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S. HRG. 111–316

HEARING WITH TREASURY SECRETARY TIMOTHY GEITHNER

HEARING

CONGRESSIONAL OVERSIGHT PANEL

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

DECEMBER 10, 2009

Printed for the use of the Congressional Oversight Panel

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CONGRESSIONAL OVERSIGHT PANEL

PANEL MEMBERS

ELIZABETH WARREN, *Chair*

PAUL ATKINS

MARK MCWATTERS

RICHARD H. NEIMAN

DAMON SILVERS

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HEARING WITH TREASURY SECRETARY TIMOTHY GEITHNER

THURSDAY, DECEMBER 10, 2009

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

The Panel met, pursuant to notice, at 10:03 a.m. in Room SD–138, Dirksen Senate Office Building, Elizabeth Warren, Chair of the Panel, presiding.

Present: Elizabeth Warren [presiding], Damon Silvers, Richard Neiman, and Paul Atkins.

OPENING STATEMENT OF ELIZABETH WARREN, CHAIR, CONGRESSIONAL OVERSIGHT PANEL

Chair WARREN. This hearing of the Congressional Oversight Panel for TARP, with Secretary of the Treasury Geithner, is now called to order.

Welcome, Mr. Secretary, to your third appearance before the Congressional Oversight Panel. We appreciate your being here and appreciate your commitment to coming every quarter.

Yesterday, this Panel released its monthly oversight report for December. It was a comprehensive assessment of TARP's accomplishments and an exploration of the places where TARP has fallen short. You made it a busy news day by announcing, at the same time, that Treasury will extend TARP until October of next year. Thus, it seems that, between the two of us, we have intensified a vigorous debate, here in Congress, about what direction the program should take going forward.

As the starting place for our conversation, I want to note the conclusion of our report. TARP was an important part of the government's rescue strategy and it helped rescue the financial system from imminent collapse. The apocalyptic fears that we were all suffering 14 months ago have not come to pass. And for that we owe a great debt of gratitude to the public servants who toiled through the darkest days of this crisis.

But, as the report also highlights, TARP has been far from an unmitigated success. Credit for consumers and small businesses remains scarce. The foreclosure crisis continues unabated. And Treasury's mitigation programs have not achieved the scope, the scale, or the permanence necessary to stabilize the housing market. Large banks survived the crisis, with the help of government support, but smaller banks continue to fail at nearly unprecedented rates. And the FDIC is in the red for the first time in 17 years.

Perhaps most disturbing of all, TARP created an implicit government guarantee for major financial institutions, a guarantee that is not shared by their smaller counterparts. The unprecedented government actions taken to stabilize the system have created a huge moral hazard that makes our system riskier and that infects the pricing of assets.

We welcome you here today, Mr. Secretary, to engage in a constructive process of evaluating the TARP and assessing whether it is serving taxpayers in the manner that was intended. I look forward to your testimony and a productive discussion.

And with that, I call on Mr. Atkins for two minutes of remarks.

[The prepared statement of Chair Warren follows:]

ELIZABETH WARREN, CHAIR
REP. JEB HENSARLING
PAUL S. ATKINS
RICHARD H. NEIMAN
DAMON SILVERS

732 NORTH CAPITOL STREET, NW
ROOM C-320
WASHINGTON, DC 20401

Congress of the United States
CONGRESSIONAL OVERSIGHT PANEL

Opening Statement of Elizabeth Warren

Congressional Oversight Panel Hearing with Treasury Secretary Timothy Geithner

December 10, 2009

Welcome, Mr. Secretary. This is your third appearance before the Congressional Oversight Panel and we appreciate your commitment to appear before us on a quarterly basis.

Yesterday, this panel released its monthly oversight report for December. The December report provides a comprehensive assessment of the performance of the Troubled Asset Relief Program, or TARP, identifying its accomplishments and exploring where it has fallen short. Meanwhile, Mr. Secretary, you notified Congress yesterday that Treasury will extend TARP until October of next year and there is a vigorous debate here in Congress about what direction the program should take going forward. We hope that the December report contributes to this debate and provides useful context on what the TARP has done and what challenges remain.

The report concludes that TARP was an important part of the government's strategy to rescue the financial system from an imminent collapse. The apocalyptic fears of last fall have not come to pass and for that we owe a great debt of gratitude to the public servants who toiled through the darkest days of the crisis. But as the report highlights, TARP has been far from an unmitigated success. Credit for consumers and small businesses remains scarce. Large banks survived the crisis with the help of government support, but smaller banks continue to fail at a nearly unprecedented rate, and the FDIC is in the red for the first time in 17 years. The foreclosure crisis continues unabated and Treasury's mitigation programs have not achieved the scope, scale, or permanence necessary to stabilize the housing market. Perhaps most disturbing of all, TARP created an implicit government guarantee for major financial institutions that is not shared by their smaller counterparts. The unprecedented government actions taken to stabilize the system have created a huge moral hazard that makes our system riskier and that infects the pricing of assets.

We welcome you here today Mr. Secretary to engage in the constructive process of evaluating the TARP and assessing whether it is serving taxpayers in the manner that it was intended. I look forward to your testimony and a productive discussion.

STATEMENT OF PAUL ATKINS, MEMBER, CONGRESSIONAL OVERSIGHT PANEL

Mr. ATKINS. Thank you, Madam Chair.

And welcome, Secretary Geithner.

Milton Friedman once said that, "Nothing is so permanent as a temporary government program." Yesterday, we learned that—what most of us had already suspected—that TARP will not die at the end of this year. The program can no longer—I think—be considered a hastily arranged effort to arrest the financial freefall. I can understand why a Treasury Secretary, any Treasury Secretary really, would want to extend TARP. Why not? It's a free option, at taxpayer expense, and essentially a blank check to finance any macroeconomic stimulus initiative that the executive branch can imagine, to the tune of hundreds of billions of dollars. But, now that last year's emergency has abated, the rationale behind TARP as a salve for financial markets in distress no longer supports Treasury's choice, I believe, to extend it.

