S. HRG. 111–412

TARP ACCOUNTABILITY AND OVERSIGHT: MEASURING THE STRENGTH OF FINANCIAL INSTITUTIONS

HEARING

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

JUNE 9, 2009

Printed for the use of the Joint Economic Committee

U.S. GOVERNMENT PRINTING OFFICE

54–082 WASHINGTON : 2010

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

JOINT ECONOMIC COMMITTEE

[Created pursuant to Sec. 5(a) of Public Law 304, 79th Congress]

HOUSE OF REPRESENTATIVES
CAROLYN B. MALONEY, New York, *Chair*
MAURICE D. HINCHEY, New York
BARON P. HILL, Indiana
LORETTA SANCHEZ, California
ELIJAH E. CUMMINGS, Maryland
VIC SNYDER, Arkansas
KEVIN BRADY, Texas
RON PAUL, Texas
MICHAEL C. BURGESS, M.D., Texas
JOHN CAMPBELL, California

SENATE
CHARLES E. SCHUMER, New York, *Vice Chairman*
EDWARD M. KENNEDY, Massachusetts
JEFF BINGAMAN, New Mexico
AMY KLOBUCHAR, Minnesota
ROBERT P. CASEY, JR., Pennsylvania
JIM WEBB, Virginia
SAM BROWNBACK, Kansas, *Ranking Minority*
JIM DEMINT, South Carolina
JAMES E. RISCH, Idaho
ROBERT F. BENNETT, Utah

NAN GIBSON, *Executive Director*
JEFF SCHLAGENHAUF, *Minority Staff Director*
CHRISTOPHER FRENZE, *House Republican Staff Director*

CONTENTS

MEMBERS

WITNESSES

SUBMISSIONS FOR THE RECORD

TARP ACCOUNTABILITY AND OVERSIGHT: MEASURING THE STRENGTH OF FINANCIAL INSTITUTIONS

TUESDAY, JUNE 9, 2009

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, DC.

The committee met, pursuant to call, at 10:05 a.m., in Room 210, Cannon House Office Building, The Honorable Carolyn B. Maloney (Chair) presiding.

Representatives present: Maloney, Hinchey, Cummings, Snyder, Brady, and Burgess.

Senators present: Klobuchar.

Staff present: Nan Gibson, Colleen Healy, Marc Jarsulic, Aaron Rottenstein, Justin Ungson, Andrew Wilson, Rachel Greszler, Lyndia Mashburn, Jeff Schlagenhauf, Jeff Wrase, Chris Frenze, and Robert O'Quinn.

OPENING STATEMENT OF THE HONORABLE CAROLYN B. MALONEY, CHAIR, A REPRESENTATIVE FROM NEW YORK

Chair Maloney. Good morning. I would like to welcome Professor Warren, the Chair of the Congressional Oversight Panel for the TARP program and I want to thank you for testifying today on the COP's new report to Congress just released this morning. I also want to compliment you on your research and all of your work in support of credit card reform. Your testimony and support were very important to the passage of the credit cardholders bill of rights. Thank you.

This is the third in a series of hearings this committee has held to examine the degree to which the Troubled Asset Relief Program has succeeded in its goals. The COP's June report examines the results of the government's stress tests, which were designed to evaluate the balance sheets of the financial institutions and provide any recommendations for further action.

The results of the stress tests conducted by the Federal Reserve have gone a long way toward restoring market confidence.

Huge losses shook confidence in the banking system, because it was not clear that some of our largest banks would remain solvent.

The Federal Reserve, Treasury and FDIC have taken steps to provide the banks with liquidity for those assets where the market evaporated guarantees for their debt issuances and capital injections.

Despite these substantial efforts, concerns remain that a deepening recession could threaten the solvency of some banks and amplify the financial crisis.

Confidence is in large measure determined by the current and future state of bank balance sheets, so it is important that investors and counterparties have a clear picture of whether banks have the capital to weather the current downturn. It is welcome news that the Obama administration is set to announce that some of the Nation's largest banks will soon be able to repay billions of TARP funds. However, the Federal Reserve has reportedly imposed additional requirements on banks that proposed to repay capital they received under TARP.

Since the stress tests were intended to estimate the necessary capital needed to be raised by bank holding companies, this raises an important question about what the stress test assumed about repayment of TARP funds. Moreover, some banks appear reluctant to perform their normal roles as providers of credit.

I was honored to testify before the COP's recent field hearing in New York City, examining problems in commercial real estate. I am very concerned about the ticking time bomb we face in commercial real estate. An estimated 400 billion in commercial real estate debt is set too mature this year with another 300 billion due in 2010. If commercial real estate developers are unable to refinance or otherwise pay those large balloon payments, we could expect to see the default rate on commercial mortgages climb much higher. That, in turn, would translate into potentially crippling bank losses that our recovering financial system is still too fragile to withstand, even with the news that banks have raised 50 billion in new private capital since the release of the stress test results.

This looming crisis in commercial real estate lending could lead to an all too familiar predicament, where banks suffer significant losses, major owners of hotels and shopping centers are forced into bankruptcy, foreclosed properties push commercial real estate prices further downward. And a perfect storm of all those forces combine to inhibit our economic recovery.

The testimony we will hear today points out that transparency and accountability are critical in a crisis such as this.

To increase transparency and to help restore confidence in our financial institution, I have introduced H.R. 1242, the TARP Accountability and Disclosure Act. This legislation would require the Secretary of Treasury to create a centralized database for the existing financial report of TARP recipients enhancing our ability to better determine how these funds are being used in a near real-time basis. I am very interested in hearing your thoughts about how this bill would help you do your job to safeguard taxpayer dollars and whether additional transparency measures are needed.

Professor Warren, I am also interested in your views to the extent TARP is accomplishing its overall mission of restoring financial stability, reinvigorating markets, increasing the flowing and availability of credit and reducing foreclosures. We look very much forward to your testimony.

[The prepared statement of Representative Maloney appears in the Submissions for the Record on page 26.]

Chair Maloney. And I now recognize Mr. Cummings for 5 minutes.

OPENING STATEMENT OF THE HONORABLE ELIJAH E. CUMMINGS, A REPRESENTATIVE FROM MARYLAND

Representative Cummings. Thank you very much, Madam Chair. I also want to thank you Professor Warren for joining us here today. The work of Congressional Oversight Panel of the Government Accountability Office and Special Inspector General continue to provide the Congress with critical evaluations of the financial recovery efforts. Congressional Oversight Panel's latest monthly report, its seventh, is an impressive assessment of the stress tests conducted by Treasury and the Federal Reserve on the 19 largest bank holding companies.

The report observes that the basic methodology and economic assumptions underlying the stress tests are reasonable and conservative. Though the report goes on to identify logical and important criticisms of the tests. The panel's findings that concerns me most is it calls for increased transparency. I have long been an advocate for the highest levels of accountability and visibility in all aspects of the economic recovery. I have often said that in order for the Obama administration to help us come out of this crisis, the public must have a sense of confidence. They must feel that they are a part, they must feel they are informed. Time and time again, the public has been asked to accept the notion that disability of a global economy depended on the injection of unparalleled sums of public funds into the private markets.

Correctly this Congress has asked that in return for our acceptance of the public rescue of private firms, the recipient companies exercise transparency in their spending and show a willingness to be accountable for their use of hard earned taxpayer dollars. The Washington Post reported yesterday that repeated requests by the largest banks to return TARP funds will likely be honored for most, if not all, of the banks that have deemed adequately capitalized under the stress test. Now we are asked to accept the contention of the banks, and their regulators that the stability of the global economy is not jeopardized by the withdrawal of the same public funds from private firms that were considered so critical to the survival of our economy just a few months ago. Accordingly in order to accept these claims we again require transparency regarding the actions of all the players. The oversight panel's report indicates that more openness is still required moving forward. The panel notes that while there has been an unprecedented level of disclosure of information regarding the stress test, it is at the same time impossible for others to replicate the same test using different assumptions and scenarios or to apply these same assumptions and scenarios to other banks.

I believe that the credibility of the banking supervisors is tarnished if their findings cannot be recreated by observers and critics alike. The oversight panel also notes that the results of the stress tests have only been released under the adverse economic scenario. While having the results of the adverse scenario is preferable to having only results under the baseline scenario, the credibility of the supervisor is again blemished by this limited release of information.

Further worsening economic conditions such as the increased unemployment rate already exceed those assumptions used under the stress test adverse scenario. As the stress tests were to an extent an exercise in establishing the public confidence in these keystone institutions, that public confidence would be strengthened by another iteration of the test conducted with the acknowledgment that economic conditions have changed and that an assessment is required, a reassessment is required.

This display of transparency and openness would again engender confidence in the legitimacy of the process. I am encouraged that the banking regulators have found that many of the Nation's largest institutions to be in good financial health and will be permitting the return of taxpayer dollars to the taxpayers. However, I remain concerned about the lack of transparency in this process. I look forward to hearing more details about the oversight panel's assessment today and I thank Professor Warren for her unfailing commitment to transparency and all aspects of the bailout process. I thank you, Madam Chair. With that, I yield back.

[Questions submitted by Representative Cummings to Elizabeth Warren appear in the Submissions for the Record on page 27.]

[Responses given by Elizabeth Warren to questions submitted by Representative Elijah E. Cummings appear in the Submissions for the Record on page 30.]

Chair Maloney. Thank you, the Chair recognizes Mr. Hinchey for 5 minutes.

OPENING STATEMENT OF THE HONORABLE MAURICE D. HINCHEY, A REPRESENTATIVE FROM NEW YORK

Representative Hinchey. Thank you very much. Professor Warren, I want to say exactly what my friend Mr. Cummings said just a few minutes ago. We very deeply appreciate all of the things that you have done. I think that the analysis that you have conducted and the recommendations that you are performing are very, very helpful, and they are very, very well.

I wanted to ask you a question about the stress test solution and whether you think that that stress test solution is going to help aiding banks get through the financial crisis and to what extent there are sort of ancillary objectives involved in that stress test.

Chair Maloney. This is opening statement.

Representative Hinchey. Oh, an opening statement.

Chair Maloney. That is a good opening statement.

