto Team to take a commercial approach to the restructuring of the company. As a result, the Administration dealt with the various creditors and stakeholders of Chrysler using the bankruptcy code as a commercial actor, which allowed New Chrysler to buy the majority of the assets of Chrysler creating a substantially healthier company. This was significantly more effective and transformative than what Chrysler had gone through in the past. Also, the Auto Team reviewed the strategic plan that the management teams of new Chrysler and its Alliance partner Fiat developed, and determined it was a viable business plan that included an appropriate level of funding from the Department of the Treasury.

11. **On September 16, 2009, CNNMoney.com reported under the title "Fiat CEO: Chrysler Worse Than We Thought":**

> **"The situation at recently rescued Chrysler Group is even more dire than first thought, the CEO of Italy's Fiat -- which came to the aid of the U.S. automaker -- said Wednesday.**
>
> **'We were surprised by how little had been done in the past 24 months,' Sergio Marchionne told reporters in Frankfurt, Germany.**
>
> **...**
>
> **Industry analyst Todd Turner of Car Concepts Automotive Research, speaking from the floor of the Frankfurt Motor Show, found it difficult to believe Marchionne's assertion that he didn't know how little work had been going on at Chrysler.**
>
> **'I'm a little surprised that he was surprised,' he said.**
>
> **More likely, Turner said, Marchionne is laying the groundwork for drastic actions that will be announced in November but may have been planned all along.**
>
> **'That is that Chrysler is over, basically,' he said of Chrysler's flagship car brand. 'Within five years, you're going to see nothing.'"**

Do you believe that Chrysler is "over, basically" and that within five years its models will be supplanted by Fiat and Alfa models?

That is not our view. The New Chrysler is being run by a new board of directors and a new management team. They are overseeing the daily management of the Company and are making decisions that they deem to be in the best interest of the Company's stakeholders. As has been stated in the past, the Administration is committed to managing its investment in the companies in a commercial manner, but will not interfere in the operations of the companies. It plans to exit those investments as soon as practicable, and will only vote on core governance issues, including the selection of a company's board of directors and major corporate events or transactions.

How is it possible that the American taxpayers will recover their investment in Chrysler?

The return will depend on the overall market, the economy, and the recovery of the auto sector. The decision to provide funds to the companies by the current Administration was based upon a determination that the companies have viable business plans. As a result, we will monitor GM and Chrysler's performance and seek the return of taxpayer funds as soon as is practicable.
Is Fiat committed to rebuilding Chrysler or is it only interested in obtaining Chrysler's "in place" dealer network in order to re-enter the American market with foreign manufactured Fiat and Alfa products?

The New Chrysler is being run by a new management team and is being overseen by a new board of directors, who have a fiduciary responsibility to Chrysler's shareholders and stakeholders. They are operating the business with a focus on shareholder value and the long-term viability of the company. Today, Fiat owns only 20% of the equity of New Chrysler. The decision to sell Fiat products through New Chrysler will be made by the New Chrysler management team for the benefit of New Chrysler's stakeholders in aggregate.

12. **According to the latest estimate from the Congressional Budget Office (CBO), the investment of TARP funds in the auto industry is expected to add $40 billion more to the deficit than CBO calculated just five months earlier in March 2009. It seems that a reasonable interpretation of such estimate is that the American taxpayers may suffer a loss of at least 50 percent of the TARP funds invested in Chrysler, GM and the other auto programs.**

    In addition, in a discussion with staff members of the Panel, Ron Bloom, the head of Treasury's Auto Task Force, stated that it is unlikely the taxpayers will recover all of their TARP funded investments in Chrysler and GM.

    How is it possible that the Administration—based upon its due diligence investigation—invested $81 billion in the auto industry only to discover less than three months later that it grossly overinvested and will suffer substantial losses?

    One of your responsibilities under EESA is to ensure "taxpayer protection." How could you have discharged that responsibility by investing TARP funds in such questionable investments?