The previous Congress reluctantly authorized TARP in response to an extraordinary financial panic. Would Congress, today, approve TARP? I cannot imagine it. That, essentially, is why it was extended, I believe. But, to extend TARP's borders, I think, is recklessness and irresponsibility in Treasury's role as a steward of the Nation's financial system.

TARP continues to inflict great economic cost, both directly to the taxpayer, in the form of actual and potential tens of billions of dollars of losses, and indirectly, as the Chair said, of moral hazard, distorted incentives created by implicit government guarantees, and inefficient government interference in the operation of private firms. Moreover, the administration's legislative proposals will not solve these problems, I believe, but only institutionalize them.

Now that unbridled financial panic, that was cited as the original justification for TARP, has disappeared, why deepen and prolong these costs? I think we're still too close to the events of last year to determine whether TARP was a success. I'm not convinced that we can even yet credit the program itself for stopping a panic in the markets.

The United States Government basically threw out $8 trillion in the form of guarantees, loans, and direct outlays to the financial markets. Something had to happen out of all that liquidity. And, in fact, I think this chart here shows how TARP rates as but a small portion of the total government outlays—this little red triangle here—compared to everything else—guarantees, outlays, and loans—that the federal government did last year.

So, the lack of political accountability, I believe, may be TARP's greatest liability of all. And I think the Treasury Department has done very little to assuage many obvious oversight concerns that this panel has expressed.

First, Treasury takes the position that TARP essentially is a revolving line of credit with a $700 billion limit on outstanding balances at any time. At your previous appearance before the panel, I asked for a legal opinion justifying the view that TARP is a revolving fund. We have yet to receive such an opinion from Treasury. I believe that this omission needs to be addressed as soon as possible.

So, I thank you.

[The prepared statement of Mr. Atkins follows:]

ELIZABETH WARREN, CHAIR
REP. JEB HENSARLING
PAUL S. ATKINS
RICHARD H. NEIMAN
DAMON SILVERS

732 NORTH CAPITOL STREET, NW
ROOM C-320
WASHINGTON, DC 20401

Congress of the United States
CONGRESSIONAL OVERSIGHT PANEL

Opening Statement of Paul Atkins

Congressional Oversight Panel Hearing with Treasury Secretary Timothy Geithner

December 10, 2009

Thank you, Madame Chairman. Welcome, Secretary Geithner.

Milton Friedman once said, "Nothing is so permanent as a temporary government program." Yesterday we learned what most of us had already suspected: TARP will not die at the end of this year. The program no longer can be considered a hastily arranged effort to arrest a financial free-fall. I can understand why a Treasury secretary would want to extend TARP – why not? It seems to be a free option at taxpayer expense – essentially a blank check to finance any macroeconomic stimulus initiative the executive branch can imagine to the tune of hundreds of billions of dollars. Now that last year's emergency has abated, the rationale behind TARP as a salve for financial markets in distress no longer supports Treasury's choice to extend it.

The previous Congress reluctantly authorized TARP in response to an extraordinary financial panic. Would Congress today approve TARP? I cannot imagine it. That essentially is why it was extended. But to extend TARP under current circumstances is irresponsible in Treasury's role to faithfully execute the laws of the land. TARP continues to inflict great economic costs, both directly to the taxpayer in the form of actual and potential tens of billions of dollars of losses and indirectly in the form of moral hazard, distorted incentives created by implicit government guarantees, and inefficient government interference in the operation of private firms. Moreover, the Administration's legislative proposals will not solve those problems, but only institutionalise them. Now that the unbridled financial panic that was cited as the original justification of TARP has disappeared, why deepen and prolong these costs? The responsible thing would be to seek renewed authority, tailored to the situation and incorporating all of the lessons learned through the very imperfect implementation of TARP.

We are still too close to the events of last year to determine whether TARP was a success. I am not convinced that we can even yet credit the program itself for stopping a panic in the markets. The United States government basically threw almost $8 trillion in the form of guarantees, loans, and direct outlays at the financial markets. Something had to happen with all of that liquidity. This chart shows that the $700 billion under TARP was but a small portion of the total government effort, including other programs of the Federal Reserve, Treasury, and the FDIC.

The lack of political accountability may be TARP's greatest liability of all, and the Treasury Department has done little to assuage many obvious oversight concerns that this Panel has expressed.

First, Treasury takes the position that TARP essentially is a revolving line of credit, with a $700 billion limit on outstanding balances at any time. Congress, however, expressly mandated that TARP funds paid back to the Treasury be used to pay down the national debt. That approach fits the emergency, temporary nature of the program with such thin strings attached – use the money once and (one hopes) get it paid back. If the money runs out, go back and ask for more. At your previous appearance before this Panel, I asked for a legal opinion justifying the view that TARP is a revolving fund, but we have yet to receive such an opinion from Treasury. This omission is unacceptable and perhaps implies the weakness of your legal position.

Second, Treasury has not provided any foundational arguments for the legal limits on TARP expenditures and on the criteria used to determine which expenditures are proper under the statute. For example, what parameters will be placed on spending TARP funds for the President's so-called "job creation" initiatives? As the financial markets have stabilized, a continuation of TARP raises the prospect that Treasury will put funds into companies with only a tenuous connection to the financial markets, just as it did with the $80 billion infusion into GM and Chrysler.

With respect to financial institutions, what justifies continuing to furnish non-systemically important institutions such as GMAC with TARP funds? Does Treasury have any objective criteria or processes at all for determining what is an appropriate TARP expenditure? The Administration's proposals for a systemic risk regime and resolution authority have similar problems of lack of predictability, rule of law, and transparency. It appears that the resolution authority is really just a way to codify TARP for years to come. Since Treasury has shown so little discipline with TARP, how can Congress delegate such vaguely defined powers with the expectation that Treasury will follow congressional intent in the future, whatever Administration may be in power?