Representative Hinchey. In the context of the opening statement, I just want to emphasize the importance of everything that you have done. We are dealing with a very serious situation here. And it is one that although there are some indications that the circumstances of improving and getting better, there are also some underlying circumstances that indicate that there is a very strong likelihood that the situations not only will not continue to get better, but they may, in fact, get a lot worse. And so all of those things are critically important to all of us and everybody across this country that we represent. And it is also very important for the fact that you have been appointed to this particular job. The Congress passed this position because we recognize how important it was for this kind of analysis. And we also recognize how effective you have been already and how effective you will continue to be. I just want to keep this very short and thank you for everything that you have done.

Chair Maloney. Thank you, Mr. Brady is recognized for 5 minutes.

Representative Brady. Madam Chairwoman, with your permission why don't I just enter my remarks for the record?

Chair Maloney. In the interest of time, thank you.

[The prepared statement of Representative Brady appears in the Submissions for the Record on page 31.]

Chair Maloney. Mr. Snyder is recognized for 5 minutes.

Representative Snyder. I will follow Mr. Brady's lead and I look forward to hearing from Professor Warren.

Chair Maloney. We are having trouble hearing from Professor Warren. They have fixed the sound. So now I would like to introduce Professor Elizabeth Warren. She is the Leo Gottlieb Professor of Law at Harvard University. She has written 8 books and more than 100 scholarly articles dealing with credit and economic stress. Her latest 2 books, The 2 Income Trap and All Your Worth were both on national best seller lists. She has been principal investigator on studies funded by the National Science Foundation and more than a dozen private foundations. Warren was the chief advisor to the National Bankruptcy Review Commission. She currently serves as a member of the Commission on Economic Inclusion established by the FDIC. She also serves on the steering committee of the Tobin Project and the National Bankruptcy Conference. Thank you so much for your work and we look so much forward to your testimony.

Professor Warren. Thank you.

Chair Maloney. Excuse me, they are saying we need to break because the sound system is not working properly.

Professor Warren. All right.

Chair Maloney. And we want to make sure we can understand everything that you are saying today.

Professor Warren. That is fine.

Chair Maloney. Five-minute break for the sound system.

[Whereupon, the Committee took a short recess.]

Chair Maloney. Professor Warren is recognized for as much time as she may consume.

STATEMENT OF PROFESSOR ELIZABETH WARREN, CHAIR, CONGRESSIONAL OVERSIGHT PANEL

Professor Warren. Thank you. Thank you Chairwoman Maloney, thank you Representative Brady, Representative Cummings, Representative Hinchey, Representative Snyder, I appreciate the invitation to be here today on behalf of the Congressional Oversight Panel and to be as helpful to you as I can.

I should start by saying I am not scripted. So since I don't have a preapproved script, you should take my comments as my comments alone and not necessarily reflecting those of the panel. I will do my best to represent the reports, but otherwise you are hearing from me.

I want to say about the Congressional Oversight Panel, we are the smallest of the oversight units here, particularly compared with the Special Inspector General. What we try to do is a fact-based analysis of the operations under the Troubled Asset Relief Program and the impact of that program. We are really trying hard to see what the effectiveness is and to make recommendations that might make it more effective.

We return to the same themes that we started with our very first report about transparency, accountability and clarity throughout the system. And they appear again in the report that we issued today. So I thought I would start with just a brief overview of that report, and then very quickly a little dance through our earlier reports to remind you what they have been about and to be here then for whatever questions you might have.

You may remember that back in early February Treasury and the Federal Reserve announced SCAP, yet another acronym, this time to assess the ability of the 19 largest bank holding companies to remain well capitalized, even under adverse circumstances. The results were reported just recently. And so for our June oversight report, we examined the stress test, we went back and took a hard look at the stress test. We have been working on it now for over a month since the program was initially announced. And here is sort of our headline findings. I know that you have had a chance it look at the report, but I want to make sure it is out there as part of our conversation. We looked first at the model for calculating the report, we looked at the economic assumptions in it. We looked at the question about replicability, how robust is this test. We looked at the limitations of the data that are used in this stress test and we make some recommendations going forward as to the transparency to the test and appropriate circumstances perhaps for repeating the stress test.

So let me start by giving you I think some very good news about the stress test and that is it is always good to believe things that you are told, but it is also good to verify them independently. So we were very concerned about just the model of the stress test. You know, there is a lot of dispute in the economic world and academic world about how stress tests have been used and whether they have been very effective. So we asked two independent experts, Professor Eric Talley and Professor Johan Walden. People who are known internationally to take a look at the model that Treasury used and the way Treasury constructed its model and give us an idea of what they thought about it. And they came back and said it was a very conservative model, conservative meaning a dependable model, a good model for stress testing. They gave it a lot of support. We got a long and detailed report from them and we have put it into our report as part of appendix one and very much integrated it into our work. They identify limits from the stress test as we then do in our report.

The first of them is the question about the worse case scenario. Part of the point of a stress test, as any family that sits around and runs a stress test, is trying to figure out what happens. You have to think what are your worst economic assumptions? That you will be laid off or your credit card interest rates may go up? You may be in default on your mortgage? What is it you need to worry about here? Well the stress test said for 2009 that the key economic assumptions under the worst case scenario would be an 8.9 percent unemployment rate. We are now at 9.4 percent for the month of May.

Now, the projection made back in February seemed like a reasonable projection at the time; unemployment obviously rose more quickly than we had anticipated. The average for the year to this point counting the earlier months when it was lower is 8.5 percent, which means we have not actually broken through the worst case scenario, but let's face it, the numbers are bad and they are headed in the wrong direction. So this is a real concern, the worst case scenario right here in 2009 is, in fact, not the worst case. We are going to see worse numbers than that.

The second concern is the limited time horizon. Modeling is always tricky. It is like the weather the further out you try to go, the more possibility there is error, the more possibility you may not be accurate. On the other hand, particularly if you have reason to know there are things you should be concerned about in the future, you could ignore that future time only at your peril. The point of a stress test is to tell us about the financial health of these institutions and whether or not they will be able to survive going forward. Our concerns do not stop with December of 2010. But the stress test does, the period of time. That is particularly worrisome because of the state of the commercial real estate mortgages.

They are on a longer period for when they will come up to be refinanced so that numbers—we were supplied numbers by representatives from Deutsche Bank, they are in our report on an annual basis—the numbers for 2011, 2012, 2013 were deeply worrisome. And the question about the adequacy of the capital reserve requirements looking at potential losses in the future, it really does say the stress test would be stronger and more meaningful if they reached across a longer period of time and dealt with this issue.

The third problem that we are concerned about is the inability to replicate the tests. I am afraid I am going to expose once again my academic background, I do a lot of empirical work. One of the most important things that you want to do in any model is establish that it is robust. And what we mean by robust is just if something changed slightly, if you altered the time period a little bit, the GDP contraction or growth shifted just slightly, you get relatively similar results. Different results but in the same ball park. If you do, then you have a lot of confidence that the test is measuring something real, that is that it is robust.

The problem is you can't rerun those tests unless you have enough details about them. And so we have pressed very hard on the Fed, who is, really the custodian of this test for more information, not about specific banks, but about the operation, how exactly, down at a gritty level, how these mathematical formulas work, how the pieces link into each other. We have not been able to get that information. And without that information, others, outsiders are not able to push on the stress test in the same way.

And then finally we would be remiss if we failed to note, this is self reported information, it is not independently verified information, and it is overseen by the same regulators that we have had in place throughout the process, and this raises questions about confidence overall.

So that brings us to our recommendations here. We recommend that the stress test should be repeated under more difficult economic circumstances and over a longer time period for obvious reasons, it is a way to test it to see how it works. We recommend the test should continue as long as the banks continue to hold large amounts of toxic assets. This is a risky situation and an appropriate time to repeat these tests. We recommend that banks be required to run internal stress tests between official reporting periods and share those results with their regulators.

In other words, I want to make it clear here, while we have concerns about the stress test, we think there are ways to strengthen it and we embrace the stress test. We think that the stress test was a good move by Treasury and the Fed and that it has brought us important information indeed. As I push for more transparency because that is the second big category of recommendation, more transparency, more accountability in the system, Treasury should release more details of their methodology and the results and publicly track the status of the macroeconomic assumptions, this is just an important part of doing this.

We want the analysts to be able to run these tests independently. I really want to put this on a spectrum though. We had trouble when we first started the Congressional Oversight Panel back in November, and in December that we had a Treasury Department that was not forthcoming with information. That has changed. The Treasury Department has been forthcoming. They have given us far more information. And I don't just mean the Congressional Oversight Panel, they have made available information under the stress test, an unprecedented amount of data. This is very unusual for the Federal Reserve to make the results of tests like this available other than simply to make announcements at the end as the FDIC does when an institution has been placed on a watch list or closed. We simply are asking for more. We think the tests were a good idea, but we would get more effectiveness from them if we had these changes, if we made them stronger.

One last recommendation I want to mention here. We also want to point out that as much as we think capital adequacy reserves are important, the capital tests are important. It is important that banks should not be forced into counterproductive fire sales, which is when they sell under enormous pressure in order to try to raise enough cash. So we very much see the importance of flexibility in dealing with the institutions that are not able to meet the capital reserve requirements that are only close, and we want to repose some confidence with our regulators in this area. So those are the recommendations coming out of the June report, which was just issued this morning, hot off the presses.

I will just give you a quick summary of our early reports just to remind you of the kind of things we have talked about and I am glad to talk about any of these reports. Our December and January reports pose 10 primary questions to the Treasury Department about their goals and their methods to stabilize the markets and to reduce foreclosures. I think it is fair to say that Secretary

Paulson's answers were often non-responsive, that they were incomplete and in some cases elusive.

Additional information on bank accountability, transparency, asset valuation, foreclosures and strategy must be provided. We have been pushing on that from the beginning.

The February report evaluated the securities that Treasury had received in exchange for the infusion of cash under the initial healthy banks program, the capital infusion program and then ultimately the support for AIG, and whether or not what the taxpayer received in response was fairly valued. Secretary Paulson in his response to our inquiry about this in December responded by saying all of those transactions had taken place, in his words, at or near par, which means for every hundred dollars put in, that the American taxpayer received $100 worth of stock and warrants. We did an independent valuation and discovered that for every $100 put in on average, we received $66 in stock and warrants. So this was an important report on valuation.

I should say that we were very much arguing in this report that had we known that we were creating these subsidies the program would likely have been structured differently from the beginning. There have not been additional infusions under that program since February.