    The purpose of all investments made under EESA, including those in the automobile industry, was to promote financial stability. In the case of the auto investments in particular, the US government made the investments because of the risks that conditions in the industry posed to the stability of financial markets as well as the economy as a whole. As noted above, the Auto Team evaluated many scenarios concerning the recoverability of the investments during its diligence process of GM and Chrysler. As described, these scenarios were a

function of various factors including assumptions around the overall market, the economy, and the recovery of the auto sector. Under some of these scenarios, GM will be able to return a high percentage of the total funds advanced by the taxpayers and Chrysler will return the money invested as part of the restructuring. Other scenarios, which in Treasury's view are more likely, show much lower recoveries for the initial loans made to GM and Chrysler, but also indicate a reasonably high probability of the return of most or all of the government funding for GM and Chrysler that was advanced as part of the restructurings. Also, as stated above, the decision to provide funds to the companies by the current Administration was based upon a determination that the companies have viable business plans.

13. **The United States government spent tens of billions of dollars of taxpayer money to bail out employees and retirees of the UAW to the detriment of non-UAW employees and retirees--such as retired school teachers and police officers from the State of Indiana--whose pension funds invested in Chrysler and GM debt.**

    What do you say to those Indiana school teachers and police officers who lost part of their pension?

    What message does the Chrysler and GM bankruptcies send to non-UAW employees whose pension funds invested in Chrysler and GM indebtedness—you lose part of your retirement savings because your pension fund does not have the special relationships of the UAW?

    What message does the Chrysler and GM bankruptcies send to the financial markets—contractual rights of investors may be ignored when dealing with the United States government?

    The President directed the auto team to take a commercial approach to the restructuring process of these companies. As a result, the Administration dealt with the various creditors to GM/Chrysler as a commercial actor would. The final division of debt, preferred, and equity securities between the various creditors was the result of arm's length negotiations.

    The UAW/VEBA had many billions of dollars of claims and labor agreements governing the companies' active workforces. As part of this process the Union agreed to major modifications in their labor agreements. Under the new contracts, the VEBA received a stake in the reorganized companies without any immediate payment. The cooperation and support of the UAW is essential to the ability of the reorganized companies to succeed.

14. **If Chrysler and GM are unable to sell a substantial number of cars at an appropriate profit margin will they be permitted to fail and liquidate or will they remain wards of the state?**

    If Chrysler and GM do not turn-around their economic prospects, does this Administration have the courage to stop throwing good money after bad?

The Administration reviewed Chrysler's and GM's business plans, which were developed by the companies. As part of this review process, the Administration's financial advisors performed sensitivity analyses by varying the assumptions underlying the business plans, and these scenarios helped the Administration with its decision making process. The Administration believes it has provided sufficient capital to fund these companies to allow them to successfully restructure and achieve sustainable operations.

15. On September 1, 2009, *The Washington Times* reported:

> **"A former Treasury official has told the watchdog for the $700 billion Wall Street bailout program that President Obama's promise to restrict lobbyist access to the bailout was made purely for political reasons.**
>
> **Months after the administration's pledge, the lobbyist rules haven't been implemented and Neel Kashkari, the one-time czar of the agency's Troubled Asset Relief Program, told the office of the special inspector general for TARP that the pledge to craft safeguards against lobbyist influence was a defensive move.**
>
> **In January, amid concerns that lobbyists would sway TARP decisions, the Treasury Department pledged to write rules to restrict their access, acting "in light of President Obama's firm commitment to transparency, accountability and oversight in our government's approach to stabilizing the financial system."**
>
> **More than six months later, the rules have not been issued."**

When will the rules mentioned in the article become effective?

Why has it taken so long to produce what should have been straight-forward restrictions on the activity of lobbyists?

Treasury issued its Instructions Regarding Communications with Registered Lobbyists and Other Persons About Emergency Economic Stabilization Act Funds on September 10, 2009 and the Instructions are posted on the Internet at www.FinancialStability.gov. In order to preserve consistency between the guidance issued regarding Recovery Act and EESA funds, Treasury waited to issue the EESA Instructions until OMB issued the final Recovery Act guidelines. We note that on January 27, 2009, Secretary Geithner announced new principles designed to limit outside influence in the EESA process and ensure that investment decisions are guided by objective assessments of the health and stability of the financial system. The principles include restricting lobbyist influence in connection with particular applications for or disbursements of EESA funds. Treasury has followed these principles since they were announced and will continue to do so.