Third, this Panel must be provided more information about the decision-making process to extend the TARP program beyond the end of this year, including the cost/benefit analysis that the statute essentially calls for.

TARP has proven costly and ineffective at achieving virtually any other of its ever-changing goals. The decision to extend TARP was yours to make and accountability for the consequences of that decision is yours as well. You now clearly own the program, warts and all. I look forward today to hearing about your goals and expectations for the TARP program and what, if any, legal limits you believe exist on TARP's scope.

Chair WARREN. Thank you.
Mr. Silvers.

STATEMENT OF DAMON SILVERS, DEPUTY CHAIR, CONGRESSIONAL OVERSIGHT PANEL

Mr. SILVERS. Good morning, and thank you, Chair Warren.

I wish to begin by saying, Mr. Secretary, that I believe the administration's decision to extend TARP was the only responsible course of action. The financial system today is not fundamentally stable, in my opinion. The mortgage foreclosure crisis is accelerating. And the overall economic situation, particularly when looked at globally, is not good. The risk of a systemic problem in the coming months is significant.

While I believe a tough resolution authority, such as proposed by the Obama administration and being acted on, hopefully, by the the House in the coming hours, would be far superior to TARP as a means of dealing with a possible future financial crisis. At the moment, Congress has not passed any such authority.

In this context, the administration's decision was the only responsible one. And as I think we—you just got a little taste of—it was an act of political courage for which I think you deserve a substantial amount of credit.

Now, we found, in our December report, released earlier this week, that TARP played a positive role in halting a runaway financial crisis in the fall of last year. I recognize this is hard to prove in the way that a mathematician would prove something, but I'm completely convinced this is true. And the reason I think this is true is—and the reason why my colleague Mr. Atkins has it wrong—is because there's a difference between liquidity and equity.

Now, nonetheless, TARP is wildly unpopular among the American public. And this is not because the public does not understand what happened. It's because the public understands all too well what happened. This panel has found, in report after report, that TARP transactions have been undertaken on less than fair terms to the public, that there have been issues of transparency in key TARP actions, including the stress tests, that the underlying weaknesses in the financial system have been inadequately addressed, and finally, and perhaps most importantly, that key credit markets that matter to the American public remain weak, with real consequences for jobs.

It did not have to be this way, and it does not have to be this way in the future. This administration has taken significant steps to make TARP a program that works in the interests of the American people and not simply in the interests of the financial firms we bailed out, including allocating significant monies to foreclosure relief and managing to avoid putting more money into the large banks. But, more must be done. TARP, in its second year, must, one, work for Main Street, not just Wall Street; two, always transact with private parties on terms that are fair to the American public; and, three, address the underlying weaknesses in our large financial institutions by cleaning up firms that are broken, rather than continuing to hope that time will heal all wounds.

This week, President Obama spoke powerfully about the need to help solve the Main Street credit crisis so businesses can create jobs. And he spoke about the role TARP might play in that mission.

I look forward today to hearing in more detail about those plans and, like the Chair and my colleagues, I'm very pleased to see you here today and thank you for your attention to the panel.

[The prepared statement of Mr. Silvers follows:]

ELIZABETH WARREN, CHAIR
REP. JEB HENSARLING
PAUL S. ATKINS
RICHARD H. NEIMAN
DAMON SILVERS

732 NORTH CAPITOL STREET, NW
ROOM C-320
WASHINGTON, DC 20401

Congress of the United States
CONGRESSIONAL OVERSIGHT PANEL

Opening Statement of Damon Silvers

Congressional Oversight Panel Hearing with Treasury Secretary Timothy Geithner

December 10, 2009

Good morning and thank you Chairwoman Warren. This hearing takes place slightly more than a year after the inception of the TARP program, and is more or less the one year anniversary of this Panel. It is appropriate that we should be joined today by Treasury Secretary Geithner in his third appearance before our Panel.

I wish to begin by saying, Mr. Secretary, that I believe the Administration's decision to extend TARP was the only responsible course of action. The financial system is not stable, the mortgage foreclosure crisis is accelerating, and the overall economic situation, particularly when looked at globally, is not good. The risk of a systemic problem in the coming months is significant. While I believe a tough resolution authority would be far superior to TARP as a means of dealing with a possible future financial crisis, at the moment, Congress has not passed any such authority. The Administration's decision was the only responsible one in this context, but it was also an act of political courage.

We found in our December report released earlier this week that TARP played a positive role in halting a runaway financial crisis in the fall of last year. Yet TARP is wildly unpopular among the American public. This is not because the public does not understand what happened, but because the public understands all too well what happened. This Panel has found in report after report that TARP transactions have been undertaken on less than fair terms to the public, that there have been issues of transparency in key TARP actions including the stress tests, that the underlying weaknesses in the financial system have been inadequately addressed, and finally that key credit markets that matter to the American public remain weak, with real consequences for jobs.

It did not have to be this way and it does not have to be this way in the future. This Administration has taken significant steps to make TARP a program that works in the interests of the American people, and not simply in the interests of the financial firms we bailed out, including allocating significant monies to foreclosure relief and managing to avoid putting more money into the large banks.

But more must be done. TARP in its second year must (1) work for Main Street, not just Wall Street, (2) transact with private parties on terms that are fair to the American public, and (3) address the underlying weaknesses in our large financial institutions by cleaning up firms that are broken, rather than continuing to hope time will heal all wounds.

Congressional Oversight Panel

This week, President Obama spoke powerfully about the need to help solve the Main Street credit crisis, so business can create jobs, and the role TARP might play in that mission. I look forward today to hearing in more detail about those plans. Thank you.

Chair WARREN. Thank you, Mr. Silvers.

Superintendent Neiman.

STATEMENT OF RICHARD NEIMAN, MEMBER, CONGRESSIONAL OVERSIGHT PANEL

Mr. NEIMAN. Good morning, Mr. Secretary.