The third, the March report examined the foreclosure crisis with particular focus on the impediments to the mortgage mitigation and why it is we are not able to stop the foreclosure, and what we can do to help the foreclosure. This report came out only a few days after the administration's foreclosure mitigation program was announced. We had established some criteria for evaluating that and we talk in that report about some ways in which we think the administration program was good, but some ways in which it very much needed to be strengthened.

In our April report, we highlighted the benefits and problems of basic approaches to dealing with financial institutions in trouble. We had experts in to talk with us about how Japan dealt with its banks when they were in financial crisis, experts from Sweden, we had someone who had been part of the RTC here in the United States when the savings and loans collapsed and someone who was a specialist on the Great Depression. That was in our hearing. In addition to that, we did lots of other studies about other times and other circumstances. We came away from that saying that successful efforts to deal with failing financial institutions had always been marked by transparency, assertiveness in dealing with the financial institutions demanding greater accountability from the financial institutions and clarity in the programs, what it is that the government was about and what it trying to do.

Our May report, the last report before this one, considered the state of small business and consumer lending and whether the TALF program was well designed to attract new capital. We concluded that there are serious problems in the small business lending area. We thought it was a much more mixed picture in terms of consumer lending. With small business lending our conclusion was that the TALF program was not likely to make a big difference in the availability of credit for small and mid-sized businesses. Once again, as I think has been the case with each of our reports, we concluded that increased transparency, accountability and a clearly delineated plan are what will be essential for getting us out of the economic crisis. That is a description of our current report and just a thumb novel our earlier reports. And I am glad to help if I can with any questions.

[The prepared statement of Elizabeth Warren appears in the Submissions for the Record on page 32.]

Chair Maloney. Thank you very much for your testimony, Professor Warren.

One of your principle recommendations is to repeat the stress test so long as banks continue to hold large amounts of toxic assets. Yet the stress tests take bank accounting value as their starting point and explicitly avoid marking certain toxic assets to market. So my question to you is, do you think that an effort should be made to recognize the losses on these toxic assets.

Professor Warren. Well, Congresswoman, you know, that is the ultimate and everything is related to everything. And if we don't have confidence in the books and what it is that the financial institutions hold out publicly to be their worth, what their assets are worth and what their liabilities are worth, it undermines not only confidence in the whole system, it really does mean that we are continuing to run risks. Mark to market is not the only way to develop some confidence in the value of the assets held by the financial institutions. But there is no doubt that any stress test and frankly any analysis of the current health of these financial institutions and how they trade on Wall Street depends on some confidence that these assets are correctly valued.

So let me simply emphasize the importance of transparency, I will leave it to the accountants to continue to argue on the right way to get that. But to say without it we can not rebuild our financial system, we cannot build it on clouds. We have to build it on reality. And reality is what those assets are really worth.

Chair Maloney. So do you think that bank lending will be affected if they continue to carry the unrecognized losses on their books?

Professor Warren. Well, to the extent that every time the banks raise capital they are concerned about these losses and they hold that capital against the future losses, they hold it in reserve, those are dollars that are not available for lending. It is just that straightforward. If the banks are not in a stronger financial position, they will not lend.

Chair Maloney. Risk at some banks were hidden in off balance sheet vehicles, only to be brought back on to bank balance sheets as these vehicles experienced losses. Do you think the stress tests have been successful in identifying where off balance sheet problems my arise over the next 2 years?

Professor Warren. Well, I want to say something complimentary here. The good news is the stress test was designed to bring the off balance sheet vehicles back and include them. I think that the stress test, without that would have been a non starter if we are going to continue to hide risks off the balance sheet. So that is the good news, they were brought back in. I hope that everything has been included, but I have to say, these are self-reported numbers. I have no personal access and my panel has no access to any additional information or any data, that is just outside what we are able to see.

Chair Maloney. And today it has been announced that major institutions will be repaying their TARP money, that they are capitalized and ready to repay the government. How will the repaid TARP money be used? Will it be recycled in new lending or will it go back to the Treasury? What will be the use of this returned TARP money?

Professor Warren. I believe based on what Secretary Geithner has said that the money will be held at least to be available to be re-spent. I think that the statute is at best ambiguous on whether this money can be recycled or whether this money must be returned to /the Treasury. And given the ambiguity, the Treasury Department certainly at least has grounds for interpreting it the way they want to interpret it. So I think that is what they are going to do with the money unless Congress tells them something differently.

Chair Maloney. Thank you. My time has expired. Mr. Brady is recognized for 5 minutes.

Representative Brady. Thank you, Madam Chairman. Professor Warren recently Neil Barofsky, the Special Inspector General for the bailout dollars issued a disturbing report that it identifies many key weaknesses in the design and implementation of government bailout. He made several recommendations and called on the Treasury Department to adopt them: that all the TARP recipients simply to account for the use of their TARP funds; that they set up internal controls to comply with such accounting; and report periodically to Treasury on the results with appropriate sworn certifications. Do you support those recommendations?

Professor Warren. Yes, Congressman, I do. Although I really want to point out much of this falls on the smaller financial institutions and very responsible financial institutions whose horses never left the barn and that the problem we have is that we are doing this 6 months after the fact. If we had set this program up last October to say you only get the money when you describe in advance what you plan to do with it and give us metrics for how we will measure that, we would be in a very different position today. Today we are in the position of asking after the fact how did you spend the money that you received. And quite frankly given the fungibility of money that is a pretty tough one to have much accountability for.

Representative Brady. I appreciate that, but it seems to me the American public it was not like we lent the bank $5 and said keep track of it. We lent them billions of dollars with the understanding they would be used in key ways. It seems to me banks and financial institutions that can track your credit card to the dime, anywhere in the world, can track these dollars at any point they wish. It seems to me odd to have the Congressional Oversight Panel, which is supposed to be our eyes and ears, not joining in every call to make sure these dollars are used transparently and with clarity.

I also question just how effective the panel has been. Over the past 6 months of your existence, how many hearings have you held with the Treasury Department as a witness? I understand it is only one.

Professor Warren. We have had—we have been able to get Secretary Geithner in to testify once. We asked Secretary Paulson repeatedly. We have asked Secretary Geithner repeatedly. I remind you that Congress did not give us subpoena power. We only have the capacity to invite.

Representative Brady. So you asked Secretary Paulson in the first month of the panel's existence?

Professor Warren. Well, I believe we asked him repeatedly. We asked him in our first month and second month and third month.

Representative Brady. So you have had one hearing with someone from Treasury who is running and implementing Treasury of the TARP.

Professor Warren. We have——

Representative Brady. My understanding is once. And then how many hearings have you had recipients of the TARP funds?

Professor Warren [continuing]. Well, we have had various field hearings where we've——

Representative Brady. Just abnormal congressional hearing with them as witnesses.

Professor Warren [continuing]. Right.

Representative Brady. To try to determine how they used the TARP funds, what was the effectiveness of it, all the things we tasked you to do.

Professor Warren. Right. I believe that would be our Milwaukee hearing, and our Prince George's County hearing.

Representative Brady. Excuse me, you had the major banks as witnesses at those hearings?

Professor Warren. Actually I will say once again, we have invited the major financial institutions to come. Without subpoena we have no way to insist on that. Yes, we have had financial institutions and yes we have had TARP recipients, but we have not been able to get everyone that we invited. We do not have subpoena power, Congressman.

Representative Brady. With all due respect, I do not know how this panel could be fulfilling its responsibility having one hearing with Treasury and the answer is none with the banks and financial institutions as witnesses. It just seems to me, we tasked you with a great deal of responsibility. And so far it has been—this is not a reflection on you, but it has been very disappointing. There has been very little value that the panel has brought to this issue or even insight on how these bailout dollars have been used.

The information is, for the most part, been redundant except for the February report which I applaud. I think the panel failed to bring transparency and clarity to TARP, and I think the result is and exemplified by there being no public confidence in how the payout dollar is being used. There is no feeling that bailouts are being done transparently and accountability and there is no congressional support, which is why, again, I think they are going through extraordinary lengths to not ask for any more dollars because there is no more public support or congressional support for this.

I frankly believe at this point given the reports that we have seen again with little value, that the panel needs to be abolished and reconstituted in a form that will actually create real insight, real analysis of a program that has only grown larger now that the repayment of the financial dollars begins to be a revolving slush fund for use of the original TARP dollars, Madam Chairman.

Chair Maloney. I want to thank the gentleman for his statements and concern about transparency. And to welcome him to cosponsor with me a bill 1242, the TARP Accountability and Disclosure Act. And this bill would require the Secretary of the Treasury to create a centralized database for the existing financial report of TARP recipients enhancing our ability to better understand how these dollars are being spent.

As the professor pointed out, she has no subpoena power. So if she requests this information, it is not necessarily coming forward. But this is this is an opportunity for us to require by law that this information be made available for Members of Congress on both sides of the aisle and for others to study and to understand. So I think this would be a step in the right direction, and I would also like to invite Professor Warren to look at this legislation and get back to us with your recommendations on how we might move forward with it.

Representative Brady. Madam Chairman, if I may, I would support that.

Chair Maloney. Great.

Representative Brady. I did just hear the professor say it is too late to hold those institutions accountable for the dollars, that is a burden on smaller institutions, I think that is a great approach.

Chair Maloney. I think it is important to understand what happened so that we have better policy going forward and possibly the Research and Accountability Disclosure Act could be expanded to other information in the financial system so that we could possibly better prevent such actions in the future. I welcome your support. Thank you so very much. Mr. Cummings.

Representative Cummings. I join you too, Madam Chair, I agree. The last thing I want to do is abolish oversight, that is the thing we need most and the American people watching this, I hope that they understand that this Congress is concerned about oversight. And I can understand Mr. Brady's point, effective and efficient oversight. But the fact is we have got to make sure that we do what needs to be done. And on that note, Professor Warren, I want to thank you for what you have done. I think you have done an outstanding job. I understand that there are certain limitations, but I want to go to something else. You talked a little bit about foreclosures, I think that was in the March report.

Professor Warren. Yes.