16. The same article in *The Washington Times* also reports:

> **"'The Treasury Department has actively obstructed our ability to determine what the true value of the TARP investments are worth and what TARP recipients are doing with taxpayer dollars. Until we have full transparency, we will never be able to know how much risk Treasury is assuming on behalf of the taxpayers,' Mr. Issa said [Rep. Darrell Issa of California, the senior Republican on the House Oversight and Government Reform Committee].."**

At a July hearing before the oversight committee, Rep. Edolphus Towns, New York Democrat and the committee chairman, threatened to subpoena Treasury Secretary Timothy F. Geithner to testify.

Mr. Towns demanded that Treasury give a full accounting of how TARP funds have been used and to make public the monthly reports that the biggest banks are required to submit to Treasury showing the dollar values of their new loans."

Will you commit to disclose in a prompt, complete and transparent manner how TARP funds are being used by the recipients—particularly the dollar amount and type of new loans?

Will you commit to assist the Panel and Representatives Issa and Towns in our respective efforts to value the various TARP investments?

Reporting on the Use of TARP Funds by TARP Recipients

Treasury is committed to transparency and has developed monthly reports that address these issues. Treasury believes that most of the information contained in SIGTARP survey responses is already captured by Treasury's Monthly Lending and Intermediation Snapshot, CPP Monthly Lending Report or Quarterly CPP Report. Specifically, these Treasury reports capture financial institution activities regarding lending, capital cushions and other reserves, and investments in mortgage-backed securities and asset-backed securities. Treasury publishes its Monthly Lending and Intermediation Snapshot to help measure the lending activities of the nation's largest financial institutions that participated in the CPP. This report includes quantitative information on lending and other intermediation activities, as well as a qualitative section that allows banks to comment on the lending environment and the host of factors outside a bank's control that affect lending levels, such as loan demand, borrower creditworthiness, capital markets liquidity and the macroeconomic environment. Although some of the largest recipients of TARP funds have recently repaid the assistance, Treasury has obtained their agreement to provide this information to Treasury for the remainder of 2009.

In addition to the Monthly Lending and Intermediation Snapshot, Treasury provides an expanded CPP Monthly Lending Report that includes the monthly

average outstanding balances of consumer loans and commercial loans and total loans from all CPP participants. Finally, Treasury publishes a Quarterly CPP Report that provides extensive detail on the financial positions and activities of both CPP and non-CPP banks based on regulatory data collected by each institution's primary financial regulator.

In our continuing effort to improve the transparency of our programs, and in order to more closely adopt the recommendations in the SIGTARP report, Treasury plans to expand its Quarterly CPP Report to include additional categories of information included in the SIGTARP survey responses underlying the SIGTARP report, such as financial institutions' repayments of their outstanding debt obligations and total investments. This expansion will begin with the next Quarterly CPP Report, scheduled to be released during October 2009.

With these efforts, including tracking the additional information discussed above, we believe these reports provide the information needed to insure transparency of the TARP programs. Moreover, because quantitative data used in these reports is based on data that is provided and reviewed by the financial institution's primary banking regulator, they constitute a more reliable and measurable way of tracking how financial institutions use their capital.

Valuation of TARP Portfolio

Treasury agrees with COP that it is in the public interest to provide periodic disclosure of the estimated value of the TARP portfolio so that the public knows the value of the investments that Treasury has made. A valuation of the portfolio was previously provided as part of the President's 2010 Budget. Under Federal law, Treasury is required to provide a valuation of its investments in connection with the preparation of its annual financial statements. In the coming months, Treasury will publish the financial statements for the fiscal year that ended September 30, 2009. The methodology used for such valuation is governed by the Federal Credit Reform Act, the Emergency Economic Stabilization Act, and Federal accounting principles. The financial statements and the methodology are being audited by the GAO.

17. Thomas E. Lauria, the Global Practice Head of the Financial Restructuring and Insolvency Group at White & Case LLP, represented a group of senior secured creditors, including the Perella Weinberg Xerion Fund ("Perella Weinberg"), during the Chrysler bankruptcy proceedings.