Yesterday morning, our panel issued a report analyzing the overall effectiveness of TARP in a comprehensive year-end review. And while the report criticized several of TARP's shortcomings to date, it also gave a large share of credit to the Treasury Department and to Congress and, in my opinion, to the Fed and the FDIC, for the achievement of the primary objectives of the EESA. TARP's primary objectives were to restore financial stability and liquidity. And this has largely been achieved, as the report stated and I elaborated in my additional views.

This reflection is critically important so that the American public can fully appreciate the depth of the crisis and how the Treasury's multi-prong response stabilized not only the financial sector, but also avoided a dramatic worsening, if not collapse, in the real economy. But, Congress also charged Treasury with using TARP funds in a manner to preserve homeownership, in addition to promoting jobs and economic growth. And we are now entering perhaps the most critical stage of Treasury's foreclosure prevention program.

Hundreds of thousands of mortgage modifications in their trial phase are at risk of not converting to permanent modifications because servicers are not obtaining adequate supporting documentation from homeowners. The majority of the homeowners in these trials are, in fact, making their modified monthly payments, but they will soon be in danger of elimination from the program and will again face foreclosure as their trial period expires with documentation still deemed insufficient. I am sure you agree that neither homeowners nor our financial system can afford a trip back to square one.

I look forward to reviewing these and other issues with you this morning, and, again, I thank you for your time with us this morning.

[The prepared statement of Mr. Neiman follows:]

ELIZABETH WARREN, CHAIR
REP. JEB HENSARLING
PAUL S. ATKINS
RICHARD H. NEIMAN
DAMON SILVERS

732 NORTH CAPITOL STREET, NW
ROOM C-320
WASHINGTON, DC 20401

Congress of the United States
CONGRESSIONAL OVERSIGHT PANEL

Opening Statement of Richard Neiman

Congressional Oversight Panel Hearing with Treasury Secretary Timothy Geithner

December 10, 2009

Yesterday morning our Panel issued a report analyzing the overall effectiveness of TARP, in a comprehensive year-end review. And while the Report criticized several of TARP's shortcomings to date, it also gave a large share of credit to the Obama Administration and to Congress (and in my opinion to the Fed and the FDIC) for the achievement of the primary objectives of EESA.

TARP's primary objectives were to restore financial stability and liquidity and this has largely been achieved, as the report stated and I elaborated on in my "Additional Views" section of the report. This reflection is critically important so that the American public can fully appreciate the depth of the crisis and how the Treasury's multi-prong response stabilized not only the financial sector but also avoided a dramatic worsening – if not collapse – in the "real economy."

But Congress also charged Treasury with using TARP funds to preserve homeownership, and we are now entering perhaps the most critical stage of Treasury's foreclosure prevention program. Hundreds of thousands of mortgage modifications in their trial phase are at risk of not converting to permanent modifications because servicers are not obtaining adequate supporting documentation from homeowners. The majority of the homeowners in these trials are in fact making their modified monthly payments, but they will soon be in danger of elimination from the program and will again face foreclosure as their trial period expires with documentation still deemed insufficient.

I am sure you agree that neither homeowners, nor our financial system, can afford a trip back to square one.

I look forward to reviewing these and other issues with you this morning and thank you again for your time with us today.

Chair WARREN. Thank you, Mr. Neiman.

I want to note that we are missing our fifth and newest panelist, Mark McWatters, who joined the panel by appointment last night. He can't be with us today because he has the flu. So, we are sorry, and we wish him well.

As you can see, Mr. Secretary, we have kept our remarks brief so that we will be able to have the maximum amount of time for questions and answers. So, I would ask that you keep your remarks to five minutes.

Mr. Secretary.

STATEMENT OF HON. TIMOTHY GEITHNER, SECRETARY, UNITED STATES DEPARTMENT OF THE TREASURY

Secretary GEITHNER. Thank you. Thank you, Chair Warren and members of the Congressional Oversight Panel. And thanks for the opportunity to come before you again to testify about this important set of policy issues facing the country.

More than a year ago, as you noted, we faced one of the most severe financial crises in the past century, a deep economic contraction, and we've now begun to turn this around. Confidence in the stability of the financial system, in the security of American savings has improved dramatically, credit is flowing again, the economy is now growing, borrowing costs have fallen, businesses have raised substantial capital from private markets, housing prices have stopped falling in many parts of the country, and job losses have slowed at a pace that is more consistent with stronger recoveries than weaker recoveries.

However, this is a very tough economy, and households and businesses still face very significant challenges. Unemployment, of course, is very, very high. Commercial real estate losses weigh heavily on many small banks, impairing their ability to extend new loans. Credit is tight for many small businesses. Foreclosures, driven now principally by unemployment, are very high.

Today, I want to outline our strategy to address these challenges, going forward, and how we're going to wind down and ultimately exit the TARP. There are four elements to the strategy:

First, we will terminate and wind down the emergency programs that were put in place at the peak of the crisis that were necessary to break the back of this financial panic. In September, we shut down the Money Market Guarantee Program, which earned taxpayers $1.2 billion. We've effectively shut down, now, the Capital Purchase Program, under which the majority of TARP investments in banks were made.

Second, we will limit new commitments under this program in 2010 to three areas: housing, small banks, and credit markets for consumers and small businesses. For housing, we're going to continue to work to mitigate foreclosures for responsible American homeowners as we take the steps necessary to continue to help stabilize the housing market. For small businesses, we recently launched initiatives to provide capital to small and community banks that commit to increase lending to small businesses. And we are reserving additional funds for additional efforts to facilitate small business lending. And finally, we're going to continue to sup-

port the securities markets that are necessary for credit flows to consumers and small businesses.

Third, beyond these limited new commitments, we will not use remaining TARP funds—unless necessary to respond to an immediate and substantial threat to our economy stemming from financial stability, a determination that I will only make after consulting with the President and the Chairman of the Federal Reserve Board and submitting written notification to Congress.

Fourth, we will continue to reduce our financial stake in banks and manage our other investments. We will keep the government out of the business decisions of these companies, and we will exit from our investments as soon as is practical and return ownership to private hands. This strategy requires a limited temporary extension of the authority provided by the Congress under the Emergency Economic Stabilization Act. It would be irresponsible to do otherwise.