Representative Cummings. This weekend something interesting happened in the 7th congressional district in Maryland 40 miles away from here. We held a foreclosure prevention meeting where 1,000 people who were losing their homes came in to Morgan State University, I sponsored it. And an interesting thing happened, we were able to—I would venture to guess out of the 1,000 people, we were able to help at least, say, 4 or 500 at least to modify their mortgages. They had an opportunity to literally sit down, professor, with 19 banks, or mortgage companies, service companies. And in doing my exit interviews, we discovered that the banks were reducing mortgage payments by anywhere between $300 per month and 1,100 per month.

And I am trying to figure out, you know, in talking to the banking people, I was a little bit surprised that they were so anxious to make those modifications. To be frank with you, I was shocked, I thought we would help some people, but not that many. And I am just wondering, in light of that kind of thing we are going to do it again in another 3 months, because we have to help people stay in their homes.

Is there a new approach with these kinds of things? Have you seen anything from, say, these mortgage lending folks whereby as to how they deal with these kinds of—when they modify a loan, whether they are dealing with that in a different way on their books? Are you following me?

Professor Warren. I think so, Congressman. And the answer is, this is one where we kept thinking the mortgage modifications would occur because they made sense economically. Yeah, it hurts to take the hit, you are not going to get payment of $120,000 at 19 percent of interest over time, some of these crazy mortgages, that it was better to cut down, take less, but keep the homeowner in place. Good from the homeowners point of view, but also for the mortgage company, a back to performing loan albeit a lower level, but a steady payment that is going to occur.

We thought they would occur and frankly they just didn't in the numbers that we expected. And that is why the administration tried different claims. You may remember back earlier under the previous administration there were these voluntary plans. The key seems to be the sort of thing that you were doing and that is finding a way to get the homeowners and the mortgage lenders, somebody who really has the authority to make changes and get them in one place at one time.

In the hearings we have held, the field hearings we have held about this, the research that we have done, over and over we hear about those who are trying to modify who can't get anybody on the phone.

Representative Cummings. Right, right.

Professor Warren. They can not get anybody to respond. Every time they call again, they have to start anew with someone. They get told one thing by one person and something else by someone different. This notion of bringing people together whether it is physically bringing them together or finding someone who can get them together on the telephone seems to be the most promising avenue that we have. So I applaud you on behalf of the 4 to 500 families who will be better off, the lenders who will be better off under these circumstances and hope that we can—we are looking for ways to scale that up and make sure it happens across the country.

Representative Cummings. Let me ask you this: In light of the government's injection of billions of dollars in working capital and other assistance into the auto industry, should there have been a stress test run on Chrysler and GM?

Professor Warren. It is an interesting question. Obviously, as part of this reorganization of these two entities, part of what confirmation of a Chapter 11 plan will entail is something called feasibility, that is this plan is going to work and this company is expected to survive going forward. In a case of large Chapter 11s, this is not because the government is involved, this is just in general. There are a lot of ways that that occurs, a lot of ways that those tests are conducted. And in effect, the industries, the companies and their creditors have been running variations on stress tests for a long time now with financially troubled institutions. I would be surprised if there is not some variation on it in the case of the auto companies.

Representative Cummings. Thank you very much.

Chair Maloney. Thank you very much. Congressman Burgess for 5 minutes.

Representative Burgess. I think, just based on the number of dollars that have gone to the automobile companies and GMAC, I think participating in the stress test is something we should do.

Let me ask you this: Congressman Brady may have actually asked this already, so I apologize if my being late requires you to answer it twice, but it is so important that people need to hear it. Has your panel disclosed to the American people whether or not TARP is working?

Professor Warren. Well, we can't disclose what isn't known. We have disclosed as much as we can. We have addressed this in our various reports. The Secretary of the Treasury says there are some positive indicators and there are some negative indicators still in the economy. And that is the best we can do. We can see changes, we try to document those and we try to point out where there continue to be weaknesses. This isn't resolved yet, Congressman, I am sorry, it is just not. We are still in mid crisis, and there are both up arrows and down arrows.

Representative Burgess. Let me ask you this: We had the Special Inspector General here before this committee a few weeks ago. Special Inspector General Barofsky testified that there were almost 20 criminal investigations underway in connection with the TARP facility for the financial sector. And his report said that these investigations involved possible public corruption, corporate stock and tax fraud, insider trading and mortgage fraud. In an NPR interview, he stated that one of the probes involves bank officials who were allegedly cooking the books in order to qualify for TARP money. So is your committee aware of this issue and have you got any additional information about these?

Professor Warren. We work very closely with the Special Inspector General. I should make clear if there was any misunderstanding when I spoke with Congressman Brady, we support the special Inspector General's efforts. We are very pleased the Special Inspector General has asked for the TARP recipients to account for the money they have received. I testified about this before and expressed our support. My only point is it is hard to do that after the fact—it is different from what it would have been if we had asked at the beginning in terms of being able to account for where the money has gone.

But yes, we work with the Special Inspector General, we might meet with him on a weekly or more often basis. I was on the phone with him yesterday morning. So we are aware of their activities. We support their activities. And we try to coordinate with their activities and be helpful in all ways that we can.

Representative Burgess. Is there any aspect of that that has been a surprise to you?

Professor Warren. Well, it is always a surprise when in the sense of perhaps a better word would be disappointment when we discover that there are people who have abused public trust. But that is why we are here to do oversight, that is why we have a Special Inspector General, that is why we have a Congressional Oversight Panel. We are here to have, in effect, two functions, to call it out when we see it and as a result, to try to act as a deterrent so there will be less of it.

Representative Burgess. Do you think you are better able to anticipate some of the problems that might occur in the future from what you have learned from past experiences?

Professor Warren. Absolutely.

Representative Burgess. And are you employing those procedures today?

Professor Warren. We do and we change not just with every monthly report, we evolve. We are a small panel, we are a small group, and we adjust. You know, Treasury itself has changed over the past 7 months, the nature of the economic crisis has changed over the last 7 months. And we have changed both as we have learned and as new problems have presented themselves. We have tried to be as responsive as we can, and as nimble as we can to try to deal with the problems as they arise.

Representative Burgess. In the brief time I have, remaining the issue of stock warrants has come of from time to time and the concern is some banks were forced to accept TARP funds and provide a stock warrants to the government and for these banks to buy back the warrants they would have to pay a price that actually would reflect a very high interest rate on funds held for only a few months. Regarding some of the banks allegedly did not need the funds in the first place, what do we do about this fact and the illiquidity of the warrants as these banks try to restore themselves to their pre TARP status?

Professor Warren. Good. Let me just say as briefly as I can three things about this. The first one is the valuation of the warrants takes place in the shadow of our February valuation of the stock and warrant transactions for the initial infusion of $350 billion into the banks. I think that is important because it is a very public reminder to Treasury and to the financial institutions that there are ways to value this, there are valuation experts. And while there may be some differences, we can review these transactions and we have made it clear that we will review these transactions. So I think that is the first thing to remember about the warrants.

The second thing I want to say is that this is the subject of our July report. We are already working on valuation over the warrants and some of the issues involved in that. And so we will have a report on that approximately 30 days from today.

The third is to say you raise, however, in this the point that there is a larger issue than simply the dollars and the valuation of the warrant and that is the profound policy questions about the representations that were made at the beginning for the financial institutions as they entered this program and what is fair under the circumstances, as well as what is right for the economy.

I hope that that is something we will also be able to address in our report, but I certainly see the issue, Congressman and I think that is the starting place for having a thoughtful conversation on it.

Representative Burgess. If I may, what are some of the barriers to being able to do that?

Professor Warren. I am sorry?

Chair Maloney. The gentleman's time has expired but you may answer that very quickly.

Professor Warren. I am sorry I don't understand the question.

Representative Burgess. The barriers on your last point you said you do want to be able to evaluate those fairly, what are some of the barriers that might occur that would prevent that or make that more difficult?

Professor Warren. There are five people on this panel and what issues they want to take on will depend, you have to have at least three people who want to talk about that set of issues. So I hope that this is an issue that we will be able to address, but I simply can't commit my fellow panelists on that.

Chair Maloney. The gentleman's time has expired.

Representative Burgess. I think that is important, I hope you will follow up. Thank you.

Chair Maloney. Mr. Hinchey for 5 minutes.

Representative Hinchey. Thank you very much, Madam Chairman. And Professor, thank you once again for everything you are doing, you are inspirational. And frankly, I wish that we had given you more power, including subpoena power because I think that you would have used that effectively in the context of the circumstances that you and we are dealing with. I think it is pretty clear that the economic circumstances that this country is facing, the dire circumstances, near-depression circumstances were caused by the manipulation of investment practices some years ago. The falsification of information and context of those investment practices.

Now we have some continuing falsification of information, one which you cited specifically not long ago in the context of your remarks with regard to getting back 66 percent, rather than 100 percent of the money that is being put in. And also, the full accountability of $700 billion which was not issued by the Congress as a grant to anybody, to just use in whatever way they want and keep, but as a kind of a loan. A no interest loan, but a loan which was to be used to bail out the banking circumstances, but as the bailout occurred, the repay back of that money to the people of this country.

So what do you think we should be doing in order to achieve those objectives? Do you think that we need some specific laws, and rules, and regulations put in? Do you think that it would be wise to give you some additional power to engage in the efforts that you are using?

And also there is one other thing that I want to ask you in the context of this, and that is the repeal of the Glass-Steagall Act, was one of the main reasons why we had this manipulation of investments and the lack of accountability. I know that that Glass-Steagall Act had been manipulated prior to its elimination back in 1999, but the elimination of that Glass-Steagall Act was intentional, and purposeful, and it was designed to allow the manipulation of these investment practices to go forward and more aggressive in completely unaccountable ways.

So I would appreciate it, I know you probably thought about it, should we be putting back into effect a modern version of Glass-Steagall Act, which would cause the separation of investment and openness of investment and honesty of investment and accountability?

Professor Warren. So, Congressman, let me see if I can do all three of these questions; very thoughtful. The first one, it is obvious. If you want us to do more work, we are your congressional oversight panel. We are here at your pleasure. And if you want us to do more work through hearings, and you want us to be able to have more Treasury officials appear in front of us, Federal Reserve officials appear in front of us, bankers appear in front of us, we can't do that without subpoena power. This is how you have designed your panel.

On the other hand, I should say there is still plenty we can do even without our subpoena power. We were able to write a report that exposed misrepresentation about the value of transactions that were occurring under TARP, and I think that has been very valuable. We have also been able to evaluate and deal with other parts of the program. And there have been real changes at Treasury. Treasury is not operating in the same way it was operating before. So I think there is a real effect out there.