On May 3, *The New York Times* reported:

> **"In an interview with a Detroit radio host, Frank Beckmann, Mr. Lauria said that Perella Weinberg *'was directly threatened by the White House and in essence compelled to withdraw its opposition to the***

> ***deal under threat that the full force of the White House press corps would destroy its reputation if it continued to fight.'***

In a follow-up interview with ABC News's Jake Tapper, he identified Mr. [Steven] Rattner, the head of the auto task force, as having told a Perella Weinberg official that the White House *'would embarrass the firm.'"* [Emphasis added.]

In a written response to the Panel following the Detroit Auto Hearing Treasury stated:

> **"As [Mr. Bloom—the head of Treasury's Auto Task Force] testified during the July 27 Field Hearing of the Congressional Oversight Panel, [he has] spoken to Mr. Rattner about this matter, and he categorically denies Mr. Lauria's allegations. [Mr. Bloom has] no knowledge of any other contact with Mr. Lauria or with people at Perella Weinberg regarding the issues mentioned above. SIGTARP will determine the appropriate use of its subpoena power."**

The response is not appropriate because Treasury failed to conduct a proper investigation of this matter by contacting Mr. Lauria and representatives of Weinberg Perella.

Will you agree to conduct a prompt and thorough investigation of this matter by contacting Mr. Rattner, Mr. Lauria and representatives of Weinberg Perella and submit your findings to the Panel?

Note 1: In a press release Perella Weinberg stated that it did not change "its stance on the Chrysler restructuring due to pressure from White House officials." Such a response is entirely different from simply denying Mr. Lauria's statements. It's possible that Perella Weinberg has issued other press releases. See *The New York Times*, May 3, 2009, at http://dealbook.blogs.nytimes.com/2009/05/03/white-house-perella-weinberg-deny-claims-of-threat-to-firm/#statement.

Note 2: Mr. Beckmann's interview with Mr. Lauria is available at http://www.760wjr.com/article.asp?id=1301727&spid=6525.

SIGTARP will determine the appropriate actions with regard to this issue.

But as noted above, I would reiterate that Mr. Rattner categorically denies Mr. Lauria's allegations.

18. Regarding the reorganization of the auto parts manufacturer, Delphi, on July 17, *The New York Times* reported:

> **"Delphi's new proposal [reached with its lender group] is similar to its agreement with Platinum [Equity, a private equity firm], which was announce June 1, the day GM filed for bankruptcy. But hundreds of objectors, including the company's debtor-in-possession lenders,**

> **derided that proposal as a *"sweetheart deal"* that gave the private equity firm control of Delphi for $250 million and a $250 million credit line." [Emphasis added.]**

On June 24 The New York Times reported that

> **"Delphi worked with G.M. and the Obama administration to negotiate with Platinum..."**

In a written response to the Panel following the Detroit Auto Hearing Treasury stated:

> **"The Delphi transactions were negotiated between GM and Delphi. GM determined a failure of Delphi would have led to high losses at GM. The auto team was involved in discussions to the extent necessary to avoid potential destruction of equity value of GM, which would have led to large losses to the Treasury investment and for the U.S. taxpayer."**

This response is not appropriate because Treasury failed to address the key issue—did the Administration advocate a "sweetheart" deal for the benefit of Platinum Equity.

Will you agree to conduct a prompt and thorough investigation of this matter by contacting all appropriate parties and submit your findings to the Panel?

Note: See *The New York Times*, July 17, 2009, at http://www.nytimes.com/2009/07/17/business/17delphi.html?_r=1&scp=8&sq=delphi%20july%20sweetheart&st=cse. See also *The New York Times*, July 24, 2009, at http://dealbook.blogs.nytimes.com/2009/06/24/tensions-grow-over-delphis-platinum-deal/?scp=1&sq=delphi%20june%2024%20sweetheart&st=cse

With regard to this issue, the Auto Team worked purely in a commercial manner to help facilitate the successful sale of assets to new GM and avoid the loss of equity value in order to protect U.S. taxpayer interests. SIGTARP will determine the appropriate actions with regard to any necessary investigations.