The expected costs of TARP have fallen dramatically. While we are extending the program, we do not expect, at this point, to deploy more than $550 billion, in total. We also expect up to $175 billion in repayments from banks by the end of next year, and substantial additional payments thereafter. And as a result, we now expect that the ultimate costs of TARP will be at least $200 billion less than was projected as recently as the August midsession review of the President's budget.

We now expect to make—not lose, but to make money on the $245 billion of investments in banks. We estimate that the TARP programs for banks will yield a positive return of over $19 billion. Indeed, banks have already repaid more than $116 billion in investments. The stress test of the major financial institutions helped accelerate repayments by providing markets with the transparency and the confidence necessary for banks to be able to raise capital from private sources. These programs, as you know, have generated significant income, roughly $15 billion, which have been used already to help pay down our Nation's fiscal obligations.

Of course, we do not expect all TARP investments to generate positive returns. It's unlikely that we will be repaid for all of our investments in AIG, GM, and Chrysler. But, even there, the outlook, too, has improved. And you'll see new estimates in the report we're issuing today.

We're going to continue to manage TARP in a transparent and an accountable manner. Earlier this morning or maybe sometime today, I'm not sure it's out yet, Treasury published the first annual financial statements for this program. These statements discuss in great detail the operations, the impact, the expected costs of the program. GAO provided an unqualified audit opinion of those statements, and concluded there were no material weaknesses in internal controls. And this is a notable achievement for the men and women that have helped put in place this very complicated, very important program in a very short period of time.

Let me just end by emphasizing, as you did, the importance that we continue to work to reinforce the process of repair in our financial system. It is absolutely essential to try and make sure that we establish a strong recovery that will put Americans back to work. And it is very important, because of the consequences created by

the actions necessary to put out this financial fire, that Congress move to adapt a strong and comprehensive package of financial reforms. And I am encouraged by the progress received to date. There's a lot of challenges ahead in getting a strong package in place. I know you've played a very helpful role in trying to help bring some thoughtful insight to those choices, and I hope you'll continue to work with us to help make sure we have a strong package of reforms in place as quickly as possible.

Thank you.

[The prepared statement of Secretary Geithner follows:]

Secretary of Treasury Timothy F. Geithner
Written Testimony before the Congressional Oversight Panel
December 10, 2009

Introduction

Chair Warren, Representative Hensarling, and members Neiman, Silvers and Atkins, thank you for the opportunity to testify before you again.

Since I last appeared before this panel, U.S. financial and economic conditions have continued to improve. Borrowing costs have fallen, and businesses have raised substantial capital from private sources. The contraction in bank lending has moderated. Residential mortgage lending by banks actually expanded last month. The economy started growing again in the third quarter, a trend that private economists predict will continue. And the pace of deterioration in the labor market has moderated.

These improvements are remarkable. One year ago, we faced one of the most severe financial crises of the past century, and the economy was contracting sharply. Fear of a possible depression froze markets and spurred businesses to lay off workers and pull back from investment.

A coordinated government response turned this around. Action taken last fall by the Department of the Treasury, the Federal Reserve, the FDIC, and other government agencies averted a catastrophic collapse of our financial system. As your latest report states, the Troubled Asset Relief Program (TARP), which was established by Congress in the Emergency Economic Stabilization Act of 2008 (EESA), played a significant role in that success. But when the Obama Administration took office, the financial system was still extremely fragile, and the economy was shrinking rapidly. The Administration swiftly initiated financial and fiscal policies to address both challenges. In particular, the Financial Stability Plan helped to shore up confidence in our financial institutions and markets, while mobilizing private capital. The Administration also redirected public support from large financial institutions to households, small banks, and small businesses.

As a result of these policies, confidence in our financial system has improved, credit is flowing, and the economy is growing. Moreover, the government is exiting from its emergency financial policies and taxpayers are being repaid. Indeed, the ultimate cost of those policies is likely to be significantly lower than previously expected. In particular, while EESA provided the Secretary of the Treasury with the authority to invest $700 billion, it is clear today that TARP will not cost taxpayers $700 billion. Banks have already repaid nearly half of TARP funds they received over the past year, and we now expect a positive return from the government's investments in banks. We also plan to use significantly less than the full $700 billion in EESA authority. As a result, we now expect that TARP will cost taxpayers at least $200 billion less than was projected in the August Mid-Session Review of the President's Budget.

This week, Treasury published the first annual financial statements for the Office of Financial Stability, which implements TARP. Audited by the GAO, these statements discuss the impact of the program and provide cost estimates for it. Today, I will provide highlights from these statements.

I will also discuss the significant financial and economic challenges that remain and what the Administration is doing to address them. We need to continue to find ways to help mitigate foreclosures for responsible homeowners and to get credit to small businesses. We also must maintain the capacity to

address potential threats to our financial system, which could undermine the recovery we have seen to date. Further, we need to reform our laws to provide stronger, more effective regulation of our financial system and to protect consumers. Doing so will decrease the need for future intervention.

In this context, I will lay out an exit strategy for TARP. There are four broad elements to that strategy:

1. terminating and winding down programs that have supported large financial institutions;

2. limiting new investments to housing, small business, and securitization markets that facilitate consumer and small business loans;

3. maintaining the capacity to respond to potential financial threats; and

4. continuing to manage equity investments acquired through TARP in a commercial manner, while protecting taxpayers and unwinding those investments as soon as practicable.

Extending TARP authority is necessary for this strategy to succeed. Therefore, earlier this week I extended that authority until October 3, 2010. While we work to return taxpayer dollars, this Administration will not waver in its commitment to preserve the stability of our financial system and to help restore economic opportunity for American families and small businesses.