Let me turn to your question about Glass-Steagall. I want to make a point about Glass-Steagall. In my view, Glass-Steagall was about systemic risk regulation. They just didn't use the fancy words back then. But the real point was to say they understood after the Depression—or in the Depression, that we had gone through these boom-and-bust cycles every 10 to 15 years, and that the banks were part of it. The banks were big risk takers. They got out there and they rolled the dice. And as long as they made money, their investors got rich. And when they went down, they took everyone down with them. They took down all their depositors, and they also took down a lot of local communities when they did it.

The basic understanding behind Glass-Steagall was, look, we can't keep doing that. That is not going to work for us. You really do not just hurt yourself. You are not like the one little business, the hardware store that goes out of business, or even the manufacturer that goes out of business. You are taking a lot down with you when you do this as a financial institution.

So the premise behind Glass-Steagall was we will create this wall, and, frankly, we will have boring banks. We will have banks that are run very much like public utilities. They will make only modest profits, but they will be absolutely rock-solid secure. And the risk-taking will be taken somewhere else where we don't have to worry about it. So if the fancy investment houses want to go out and take those risks, that is fine, but they won't take anyone down but themselves.

Of course, what happened is not only did we find our—not we—did the financial institutions find ways to get around Glass-Steagall, and we weakened Glass-Steagall, the markets matured, they changed, so that dividing along a bank-nonbank line, as we had in Glass-Steagall, we believe now is not the most effective way to do it.

Every time we talk now about systemic risk regulation, we are addressing precisely the same question that was addressed during the Depression: How do we find a way to have a certain kind of financial institution that can hold deposits, that can be safe, that can be secure, that we can put our paychecks in, that we can write checks on and know that money can be transmitted across the country or around the world, and how do we separate that from something that is risky and, frankly, either can be allowed to fail without any government intervention and without having taxpayer involvement? How can we accomplish that? And there is a lot of conversation around that right now.

We have some recommendations in our own regulatory reform report, which I erroneously omitted in going through our monthly reports. We also did a regulatory reform report at your request.

So I think that is the issue, Congressman. It is systemic risk regulation, for which Glass-Steagall had kept us safe for more than 50 years. In a changed world we are going to have to have a new version of it

Chair Maloney. Thank you very, very much.

Congressman Snyder.

Representative Snyder. Thank you, Madam Chair.

Professor Warren, I need to make a comment. As you know, my wife and I have 6-month-old, today, triplet boys, plus a 3-year-old. And 3 months ago my wife went on leave from her job as a Methodist minister, which meant we went from being a two-income family to a one-income family. I tell you what; your book made a whole lot more sense to me the last couple of months. I appreciate all the work you have done on the financial pressures on American families.

I wanted to ask, on page 36 of the report you say, "The most direct way for a BHC to increase its capital base is to earn net income from its normal banking business and add that income to its capital accounts." And then the report goes on to say, "They are not going to be able to earn their way out of it as you look ahead."

My question is: Can the opposite occur? By that, I mean I am not sure what normal banking business is, frankly, anymore. It seems to me that sometimes normal banking business is almost predatory, as you see computer programs that are designed to prioritize the processing of debits and checks in such a way that it will drive people into more overdrafts, which is essentially loaning money at exorbitant rates. You know what I am talking about.

The Chairwoman here has done wonderful work on dealing with credit cards, and we hope—I think there is clearly predatory behavior there. I think Congress is very interested in looking at what we consider normal banking business now compared to perhaps what it was in the past and what it ought to be.

Can we go the other way in which we would lower the income of banks in such a way as we get rid of some of these predatory practices that could put some in jeopardy, too, as they have been putting too much of their business income from things that they ought to really not be doing?

Professor Warren. We talk a lot about the transformation of the banking world and the investment world from the Wall Street perspective, but the real transformation has occurred at the household level. Consumer lending just does not look like it did 30 years ago. The whole business model has changed.

You know, the notion that we carry in our heads that some lender looked at you and evaluated whether or not you would be able to repay this, added a little bit on an interest rate for risk and is making money by screening customers, it simply isn't true anymore. We have shifted over to a model where those who sell these financial instruments—let us just take credit cards, for example—will identify two or three main things that you can see: the nominal interest rate, which is often not the true cost; the free gift; and the warm and fuzzy relationship with the financial institution. And then the business model is to pump up revenues and profits with all the things hidden in the fine print.

According to the Wall Street Journal, the typical credit card contract, just to focus there, has gone from a page and a half long in 1980 to more than 30 pages today. And that extra 30 pages is not put there to help families.

So I think it is important in this crisis because you really get down to the heart of what it means to have a working financial system.

The way I see this, this problem started one household at a time; one lousy mortgage, one overwrought credit card, one bad loan at a time down at the household level. So much was promised in the way of profits that those loans were aggregated. They were then put into trusts. They were then sold on up the loan so that the riskiness at the household level became magnified across the American economy and ultimately throughout the world economy.

If we go back to a world where the basic consumer financial products are just steady, and they are just plain vanilla, they are ones that have a level playing field. Nobody should be protected from making mistakes. You go to the mall and spend $2,000 that you really can't afford, you should have to pay that. If you buy a house with five bedrooms and a spa bath that you really can't afford, you really should have to pay for that or lose that house.

But ordinary people who have done ordinary transactions deserve just some ordinary instruments to be able to do that. If that is the case, that will not only help us at the family level, it will completely reform what our financial institutions look like and ultimately give us a far more secure financial system.

Representative Snyder. In the short run, a bank who has been making their income off of taking advantage of families, they may hurt in the short run, but in the long run, we as a country, our economy and our whole credit markets will come out better.

Professor Warren. Absolutely, Congressman Snyder. I can't say it better than that because that is the answer.

Representative Snyder. Thank you.

Thank you, Madam Chair.

Chair Maloney. Senator Klobuchar.

Senator Klobuchar. Madam Chairman, thank you for holding this hearing today. Thank you for your leadership.

And thank you, Ms. Warren, for what you are doing.

I have always believed that we need to restore stability in our financial markets, and you have been a leader with that. And to do that, we have to get the best possible results for the American taxpayers at the lowest cost, and, to me, this means transparency and accountability. And that is your focus.

I believe when you look at the past, previous to this administration, there was not that kind of accountability and transparency. We did not have that. And while there is a lot of criticisms we can lob now—and we are in a transition period—when you look at what got us into this mess in the first place, loopholes that were allowed to be open, and there is blame on both sides for that; the leverage that the SEC allowed back in I think it was 2004; and just a bunch of things that went wrong, from Bernie Madoff on, that shouldn't have happened. And so that is why I appreciate what you are trying to do here. In a way, you are starting from scratch.

We are trying to get here, instead of a short-term view of our economy and our business markets, we are trying to get a long-term view on trying to encourage responsible behavior.

So I wanted to first start with these stress tests. I can say that the announcement of them caused a lot of stress in our State. We have a lot of banks. In the end, I think they fared well and worked hard. And we also have some small community banks that are doing well.

Do you foresee a need to continue to do these stress tests? At the time when they were first announced, I was very concerned that the stress tests themselves had an effect on the stocks of banks that actually hadn't gotten into messes because people were fearful that all the banks were going to be nationalized, and there was all that kind of talk. I think it has evened out now with the results of these stress tests, with the fact that some of the capital has been raised. But could you talk about that in terms of going forward?

Number one, do you see this as a good sign that—I think it was the estimates are how much money, the billions of dollars that have been raised since the announcement of a stress test II. How do you see them working going forward?

Professor Warren. Yes. We embrace the stress test, Senator. I know they made everyone nervous at the beginning, but the consequence ultimately was to put more information into the marketplace, information that had more reliability than the rumors that were circulating. As you said, when everyone is worried that, oh, my gosh, all the banks may fail; they may all be nationalized; they may have a terrible crisis, this has a terrible effect not just on a market, but across the country. What financial institutions are going to lend to small businesses under those circumstances? What medium-sized businesses are going to expand their inventories if they think that is where the economy is headed?

Poor information puts us in a position of trading in scare rumors. So I am a strong believer that the more information we can get out there, and the more reliable that information is, there will be some bumps at the beginning, but not only will there be readjustment, we begin to rebuild on a solid foundation.

So, my view, and I believe our panel's view, on stress test unanimously here is, yes, we like them. We think they could be stronger, and we think they should be used in more ways and more often.

Senator Klobuchar. Okay. One of the other things that you have talked about before is this idea of systemic risk; how a few actors can do some bad things, and suddenly the whole system starts going under. So we are looking right now at reforms for regulating the market, and we want to do it in a prudent way, and we want to do it quickly. What do you think we should be doing?

Professor Warren. Well, I am going to start with how to frame the issue, because that is the one that concerns me the most. The really tricky part in this one is to identify what it is that puts us at risk. Is it size, is it concentration, is it the kind of industry you work in?

We have had big companies fail. Enron failed. It was huge. Worldcom failed. It was huge. And those businesses were liquidated, and they were liquidated in a very short period of time. Very serious consequences, for example, in the case of Enron, on employees who were laid off. I am not saying it is not done without pain. But I don't know if you know this: Enron was making the argument shortly before it was forced into bankruptcy that it would cause systemic failure; that it was out there in the power industry; that it was such an important player in that industry. And, of course, that wasn't true at all. We said, this is the problem. This is where you are financially. And we are going to have to liquidate you.

So what I want to emphasize here is the importance as we look at it about identifying what the risk is before we just head off and say, okay, so if there is going to be—make sure we know what the problem is before we go to the solution.

And, if I could—I know I am over your time—but if I could work in one other point, and that is to go back to where you started just now, and that is at the household level, at the family level. We not only increased risk for large institutions and for our biggest banks, we did it for American households. American households now stand at owing 130 percent of their annual income in total debt. That is a staggering number. We have been hitting numbers that are unprecedented. We have never even been close to these numbers at any point in our history.

When we reform financial products and put some basic safety in so that families are themselves more economically stable, and we are not introducing into the stream of financial commerce these high-risk, high-profit instruments, we turn the risk down in the system overall, and, frankly, we can deal with systemic risk with a lighter touch.