Questions for the Record from Panelist Paul Atkins

1. **Sec 116 (b) (1) of the Emergency Economic Stabilization Act (EESA) provides that "[t]he TARP shall annually prepare and issue to the appropriate committees of Congress and the public audited financial statements prepared in accordance with generally accepted accounting principles, and the Comptroller General shall annually audit such statements in accordance with generally accepted auditing standards."**

   What is the current status of this audit? Have the auditors begun work on it, including planning and scoping? Is Treasury consulting with any outside firms in producing the audit? When do you expect the audit to be completed? When do you expect to issue it to the "appropriate committees of Congress?"

   The first audited financial statements for OFS will be for the fiscal year that ended September 30, 2009. The audit is ongoing with Government Accountability Office (GAO) staff on site with OFS. The entrance conference for the financial statement audit was conducted on February 27, 2009. Bi-weekly audit review meetings between OFS and GAO have been held since mid April 2009. Treasury engaged Ernst & Young (E&Y) to assist with accounting services and PricewaterhouseCoopers (PWC) to assist with internal controls in October 2008. The audit is anticipated to be completed on November 8, 2009 and OFS will issue the financial statements in accordance with the timelines set forth by the Office of Management and Budget.

2. **SEC. 106. (d) of EESA states that "[r]evenues of, and proceeds from the sale of troubled assets purchased under this Act, or from the sale, exercise, or surrender of warrants or senior debt instruments acquired under section 113 shall be paid into the general fund of the Treasury for reduction of the public debt."**

   Treasury apparently takes the position that the $700 billion of TARP funds is essentially a line of credit that may be paid down and re-borrowed. If Treasury recycles these "revenues" and "proceeds" for the purchase of other troubled assets, then how does that achieve a "reduction of the public debt?" If Treasury continues to produce a profit on the sale of assets and warrants, does it believe that the program can exceed $700 billion? Please provide Treasury's detailed legal analysis on the issue of reusing TARP funds.

   When financial institutions repay financial assistance they have received under TARP, the Treasury Department does not re-use the funds from the repayments to provide new TARP financial assistance. Treasury deposits the proceeds of repayments into the Treasury general fund for reduction of the public debt, as required by section 106(b) of the Emergency Economic Stabilization Act of 2008, as amended ("EESA").Such repayments do, however, reduce the amount of

outstanding troubled assets that count against the maximum amount of troubled assets that Treasury is authorized to purchase under the TARP (i.e., the "statutory cap"), and Treasury has authority through the statutory termination date to enter into new commitments to purchase additional troubled assets up to the statutory cap and has continuing authority to fund such purchases if committed before the termination date.

In answer to the specific additional questions asked above, we provide the following information:

The warrants that Treasury receives in connection with purchasing troubled assets are not themselves troubled assets. The proceeds from the sale of warrants are deposited into the general fund for reduction of the public debt, as required by section 106(b) of EESA, but because the warrants are not themselves troubled assets, their sale does not reduce the amount of troubled assets that count against the statutory cap. Similarly, the revenues from dividend and interest payments that Treasury receives on account of troubled assets that Treasury has purchased are deposited into the Treasury general fund, but these revenues do not reduce the amount of troubled assets that count against the statutory cap.

If a troubled asset is sold back to a financial institution at a higher price than was paid by Treasury, the amount of troubled assets that count against the statutory cap is reduced as described above, but the amount of that reduction would not include the amount of such return. Section 115(b) of EESA provides that it is the "purchase price" of a troubled asset that counts against the statutory cap, so when a troubled asset is sold back, the amount of reduction of troubled assets that count against the statutory cap would not be measured by the sales price, but rather by the original purchase price.

3. **How much funding has been repaid to TARP? How much funding has Treasury committed to all of the various programs under TARP? Please provide a full list of all current and proposed programs under TARP, and how much Treasury has committed to (and expended for) each of these programs.**

As of COB September 29, 2009, $636.85B has been publically announced; $444.05B has been obligated; $365.09B has been disbursed for the various TARP programs and a total of $85.20B has been repaid to the Treasury Department. The breakdown of these figures is listed below:

TARP Funds as of 9/29/2009

Program Titles	**Announced**	**Obligated**	**Disbursed**	**Repaid**
*(*All dollars in billions*)*				
Capital Purchase Program (CPP)	**$218.00**	**$204.62**	**$204.62**	
CPP Redemptions/Repayments				$ 70.69
Proceeds from Warrants and Stock				$ 2.90
Dividends and Other Income				$ 9.24
Targeted Investment Program (TIP)	**$ 40.00**	**$ 40.00**	**$ 40.00**	
Asset Guarantee Program (AGP)	**$ 5.00**	**$ 5.00**	**$ 0.00**	
Capital Assistance Program (CAP)	**TBD**	**TBD**	**TBD**	
Consumer and Business Lending Initiative (CBLI)	**$ 70.00**	**$ 20.00**	**$ 0.10**	
Public-Private Investment Program (PPIP)	**$100.00**	**$ 0.00**	**$ 0.00**	
AIG Investments	**$ 70.00**	**$ 69.84**	**$ 43.21**	
Automotive Industry Financing Program (AIFP)	**$ 82.59**	**$ 81.05**	**$ 75.90**	
Auto Loan Principal Repaid				$ 2.14
Interest Received from Loans				$ .21
Proceeds from Additional Notes				$ .02
Making Home Affordable (MHA)	**$ 50.00**	**$ 22.28**	**$ 0.00**	
Helping Families Save Their Homes Act	*$ 1.26*	*$ 1.26*	*$ 1.26*	
Program Totals:	**$636.85**	**$444.05**	**$365.09**	
Total Revenues Repaid to TARP:				**$ 85.20**

4. **Sec. 120 (b) of EESA states "[t]he Secretary, upon submission of a written certification to Congress, may extend the authority provided under this Act to expire not later than 2 years from the date of enactment of this Act. Such certification shall include a justification of why the extension is necessary to assist American families and stabilize financial markets, as well as the expected cost to the taxpayers for such an extension."**

   This provision essentially calls for Treasury to employ a cost-benefit analysis in determining whether to extend the program. Will Treasury conduct a rigorous economic analysis, including all direct and indirect costs of TARP? Will moral hazard be a consideration? What specific criteria will Treasury use in determining whether it intends to extend TARP? Will Treasury use the results of any cost analysis it produces?

   What are the current costs of the TARP, not just in terms of out-of-pocket expenses, but also other real, if latent, costs such as moral hazard? Has Treasury produced any type of cost analysis of the current cost of TARP to the taxpayer? Is so, what were the results?

The Administration is evaluating the necessity, efficacy, and cost of its financial policies, including programs implemented under TARP. We are committed to setting our country on a fiscally sustainable path, an objective the Administration has pursued despite the overwhelming needs for public intervention that we inherited. We continue to attempt to minimize the potential costs of our policies to taxpayers, while stabilizing and rehabilitating financial markets and creating conditions for sustainable economic growth.

Pursuant to the requirements of ESSA, if we elect to extend the authority provided under Sections 101(a), 101(a)(3), and 102 of the Act, we will provide Congress with written certification of why the extension is necessary to assist American families and stabilize financial markets, as well as the expected cost to the taxpayers for such an extension. These are factors that the Administration has considered carefully in deciding whether to initiate, continue, or wind down TARP programs. And as I explain in my response to Panelist Congressman Hensarling's questions, these are factors that will inform our decision of whether to extend EESA authority.

Note that financial results for TARP suggest that these programs can be implemented responsibly and with sufficient protections for taxpayers. Following the successful conclusion of the large bank "stress tests" initiated as part of the Obama Administration's Financial Stability Plan, banks were able to raise a substantial amount of new private capital. As a result, banks have repaid more than $70 billion in TARP capital, allowing us to reduce the projected national debt by a similar amount. While it is difficult to project the ultimate return to taxpayers for all TARP investments, in those cases where the government's stake in banks has been sold completely, taxpayers have earned a 17 percent return.

Per the timelines established by the Office of Management and Budget, Treasury will publish a financial statement that includes detailed cost estimates for each TARP program. Those estimates are based on actual and projected cash flows from repayment and income Treasury investments, as well as administrative costs. And the programmatic cost estimates reflect adjustments to the discount rate for market risks. The financial statement will include an analytical discussion and copious footnotes to provide context and transparency into our methods of estimating costs. We have hired E&Y and prominent economists to review and improve our methods of estimation, and various asset managers have validated the results. In addition, GAO is conducting a financial audit that includes TARP programs.