TARP Performance

The primary purpose of TARP was to restore the liquidity and stability of our financial system. That system plays a critical role in our economy, for example, by helping businesses raise funds and pay employees, providing consumers with convenient forms of credit, financing education, and allowing millions of Americans to own homes. The success or failure of TARP must be evaluated first and foremost on whether it has achieved that primary purpose.

Second, EESA required that TARP be used in a manner that maximized overall returns to taxpayers, while preserving home ownership and promoting jobs and economic growth.

As I will discuss, TARP has been successful by each measure, although challenges remain that require us to refocus initiatives, particularly toward mitigating foreclosure and getting credit to small businesses.

Impact on the Financial System

Measuring the impact of TARP in isolation is challenging. The health of the overall system and its impact on the U.S. economy are the most important metrics by which we can measure the effectiveness of these policies. However, the cost of the financial system collapse that was averted by TARP and the other government actions taken in the fall of 2008 and since then will never be known. Moreover, it is difficult to measure separately the impact of TARP, as it was part of a coordinated government response to restore confidence in our financial system. Nevertheless, a few TARP programs were uniquely targeted to specific markets and institutions. In those instances, we can measure performance more directly.

At a broad level, confidence in the stability of our financial markets and institutions has improved dramatically over the past year. Interbank lending rates, which reflect stress in the banking system, have

returned to levels associated with more stable times. Credit-default swap spreads for financial institutions, which measure investor confidence in their health, have also fallen significantly.

At the same time, borrowing costs have declined for many businesses, homeowners, and municipalities, allowing them to raise substantial capital from private sources. Corporations, for example, have raised over $1 trillion from bond issuance this year. While much of the issuance early this year was supported by government guarantees, private investors have funded most new corporate debt without public support in recent months. Importantly, banks have raised substantial funds from private sources since federal regulators released the results of their "stress test" of major U.S. financial institutions. As a result, the U.S. banking system is better capitalized today. TARP investments provided our financial institutions with an important bridge to critical access to private capital.

More narrowly targeted programs have also had a significant impact. Securitization markets that provide important channels of credit for consumers and small businesses have improved, in large part because of the government's Term Asset-Backed Securities Loan Facility (TALF). Spreads in these markets have narrowed considerably in response to announcements and actions through the program. New issuance has picked up and is shifting from public support to purely private financing. Prices for impaired securities on bank balance sheets have improved significantly this year. Announcements for the Public-Private Investment Program have contributed to these improvements, and the recently-formed Public-Private Investment Funds have started to purchase troubled assets from banks. Meanwhile, housing markets are showing some signs of stabilizing. Thanks in part to federal government financial policies, mortgage rates remain near historic lows, and home prices and sales are increasing. Millions of Americans have refinanced their mortgages since we announced the Making Home Affordable program, and over 650,000 trial modifications have been initiated under the Home Affordable Modification Program, which is largely funded by TARP.

As credit conditions have improved, the U.S. economy has started to grow again, and job losses have slowed. These are significant improvements from where we were last year.

However, the financial and economic recovery still faces significant headwinds. Unemployment remains very high, along with foreclosure and delinquency rates, and housing markets are still overwhelmingly dependent on government support. Lending standards are tight and bank lending continues to contract overall, although the pace of contraction has moderated and residential mortgage lending by banks has stabilized. Commercial real estate losses weigh heavily on many small banks, impairing their ability to extend new loans. Further, although securitization markets have improved, parts of those markets are still impaired, especially for securities backed by commercial mortgages. These conditions place enormous pressure on American families, homeowners, and small businesses, which rely heavily on bank lending. Later, I will describe how we are refocusing EESA-funded programs to mitigate this pressure.

In sum, TARP has largely succeeded in achieving its primary goal, and we are winding down many initiatives established under the program. However, four tasks remain for TARP: preserving financial stability, which is essential for long-term economic growth; mitigating foreclosure for responsible American homeowners; getting credit to small businesses; and supporting securitization markets that facilitate consumer and small business loans.

Financial Returns and Expected Cost

The expected cost of using TARP to stabilize our financial system has fallen dramatically. While EESA provided the Secretary of the Treasury with the authority to invest $700 billion, the ultimate cost for taxpayers will undoubtedly be far less.

One way of evaluating the program's cost is its impact on the Federal deficit. We now expect that TARP's contribution to Federal deficits will be at least $200 billion less than was projected in the August Mid-Session Review of the President's Budget, which assumed a $341 billion cost.[1] And the expected budgetary impact of $364 billion in funds disbursed in Fiscal Year 2009 has fallen from $151 billion to $42 billion.

This improvement is driven by two factors: (1) investments are generating higher returns than previously anticipated, and (2) we do not anticipate using the full spending authority granted by EESA. We now expect to make – not lose – money on $245 billion of investments in banks. We estimate that in the aggregate, major bank stabilization programs funded through TARP will yield a positive net return of over $19 billion, thanks to dividends, interest, early repayments, and the sale of warrants. In short, taxpayers are being repaid at a substantial profit by banks.

Repayments are already substantial. To date, banks have returned $116 billion in taxpayer investments – nearly one-third of all TARP disbursements to date. Further, we anticipate that total repayments could reach $175 billion by the end of next year; that is, nearly half of TARP disbursements to date.

These early repayments are testaments to the success of the government's efforts to stabilize and rehabilitate our financial system. Private investors now have much greater confidence in the prospects of our major financial institutions. This is reflected in the significant private fundraising by banks this year. Just last week, Bank of America raised $19.3 billion in common equity – after it announced that it would repay $45 billion of government investments. More broadly, the largest U.S. banks have raised over $110 billion in common equity and other regulatory capital since we announced the results of the "stress test" in May. That nearly matches the $116 billion in repayments we have received.

TARP programs have already generated significant income – roughly $15 billion – which has been used to pay down the debt. Our outstanding equity investments continue to generate substantial income through dividends. And we are adding to the taxpayer's return by auctioning warrants. Last week, for example, we raised nearly $150 million from the sale of Capital One warrants. We expect substantial income from additional warrant sales over the next few weeks.