Those who are worried about the heavy hand of government on systemic risk at the back end would be well to observe that modest changes at the front end could mean that we require less intervention and less supervision overall. If we make this system solid from the beginning, it will be solid throughout.

Senator Klobuchar. Thank you very much. I am looking forward to learning more about—I know the proposal for a financial commission to help consumers with these products. I think it is a very interesting idea.

Thank you.

Professor Warren. Thank you, Senator.

Chair Maloney. I want to thank you, Professor Warren, for your extraordinary leadership. You are truly a star.

We have many competing hearings taking place on financial regulation, health care reform, and energy. We are going to be presenting our additional questions to you in writing.

We thank you for your time, your dedication, your commitment to public service, and your really incredible influence that you have had on financial reform.

Thank you very much.

Professor Warren. Thank you.

Representative Burgess. Madam Chairman, may I ask unanimous consent that my opening statement be inserted in the record?

Chair Maloney. Absolutely.

[The prepared statement of Representative Burgess appears in the Submissions for the Record on page 35.]

Chair Maloney. I would like to say that everyone has an opportunity to submit their questions.

The meeting is adjourned.

[Whereupon, at 11:25 a.m., the joint committee was adjourned.]

SUBMISSIONS FOR THE RECORD

PREPARED STATEMENT OF REPRESENTATIVE CAROLYN B. MALONEY, CHAIR

Good morning. I want to welcome Prof. Warren, the Chair of the Congressional Oversight Panel (COP) for the Troubled Asset Relief Program (TARP), and thank you for testifying today on the COP's new report to Congress, just released this morning.

This is the third in a series of hearings this committee has held to examine the degree to which the Troubled Asset Relief Program has succeeded in its goals. The COP's June report examines the results of the government "stress tests," which were designed to evaluate the balance sheets of financial institutions and provides recommendations for further actions.

The results of the stress tests conducted by the Federal Reserve have gone a long way toward restoring market confidence.

Huge losses shook confidence in the banking system, because it was not clear that some of our largest banks would remain solvent.

The Federal Reserve, Treasury and FDIC have taken steps to provide the banks with liquidity for those assets where the market had evaporated, guarantees for their debt issuances, and capital injections.

Despite these substantial efforts, concerns remain that a deepening recession could threaten the solvency of some banks and amplify the financial crisis.

Confidence is in large measure determined by the current and future state of bank balance sheets, so it's important that investors and counterparties have a clear picture of whether banks have the capital to weather the current downturn.

It is welcome news that the Obama Administration is set to announce that some of the nation's largest banks will soon be able to repay billions of TARP funds.

However, the Federal Reserve has reportedly imposed additional requirements on banks that propose to repay capital they received under TARP. Since the stress tests were intended to estimate the necessary capital needed to be raised by bank holding companies, this raises an important question about what the stress tests assumed about repayment of TARP funds.

Moreover, some banks appear reluctant to perform their normal roles as providers of credit.

I was honored to testify before the COP's recent field hearing in New York City examining problems in commercial real estate.

I am very concerned about the ticking time bomb we face in commercial real estate lending. An estimated $400 billion in commercial real estate debt is set to mature this year with another $300 billion due in 2010.

If commercial real estate developers are unable to refinance or otherwise pay those large balloon payments, we could expect to see the default rate on commercial mortgages climb much higher.

That in turn would translate into potentially crippling bank losses that our recovering financial system is still too fragile to withstand, even with the news that banks have raised or announced some $50 billion in new private capital since the release of the stress test results.

This looming crisis in commercial real estate lending could lead to an all-too-familiar predicament, where banks suffer significant losses, major owners of hotels and shopping centers are forced into bankruptcy, foreclosed properties push commercial real estate prices further downward, and a perfect storm of all these forces combine to inhibit our economic recovery.

The testimony we will hear today points out that transparency and accountability are critical in a crisis such as this.

To increase transparency and to help restore confidence in our financial institutions, I have introduced H.R. 1242, the TARP Accountability and Disclosure Act.

This legislation would require the Secretary of Treasury to create a centralized database for the existing financial report of TARP recipients, enhancing our ability to better determine how these funds are being used in a near real-time basis.

I am interested to hear your thoughts about how this bill would help you do your job to help safeguard taxpayer dollars, and whether additional transparency measures are needed.

Prof. Warren, I am also very interested in your views about the extent to which TARP is accomplishing its overall mission of restoring financial stability, reinvigorating markets, increasing the flow and availability of credit, and reducing foreclosures.

I look forward to your testimony.

ELIJAH E. CUMMINGS
7TH DISTRICT, MARYLAND

COMMITTEE ON
TRANSPORTATION AND INFRASTRUCTURE
CHAIRMAN, SUBCOMMITTEE ON COAST GUARD AND MARITIME TRANSPORTATION
SUBCOMMITTEE ON RAILROADS, PIPELINES AND HAZARDOUS MATERIALS

COMMITTEE ON
OVERSIGHT AND GOVERNMENT REFORM
SUBCOMMITTEE ON DOMESTIC POLICY
SUBCOMMITTEE ON FEDERAL WORKFORCE, POSTAL SERVICE AND THE DISTRICT OF COLUMBIA

JOINT ECONOMIC COMMITTEE

SENIOR WHIP

Congress of the United States
House of Representatives
Washington, DC 20515

2235 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515-2007
(202) 225-4741
FAX: (202) 225-3178

DISTRICT OFFICES:
1010 PARK AVENUE
SUITE 105
BALTIMORE, MD 21201-5637
(410) 685-9199
FAX: (410) 685-9399

754 FREDERICK ROAD
CATONSVILLE, MD 21228-4504
(410) 719-8777
FAX: (410) 455-0110

8267 MAIN STREET
ROOM 102
ELLICOTT CITY, MD 21043-4803
(410) 465-8259
FAX: (410) 465-8740

www.house.gov/cummings

July 2, 2009

Professor Elizabeth Warren
Chair, Congressional Oversight Panel for the Troubled Assets Relief Program
732 North Capitol St., NW
Rooms C-320 and C-617
Mailstop: COP
Washington, DC 20401

Dear Professor Warren:

Thank you for your appearance before the Joint Economic Committee ("JEC") in June. I appreciate your frankness in the discussion, and value the work you and your colleagues have done at the Congressional Oversight Panel ("COP") for the Troubled Assets Relief Program ("TARP"). The COP, the Special Inspector General for TARP, and the Government Accountability Office all continue to ensure that transparency and accountability remain at the forefront of financial recovery efforts.

As Chair Maloney mentioned at the time, due to the hearing being cut short, Committee members would be submitting additional questions for the record. I look forward to your responses to the attached questions.

Thank you again for your hard work on behalf of the American people.

Sincerely,

Elijah E. Cummings

Elijah E. Cummings
Member of Congress

Additional Questions for the Record – Professor Elizabeth Warren

1. In your first report you noted that there was a disappointing level of cooperation from then-Secretary of Treasury Paulson. You noted at the hearing that the level of cooperation from the Treasury Department has since improved. What complaints do you still have regarding cooperation by regulatory bodies?

2. Many of the banks that were part of the stress tests saw the share prices of their stock rise after the tests, despite having to raise more capital.

    a. Do you have concerns about the role that repeated stress tests might play in the behavior of the banks' stock price?

    b. In that the tests seem to have had a real effect on the price of the stock, should investors be provided more information about the tests?

3. The COP report noted that the two-year timeframe on the stress tests raised concerns, especially in light of some projections that rates of default for commercial real estate may increase after 2010.

    a. Are there other economic assumptions that the supervisors used that may be problematic given the two-year timeframe?

    b. Would it be beneficial (either for you or for the taxpayers) for the tests to be run out, *e.g.*, 3-4 years, acknowledging some element of uncertainty in the projections, but capturing other variables (like commercial real estate market changes) that may be overlooked in the short-term?

4. It is my understanding that the stress tests were not a question of how much strain a bank could handle before becoming insolvent – but rather a question of how each bank could handle a specific set of circumstances.

    a. In light of the fact that we have seen staggering economic conditions recently that have brought down one-time pillars of Wall Street like Bear Stearns and Merrill Lynch, do you think, even if the results were kept confidential, that the Supervisors should be conducting tests to determine the conditions under which a bank would hit its "breaking point"?

5. Some have conjectured that one reason regulators may not have allowed firms to repay TARP money earlier was that it could create pressure on other firms to repay funds before they were able, in order to not be seen as weaker than firms that already paid back their funds. The Panel wrote in its report that by applying the stress tests to only the 19 largest bank holding companies, that regulators could be putting smaller banks at a competitive disadvantage: (1) by not having the viability of smaller banks confirmed by stress testing; and (2) implying that the 19 largest banks were "too big to fail". Do you believe stress tests should be conducted on smaller banks, and should the same scenarios and assumptions should be used for any testing of smaller banks?

RESPONSES GIVEN BY PROFESSOR ELIZABETH WARREN TO QUESTIONS SUBMITTED BY REPRESENTATIVE ELIJAH E. CUMMINGS

1. Treasury's cooperation has improved greatly since the Panel first began its work in late 2008. Treasury officials have testified before the Panel on nine different occasions, and Secretary Geithner is scheduled to testify again before the Panel in late June.

   Overall, the federal regulatory bodies have cooperated with our efforts. In the 19 public hearings we have held, we have heard testimony from a number of regulatory bodies, including the Board of Governors of the Federal Reserve, the Federal Reserve Bank of New York, the Federal Deposit Insurance Corporation (FDIC), and the Government Accountability Office (GAO). We also communicate with SIGTARP and GAO on a regular basis and coordinate our efforts to provide for more effective oversight.

   In addition to holding hearings in Washington, D.C., the Panel also travels to areas of the country that have been hard hit by the financial crisis and hears the perspectives of state and local regulatory officials. The Panel recently traveled to Arizona to hear from small businesses about their ability to access credit. Oversight of this topic is a crucial role of our panel, as Secretary Geithner recently designated small business credit as one of the primary focuses of TARP. We heard testimony from the FDIC regional director, the Small Business Administration district director, owners of local small businesses, and officials from two of the state's largest locally-based small business lenders. All were very cooperative and helpful in the Panel's efforts in collecting data and input for our upcoming May report on small business lending.