The Administration appreciates that intervening in financial markets any longer than necessary risks distorting markets. Although it is difficult to quantify those costs, they are real. For this reason, we are terminating programs as soon as practicable. For example, we recently ended the Money Market Mutual Fund Guarantee program put in place last fall, which guaranteed at its peak over $3 trillion in assets. Once financial conditions stabilize and we finish winding down our extraordinary financial programs, we will need to evaluate the appropriate

role for government in financial markets in the broader context of regulatory reform.

System-wide breakdowns of the financial system can have devastating impacts on households and businesses. Ever since the Great Depression, the government has provided a safety net for essential parts of the financial system in order to limit the economic fallout from financial instability. As your question suggests, by insulating financial institutions from the full consequences of their actions, that safety net encourages risk taking. Effective regulation is essential to contain this moral hazard.

The Administration has put forward specific proposals to reform our regulatory structure to accomplish these objectives. For example, we propose holding the largest, most interconnected financial firms to tougher standards: tougher capital standards, tougher liquidity requirements, and tougher supervision and regulation regardless of their legal form. These higher standards help ensure that our largest financial institutions take into account the risks that they impose on the system as whole. Further, any losses incurred in managing the failure of a large, interconnected financial firm should be recouped through assessments on financial firms that benefit most directly from financial stability, commensurate with size and risk. Those financial firms –not the taxpayer – will bear the ultimate cost of that resolution under our proposals.

Regulatory reform will minimize moral hazard in our financial institutions, reduce the need for future government support, and make the financial system more stable, efficient, and robust.

5. **Does Treasury plan to include TARP in its review as required by the Government Performance Results Act? If not, why not? If so, how detailed will this review be? To what extent has Treasury been working on this review?**

   OFS/TARP will be included in the overall Treasury review of its performance as required by the GPRA. OFS has drafted five overall goals and 15-20 corresponding performance indicators. Currently these goals and indicators are being vetted through the standard Treasury process, and following this will be sent to OMB for approval. Concurrently, OFS is creating the data set that will allow us to track performance of these indicators. Our plan is to include these baseline results in Treasury's Fiscal Year 2009 Performance Summary.

6. **Why did Treasury make the decision to put its ownership of AIG in a trust, but not its ownership of General Motors? What are the implications of the Government Corporations Control Act with respect to the government's ownership in AIG and General Motors? Also, Treasury has stated its intention to put its ownership of Citigroup in a trust; however, this has not yet occurred. When does Treasury plan to fulfill this commitment?**

O

(a) The interests in AIG that Treasury received from its TARP investments are not held in a trust. They are held by Treasury.

The trust established pursuant to the AIG Credit Facility Trust Agreement (the AIG Trust) was created by the Federal Reserve Bank of New York (FRBNY) to hold assets the FRBNY received in consideration for its loans to AIG. These loans were not made by Treasury pursuant to EESA.

The customary purpose of a trust is to divide beneficial ownership of the assets within the trust from control or supervision over those assets. The AIG Trust is an independent voting trust, providing the trustees with the sole voting power of the AIG shares held in the trust.

Treasury does not have authority under EESA to create an independent voting trust because EESA requires that any vehicle created by the Treasury to manage assets acquired under EESA must be "subject to supervision by the Secretary" (EESA Section 101(c)(4)). It is the view of Treasury that a trust providing the trustees with voting discretion would not satisfy the "supervision" requirements of EESA.

(b) The Government Corporation Control Act (GCCA) prohibits the United States government from establishing or acquiring corporations to act as an agency unless there is a law of the United States specifically authorizing the action. The GCCA does not apply because, among other reasons, neither GM nor AIG "act as an agency."

(c) The term sheet provided with a February 27, 2009 press release regarding Citigroup's exchange offering, through which Treasury would exchange a portion of its non-voting preferred stock for common stock, stated that it was "anticipated that [the United States Government] will hold such securities in a trust". This term sheet was a transaction outline representing contemplated terms of the potential exchange. Treasury subsequently determined that a trust was not appropriate and did not put the securities into a trust.