However, we do not expect all TARP investments to generate positive returns. There is a significant likelihood that we will not be repaid for the full value of our investments in AIG, GM, and Chrysler. But here too the outlook has improved. We now expect these institutions to repay $14 billion more than was originally projected.

Furthermore, expenditures through the Home Affordable Modification Program were never intended to generate revenue. Consistent with the mandate of EESA, this program was created to help mitigate foreclosure for responsible but at-risk homeowners. The program requires mortgage lenders to share the financial burden of meeting that goal.

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[1] *This amount reflects the estimated programmatic and administrative costs of TARP that impact on Federal deficits.*

In sum, the ultimate return on TARP investments will depend on how the economy and financial markets evolve, and whether we can reform financial regulation and consumer protection in meaningful, efficient ways. But the bottom line is as follows. In combination with other government programs, TARP helped prevent a financial collapse that would likely have plunged this country into a much deeper recession, led to staggering job losses, and further reduced tax revenue. The financial system continues to improve, private capital is replacing public support, and the economy is growing again. Taxpayers should get back the vast majority of funds invested through TARP. And the ultimate fiscal cost of the program will be substantially less than originally expected, thereby reducing the burden on current and future taxpayers.

Exit Strategy for TARP

Next, I will lay out our exit strategy for TARP. There are four broad elements to that strategy.

First, we will continue terminating and winding down many of the government programs put in place to address the crisis. That process is already well underway. In September, Treasury ended its Money Market Fund Guarantee Program, which guaranteed at its peak over $3 trillion of assets. The program incurred no losses, and generated $1.2 billion in fees. New issuance under the FDIC's Temporary Liquidity Guarantee Program (TLGP) ended in October. Credit extended through Federal Reserve liquidity programs has declined substantially as market conditions have improved, and most of these programs are scheduled to expire at the beginning of February.

With respect to TARP, support for large financial institutions is coming to an end. The Capital Purchase Program, under which the bulk of support to banks has been provided, is effectively closed. Before this Administration took office, nearly $240 billion in TARP funds had been committed to banks. Since January 20, we have committed approximately $7 billion to banks, much of which went to small institutions. Major U.S. banks subject to the "stress test" conducted last spring have raised over $110 billion in high-quality capital from the private sector. And banks have repaid $116 billion of TARP funds.

Second, we must fulfill EESA's mandate to preserve home ownership, stimulate liquidity for small businesses, and promote jobs and economic growth. To do so, we will limit new commitments in 2010 to three areas.

- We will continue to mitigate foreclosure for responsible American homeowners as we take the steps necessary to stabilize our housing market.

- We recently launched initiatives to provide capital to small and community banks, which are important sources of credit for small businesses. We are also reserving funds for additional efforts to facilitate small business lending.

- Finally, we may increase our commitment to the Term Asset-Backed Securities Loan Facility (TALF), which is improving securitization markets that facilitate consumer and small business loans, as well as commercial mortgage loans. We expect that increasing our commitment to TALF would not result in additional cost to taxpayers.

Third, beyond these limited new commitments, we will not use remaining EESA funds unless necessary to respond to an immediate and substantial threat to the economy stemming from financial instability.

As a nation we must maintain capacity to respond to such a threat. Banks are still experiencing significant new credit losses, and the pace of bank failures, which tend to lag economic cycles, remains elevated. At the same time, many of the Federal Reserve and FDIC programs that have complemented TARP investments are ending. This creates a financial environment in which new shocks could have an outsized effect – especially if an adequate financial stability reserve is not maintained. As we wind down many of the government programs launched initially to address the crisis, it is imperative that we maintain this capacity to respond if financial conditions worsen and threaten our economy. However, before using EESA funds to respond to new financial threats, I would consult with the President and Chairman of the Federal Reserve Board and submit written notification to Congress. This capacity will bolster confidence and improve financial stability, thereby decreasing the probability that it will need to be used.

In order to meet these challenges, earlier this week I notified Congress that I extended the temporary authority provided to me under EESA to October 3, 2010. Even with this extension, we expect that TARP will cost taxpayers at least $200 billion less than was projected in the August Mid-Session Review of the President's Budget, including $25 billion in potential costs from TARP commitments in 2010. We expect that the vast majority of these potential costs would come from mitigating foreclosure for responsible American homeowners as we take the steps necessary to stabilize our housing market.

By stabilizing our financial system, assisting responsible homeowners, and getting credit to small businesses, EESA authority will continue to improve the outlook for our economy and American workers. And it will do so within the limits established by Congress in EESA. Further, while we are extending the $700 billion program, we do not expect to deploy more than $550 billion. We also expect up to $175 billion in repayments by the end of next year, and substantial additional repayments thereafter. The combination of the reduced scale of TARP commitments and substantial repayments should allow us to commit significant resources to pay down the federal debt over time.

Fourth, we will continue to manage the equity investments acquired through EESA in a commercial manner, while protecting taxpayers and unwinding those investments as soon as practicable. We will exercise our voting rights only on core issues such as election of directors, and not interfere in the day to day management of individual companies. In addition, as the steward of taxpayers' funds, Treasury will manage investments in a manner that ensures accountability, transparency and oversight. And we will work with recipients of EESA funds and their supervisors to accelerate repayment where appropriate. We want to see the capital base of our financial system return to private hands as quickly as possible, while preserving financial stability and promoting economic recovery.

Conclusion

In conclusion, I can report significant improvements in our financial markets and economy, as well as the positive financial results of our TARP programs. However, our job is far from finished. History suggests that exiting too soon from policies designed to contain a financial crisis can significantly prolong an economic downturn. While we exit our emergency financial policies, we must not waver in our resolve to ensure the stability of the financial system and to support the nascent recovery that the Administration and Congress have worked so hard to achieve. Improvements in the financial performance of TARP programs put us in a better position to address the financial and economic challenges that many Americans still face. The Department of the Treasury looks forward to continuing to work with you and the Congress to achieve these goals.