2a. Markets function best when investors have access to reliable and accurate information. As you note, investors responded positively to the stress tests as the share prices of many banks went up. While it is difficult to predict how investors would respond to repeated stress tests, providing investors, and taxpayers for that matter, with reliable and accurate information as to the health of a financial institution should be more of a concern than the effect such information could have on the institution's stock price. Treasury made its first infusions of TARP capital less than two years ago and investors must have access to the best information available in order to restore confidence to our financial markets. I would have more concerns if the stress tests were not repeated.

   It is also important to realize that although the 2009 stress tests provided valuable information on America's 19 largest bank holding companies, many smaller banks continue to face financial strain and have never been subjected to stress testing. In particular, troubled commercial real estate assets are a serious concern for many smaller institutions. Regulators should extend the stress tests in some form to these banks as well.

2b. I have said repeatedly the public should have access to greater detail about the stress tests, including the inputs and models used and the results found under a variety of economic assumptions. Transparency and accountability will help to restore market functions and earn the confidence of the American people.

3a. Unemployment remains a national concern. In each of the first three months of 2010, the unemployment rate has been 9.7 percent. The unemployment rate assumed for all of 2010 under the stress tests' "more adverse" scenario was 10.3 percent. Forecasting is a difficult game. It is impossible to predict with exact certainty what the actual unemployment rate will be for 2010, however, given that many small- and medium-sized banks are suffering severe commercial real estate losses this year, Treasury and the Federal Reserve should consider re-employing the tests with more rigorous assumptions, including a higher unemployment rate than was assumed under the "more adverse" economic scenario.

3b. Yes. As you noted, commercial real estate is a serious concern that could undermine an already weakened financial system. It would be very beneficial to run the tests out for three to four years and to incorporate variables such as changes to the commercial real estate market.

4. Yes, such tests would be useful. The more rigorous the stress test, the better the understanding that regulators will have on the resiliency of financial institutions in different economic scenarios.

5. As I noted above, the Panel has expressed serious concerns that only 19 bank holding companies have undergone stress testing. America is home to thousands of small- and medium-sized banks that play a critical role in the financial sys-

tem, most especially in the small business and commercial real estate markets. The Panel recognizes that it may not be possible to stress test every bank in the country and that the stress tests may need to be modified to account for the differences between a large Wall Street bank and a small community bank. Even so, a stress test that considers only 19 banks cannot possibly provide a complete picture of the American financial system.

Prepared Statement of Representative Kevin Brady, Senior House Republican

It is a pleasure to join in welcoming Chairwoman Warren before the Committee this morning.

With nearly $3 trillion at risk and the lack of transparency that veils the Troubled Asset Relief Program (TARP) and its costs, we need as much oversight as possible to protect the taxpayers. The stress tests of the 19 largest banks did appear to clarify a number of issues with respect to their financial position, even if some aspects of the stress tests raise questions.

For example, some of the economic assumptions used in the stress tests are not very severe, even under the adverse scenario presented. The assumption of an unemployment rate of 8.9 percent in 2009 and 10.3 percent in 2010 is not pessimistic, but instead appears to be fairly optimistic given that the unemployment rate has already reached 9.4 percent and is expected to go significantly higher. The stress tests' application of relatively high potential losses on loans and securities investments does offset the insufficiently adverse economic assumptions to some extent.

Given the huge amounts of money and credit injected into the economy by the Federal Reserve, it is reasonable to expect some economic recovery by next year. However, the unprecedented size and scope of the actions undertaken by the federal government to deal with the financial crisis do pose risks to the government's financial health and to a sustained economic recovery.

For instance, huge federal deficits and mounting debt under Administration policies will continue into the foreseeable future, undermining the financial position of the U.S. government. As the Financial Times noted of a recent U.S. Treasury auction, "the issue of bond supply came into sharp focus . . . as the Treasury auctioned $101 billion of new notes—part of an expected $2,000 billion of new issuance in the financial year to fund the U.S. budget deficit." The article goes on to discuss how the "surge in yields also sent the fixed U.S. 30-year mortgage rate above 5 percent—prompting speculation that the Fed might increase its Treasury buy-backs."

As the OECD has noted, governments worldwide are projected to issue about $12 trillion in debt this year, adding to upward pressure on interest rates. The very real threat that these massive government debts may be monetized raises the specter of future inflation and increases the potential for long-term interest rates to move even higher. Higher long-term interest rates are already increasing mortgage rates and making home refinancing and home purchases more expensive and difficult. The danger is that the government's fiscal irresponsibility will force up interest rates and undermine the prospects for economic recovery, a recovery on which a return to financial stability depends. If higher interest rates further depress the housing market and mortgage investments, losses on mortgage loans and investments will only worsen, raising the cost of TARP.

Deterioration in financial conditions would increase the costs of TARP, but there are other potential costs of this program that result from its faulty design. Recently, Neil Barofsky, Special Inspector General of TARP (SIGTARP), issued a disturbing report that identifies many key weaknesses in the design and implementation of the government bailouts that could greatly increase their cost. For example, according to the report, the Treasury Department has "indicated that it will not adopt SIGTARP's recommendations that all TARP recipients account for the use of TARP funds; set up internal controls to comply with such accounting; and report periodically to Treasury on the results, with appropriate sworn certifications."

Regarding the Public-Private Investment Program (PPIP) unveiled by Secretary Geithner, the SIGTARP report notes, "Many aspects of PPIP could make it inherently vulnerable to fraud, waste, and abuse." Vulnerabilities include the huge size of the program along with conflicts of interest, collusion, and money laundering. With regard to money laundering, the report notes that it would be unacceptable if TARP or related funds "were used to leverage the profits of drug cartels or organized crime groups." With regard to another component of the bailouts, the report said, "Treasury should require additional anti-fraud and credit protection provisions specific to all MBS, before participating in an expanded TALF, including minimum underwriting standards and other fraud prevention measures."

I have repeatedly called on Secretary Geithner to adopt these SIGTARP recommendations to protect the trillions of taxpayer dollars at risk in TARP. The question remains: Why does the Treasury refuse to adopt these recommendations to prevent waste, fraud, and abuse in TARP? The government's extensive intervention in the economy has gone way too far even allowing for a financial crisis, but the least we can expect is that taxpayer money not be misappropriated or stolen. Treasury should act quickly to implement the SIGTARP recommendations.

PREPARED STATEMENT OF PROFESSOR ELIZABETH WARREN, CHAIR, CONGRESSIONAL OVERSIGHT PANEL

Thank you, Chairman Maloney, Vice Chairman Schumer, Ranking Member Brownback, Representative Brady, and members of the Joint Economic Committee for inviting me to testify regarding oversight of the Troubled Asset Relief Program (TARP). We share a desire to bring accountability and transparency to the TARP program, and I am pleased to assist your efforts in any way I can.

From the outset I would like to stress that although I am Chair of the Congressional Oversight Panel, I do not have a pre-approved script. The views I express today are my own and do not necessarily represent those of each member of the panel.

The Congressional Oversight Panel was created in last year's Emergency Economic Stabilization Act. The job of the Panel is to "review the current state of the financial markets and the financial regulatory system" and report to Congress every 30 days. We have released seven oversight reports, as well as a special report on regulatory reform required by the legislation.

The Oversight Panel is one of three organizations to which the TARP legislation gives oversight responsibilities. My staff and I work closely with GAO and the Special Inspector General to ensure that all our oversight efforts complement, not duplicate, one another. We all want to make the whole of our work greater than the sum of its parts.

The Oversight Panel is the smallest of the three organizations. We see our contribution as fact-based analysis designed to raise issues about the operation and direction of the TARP and about the broader effort to restore stability to the economic system. In the Emergency Economic Stabilization Act, Congress specifically asked that the Oversight Panel conduct oversight on: the use of Treasury's authority under TARP; the Program's effect on the financial markets, financial institutions, and market transparency; the effectiveness of foreclosure mitigation efforts; and the TARP's effectiveness in minimizing long-term costs and maximizing long-term benefits for the nation's taxpayers. Our ultimate question is whether the TARP is operating to benefit the American family and the American economy. If we believe the answer is no, we will ask "why not," and try to suggest alternatives.

Today marks the release of the Panel's seventh report, entitled "Stress Testing and Shoring Up Bank Capital," and I would like to begin by reviewing our report.

Across the country, many American families have taken a hard look at their finances. They have considered how they would manage if the economy took a turn for the worse, if someone were laid off, if their homes plummeted in value, or if the retirement funds they had been counting on shrunk even more. If circumstances get worse, how would they make ends meet? These families have examined their resources to figure out if they could weather more difficult times—and what they could do now to be better prepared. In much the same spirit, federal banking regulators recently undertook "stress tests" to examine the ability of banks to ride out the financial storm, particularly if the economy gets worse.

Treasury recognized the importance of understanding banks' ability to remain well capitalized if the recession proved worse than expected. Thus, Treasury and the Federal Reserve announced the Supervisory Capital Assessment Program (SCAP) to conduct reviews or "stress tests" of the nineteen largest bank holding companies. Together these nineteen companies hold two-thirds of domestic bank holding company assets. As described by Treasury, the program is intended to ensure the continued ability of U.S. financial institutions to lend to creditworthy borrowers in the event of a weaker-than-expected economic environment and larger-than-estimated losses.

Understanding the recently completed stress tests helps shed light on the assumptions Treasury makes as it uses its authority under EESA. As Treasury uses the results of these tests to determine what additional assistance it might provide to financial institutions, the tests also help determine the effectiveness of the TARP in minimizing long-term costs to the taxpayers and maximizing taxpayer benefits, thus responding to another key mandate of the Panel.

As part of their regular responsibilities, bank examiners determine whether the banks they supervise have adequate capital to see them through economic reversals. Typically, these bank supervisory examination results are kept strictly confidential. The stress tests built on the existing regulatory capital requirements, but because the stress tests were undertaken in order to restore confidence in the banking system, they included an unprecedented release of information.

The stress tests were conducted using two scenarios: one test based upon a consensus set of economic projections and another test using projections based on more adverse economic conditions. The only results that have been released are those based on the adverse scenario. These test results revealed that nine of the nineteen banks tested already hold sufficient capital to operate through 2010 under the projected adverse scenario; those banks will not be required to raise additional capital. Ten of the nineteen banks were found to need additional capital totaling nearly $75 billion in order to weather a more adverse economic scenario. Those banks that need additional capital must present a plan to Treasury by June 8, 2009, outlining their plans to raise additional capital. All additional capital required under the stress tests must be raised by November 9, 2009, six months after the announcement of the stress test results. Some bank holding companies have already successfully raised billions in additional capital.

Like the case of the family conducting its own stress test of personal finances, the usefulness of the bank stress test results depends upon the methods used and the assumptions that went into conducting the examinations. To help assess the stress tests, the panel engaged two internationally renowned experts in risk analysis, Professor Eric Talley and Professor Johan Walden, to review the stress test methodology.

Based on the available information, the professors found that the Federal Reserve used a conservative and reasonable model to test the banks, and that the model provides helpful information about the possible risks faced by bank holding companies and a constructive way to address those risks.

The professors also raised some serious concerns. They noted that there remain unanswered questions about the details of the stress tests. Without this information, it is not possible for anyone to replicate the tests to determine how robust they are or to vary the assumptions to see whether different projections might yield very different results. There are key questions surrounding how the calculations were tailored for each institution and questions about the quality of the self-reported data. It is also important to note that the stress test scenarios made projections only through 2010. While this time frame avoids the greater uncertainty associated with any projection further in the future, it may fail to capture substantial risks further out on the horizon. Based on testimony by an analyst from Deutsche Bank at the Panel's May field hearing in New York City, the projected rise in the defaults of commercial real estate loans after 2010 raises concerns.

In evaluating the useful information provided by the stress tests, as well as the remaining questions, the Panel offers several recommendations for consideration moving forward:

- The employment numbers for 2009 have already exceeded the harshest scenario considered so far, suggesting that the stress tests should be repeated.
- Stress testing should also be repeated so long as banks continue to hold large amounts of toxic assets on their books.
- Between formal tests conducted by the regulators, banks should be required to run internal stress tests and should share the results with regulators.
- Regulators should have the ability to use stress tests in the future when they believe that doing so would help to promote a healthy banking system.

The Federal Reserve should be commended for releasing an unprecedented amount of bank supervisory information, but additional transparency would be helpful both to assess the strength of the banks and to restore confidence in the banking system. The Panel recommends that the Fed release more information on the results of the tests, including results under the baseline scenario. The Fed should also release more details about the test methodology so that analysts can replicate the tests under different economic assumptions or apply the tests to other financial institutions. Transparency will also be critical as financial institutions seek to repay their TARP loans, both to assess the strength of these institutions and to assure that the process by which these loans are repaid is fair.

Finally, the Panel cautions that banks should not be forced into counterproductive "fire sales" of assets that will ultimately require the investment of even more taxpayer money. The need for strengthening the banks through capital increases must be tempered by sufficient flexibility to permit the banks to realize full value for their assets.

I would like to briefly mention the Panel's other reports, which cover a wide range of important topics.

In December, we issued our very first report, identifying a series of ten primary questions regarding Treasury's goals and methods. These questions must be answered in order for Treasury to be successful:

- What is Treasury's strategy?
- Is the strategy working to stabilize markets?
- Is the strategy helping to reduce foreclosures?
- What have the financial institutions done with the taxpayers' money received so far?
- Is the public receiving a fair deal?
- What is Treasury doing to help the American family?
- Is Treasury imposing reforms on financial institutions that are taking taxpayer money?
- How is Treasury deciding which institutions receive the money?
- What is the scope of Treasury's authority?
- Is Treasury looking ahead?

These questions were posed to then-Treasury Secretary Paulson in a letter. They were further expanded with subsidiary questions seeking additional information.

In January, the Secretary's response provided the basis for our report. An analysis of the response revealed that many answers were non-responsive or incomplete. It was disappointing that the answers were, and in some cases continue to be, elusive, given that the questions are basic and should have been answered when initially framing the program. It was disconcerting, to say the least, having hundreds of billions of dollars spent seemingly without a plan. The report found that, in particular, Treasury needed to provide additional information on bank accountability, transparency, asset valuation, foreclosures, and strategy.

In February, the Panel returned to the central question of whether the public was receiving a "fair deal" when Treasury used TARP funds to make capital infusions into financial institutions. We worked with recognized independent experts to develop multiple valuation models to determine whether the securities Treasury received had a fair market value equal to the dollar amount of the infusions. With minimal variation, the models all demonstrated that Treasury made its infusions at a substantial discount. Treasury received securities that were worth substantially less than the amounts it had paid in return. In all, Treasury overpaid by an estimated $78 billion. For each $100 Treasury invested in these financial institutions, it received on average stock and warrants worth only about $66 at the time of the transaction. While there may have been good reasons to subsidize the banks last fall, it is critical that Treasury be clear in explaining its goals in these transactions. It will be especially important going forward to have independent valuations and transparency as many financial institutions intend to repay TARP funds and buy back their warrants. Treasury will be making many important policy choices as it negotiates the sale of these warrants, including timing, procedures, terms, and pricing for the redemption by banks. We will take up these issues in our July report.

In March, the Panel examined the foreclosure crisis, as directed in the statute. In considering mortgage foreclosure mitigation, we gave particular consideration to impediments to mitigation efforts. We offered a checklist of items to evaluate the likely effectiveness of any proposal to halt the cascade of mortgage foreclosures.

- Will the plan result in modifications that create affordable monthly payments?
- Does the plan deal with negative equity?
- Does the plan address junior mortgages?
- Does the plan overcome obstacles in existing pooling and servicing agreements that may prevent modifications?
- Does the plan counteract mortgage servicer incentives not to engage in modifications?
- Does the plan provide adequate outreach to homeowners?
- Can the plan be scaled up quickly to deal with millions of mortgages?
- Will the plan have widespread participation by servicers and lenders?

We were pleased to see that the Administration's Homeowner Affordability and Stability Plan addressed many of these issues, although the Panel noted serious concern with areas left unaddressed in the original plan, including lack of a safe harbor for mortgage servicers that results in impediments to restructuring mortgages, incomplete consideration of second mortgages, unclear enforcement, and a failure to address seriously underwater mortgages. It is encouraging to see that the initiative is evolving to deal with some of these concerns. The Panel plans follow up work over the coming months to measure progress in foreclosure mitigation.

In April the Panel further analyzed the evolving strategy of Treasury. We focused on lessons from the previous financial crises, both foreign and domestic, to help inform our analysis of the current situation. The report examined four case studies of particular relevance: the Japanese "Lost Decade" of the 1990s; the Swedish experience with bank nationalization in the 1990s; the establishment of the Resolution Trust Corporation (RTC) in response to the American Savings and Loan collapse in the late 1980s; and the actions taken to stabilize the financial and housing sectors during the Great Depression. The report highlighted the benefits and problems of several basic approaches to dealing with failing banks—liquidation, reorganization, or subsidization—based on these historic examples. The review highlighted that each successful resolution of a financial crisis involved four key elements: transparency, assertiveness, accountability, and clarity.

In May the Panel considered the state of small business and consumer lending and provided an assessment of the Term Asset-Backed Securities Loan Facility (TALF). The TALF is intended to support more lending by financing credit through asset-backed securities. These are securities that represent interests in pools of loans made to small businesses and households. Our primary question was whether the TALF program is well-designed to attract new capital. The program allows the investors to reap a substantial portion of the potential profits, but leaves taxpayers to absorb a large portion of potential losses. Even with this asymmetry, there was a slow initial uptake to the program. More recent subscriptions have shown greater participation. Unfortunately, other factors may mean that even a well-designed program could have difficulties helping market participants meet the credit needs of small businesses and households. Families are awash in debt and in the process of deleveraging. Stagnant wages and rising unemployment further constrain the ability of households to manage ever-larger debt loads, suggesting that strategies to increase consumer lending may be counterproductive for American families—and ultimately for the economy. TALF is unlikely to have a meaningful impact on small businesses, as asset-backed securities have never been a significant source of small business funding. The report raises questions about whether taxpayer support for small business lending should be concentrated elsewhere, such as increased availability of SBA loans.

What have we learned thus far? In a crisis, transparency, accountability and a coherent plan with clearly delineated goals are necessary to maintain public confidence and the confidence of the capital markets. Sophisticated metrics to measure the success and failure of program initiatives are also critical. Assuring that the TARP reflects these elements underlies all of our oversight efforts.

Thank you again for the opportunity to explain the work of the Congressional Oversight Panel. I look forward to answering your questions.

PREPARED STATEMENT OF REPRESENTATIVE MICHAEL C. BURGESS, M.D.

Since the downward spiral of our financial markets, the federal government has intervened on behalf of financial institutions by giving them nearly a trillion dollars of taxpayer money. In the Congressional Oversight Panel's most recent report issued on April 7, 2009, the report showed that the Treasury has spent or committed $590.4 billion of TARP funds but the total value of all direct spending, loans and guarantees provided to date in conjunction with the TARP now exceeds $4 trillion dollars.

As Ms. Warren's written testimony shows, the Department of Treasury—and the U.S. taxpayer—didn't get much value for this astronomical spending (and borrowing). When the Treasury used TARP funds to make capital infusions into financial institutions, the American taxpayer received in exchange securities in these companies. Ms. Warren states that the Treasury OVERPAID by an estimate of $78 billion dollars. Considering the stress tests of our financial institutions show these same financial institutions will quote-unquote "NEED" another $75 billion in taxpayer money, perhaps someone somewhere should have been paying more attention to where all this money is going to.

But no one seems to be. The Treasury Department has had exactly one oversight meeting as it relates to the spending of TARP money and ZERO meetings with the financial institutions who have received TARP money. Zero, even though $590.4 billion dollars has been given out.

All this borrowing is more problematic because of the large amount of debt.

Money borrowed to shore-up these financial institutions merely freezes the opportunity for credit markets to invest in other areas of the marketplace, such as healthcare or transportation. Most importantly it freezes the ability of the U.S. government to use a billion dollars a month in interest payment in debt to invest in real solutions for Americans real problems such as the loss of jobs, which we have already held multiple hearings on.

In 1933, Irving Fisher (who may have been one of the greatest American economists) stated that excess debt controls nearly all economic variables. I agree with him.

Furthermore, we can not borrow our way out of excess debt. We will have to pay for it.

America will recover and our financial structure will survive. But the operative factor may be the one thing no one wants to say or hear. It may just take time. Until that time, I reject the notion we should give another dollar of the hard-earned money of our taxpayers to these financial institutions unless we know a job will be created—or debt will be paid for.

○