Appendix: U.S. Credit Conditions

Confidence in the stability of our financial markets and institutions has improved dramatically over the past year. Interbank lending rates, which reflect stress in the banking system, have returned to levels associated with more stable times. For example, the spread of one-month Libor to the overnight index swap has fallen from a peak of about 340 basis points last fall to roughly 10 basis points today. Credit-default swap spreads for financial institutions, which measure investor confidence in their health, have also fallen significantly. An aggregate measure of credit-default swaps for the largest U.S. banks reached over 450 basis points last fall and is roughly 100 basis points today.

Borrowing costs have declined for many businesses, homeowners, and municipalities. Investment-grade corporate bond rates have fallen by over 70 percent since last fall, and high-yield bond rates have fallen by more than half. Fears of default on these bonds have receded, providing further relief on prices. The CDX investment-grade index, an aggregate measure of credit-default swaps for highly-rated companies, has fallen about 35 percent from its October peak. Further, conventional 30-year mortgage rates remain under five percent at historic lows. AAA municipal bond rates are three percent, down from five percent last fall.

As borrowing costs have come down, businesses have raised substantial capital from private sources this year. Corporations, for example, have raised over $900 billion in investment-grade debt and over $100 billion in high-yield debt this year. While much of the new issuance early this year was supported by government guarantees, private investors have funded most new corporate debt without public support in recent months. Nearly 50 percent of new issuance was guaranteed by the government in January. Only 14 percent was guaranteed in October. Importantly, banks managed to raise substantial private capital following the release of the results from the federal government "stress test" of major U.S. financial institutions. Since the results were released, banks have roughly $90 billion in new common equity and about $60 billion in debt that is not guaranteed by the federal government. As a result, the U.S. banking system is much better capitalized today. Furthermore, state and local governments have been able to issue debt at levels in line with recent years.

Securitization markets that provide important channels of credit for consumers and small businesses have also improved, in large part because of programs launched under the TARP. Announcements about the Term Asset-Backed Securities Loan Facility (TALF) helped narrow spreads in these markets even before the program began operating. This trend has continued, with spreads on TALF-eligible asset-backed securities (ABS) back to pre-crisis levels today, and spreads on non-TALF-eligible ABS more than 90 percent off their peaks from last fall. Issuance of ABS backed by consumer and business loans has averaged $14 billion per month since the government launched TALF in March, compared to less than $2 billion per month in the six months prior to the program's launch. And as with corporate bonds, new issuance in the ABS market is shifting from public support to purely private financing. Issuance of non-TALF eligible ABS increased from one percent of total issuance in August to 64 percent last month.

Prices for impaired securities that constrain bank lending have improved significantly this year. This is due in part to general market improvement and in part to announcements for the Public-Private Investment Program, which was designed to remove these securities from banks. Most of the Public-Private Investment Funds have now been formed and are starting to purchase legacy securities. The activity of these funds should continue to contribute to price improvements in these markets.

Meanwhile, housing markets are showing some signs of stabilizing and wealth is recovering, which should stimulate consumer spending -- vital to American economic growth. Thanks in part to federal government financial policies, mortgage rates remain near historic lows. Home prices have increased over the past six months, following consistent declines since 2006. For example, the seasonally adjusted S&P/Case-Shiller U.S. National Home Price Index rose by 1.8 percent and 1.9 percent in the second and third quarters, respectively. Since March, sales of existing single-family homes have increased by 20 percent. Over 2.7 million mortgages have been refinanced since Treasury-OFS announced its Making Home Affordable program, and over 650,000 trial modifications have been initiated under the Home Affordable Modification Program, which is largely funded by TARP. Household net worth increased by $2 trillion in the second quarter, the first increase since the third quarter of 2007.

As credit conditions have improved, the U.S. economy has started to grow again and job losses have slowed. The economy expanded at an annual rate of 2.8 percent in the third quarter of 2009, snapping four consecutive quarters of negative growth. Private economists generally expect moderate growth over the next year. The unemployment rate fell to 10 percent in November. Between August and October, nonfarm payroll job losses averaged 135,000 a month. In November, payroll job losses were essentially unchanged.

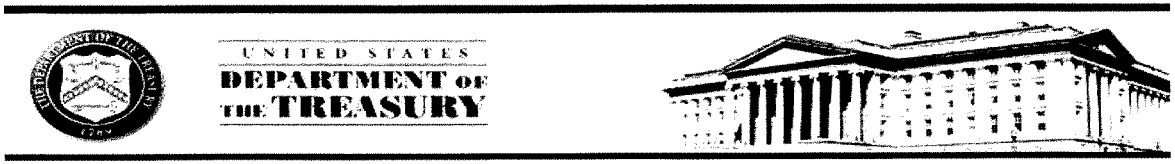
However, the financial and economic recovery still faces significant headwinds. Unemployment remains high, along with foreclosure and delinquency rates. Although RealtyTrac's October report shows a third straight month of decreasing foreclosure activity, foreclosures are still up nearly 19 percent since October 2008. And delinquencies of subprime residential mortgages reached over 26 percent and conforming mortgages nearly seven percent in the third quarter. Further, according to First American CoreLogic, roughly one in four homeowners owed more on their mortgages than the properties were worth in the third quarter of 2009. These conditions place enormous pressure on American families and homeowners.

Bank lending continues to contract overall, although the pace of contraction has moderated and some categories of lending are growing again. For example, commercial and industrial loans contracted at an annual rate of 27 percent in the third quarter, but 16 percent since then. Such loans are particularly important for small businesses, which generally cannot raise money by issuing debt in securities markets. Meanwhile, residential mortgage loans from banks have increased at an annual rate of two percent since the third quarter.

The contraction in many categories of bank lending reflects a combination of persistent weak demand for credit and tight lending standards at the banks, amidst mounting bank failures and commercial mortgage losses. There have been 130 bank failures this year, compared with 41 over the decade that preceded the current recession. And the number of banks that the FDIC classifies as "problem institutions" has reached over 550 this year, compared with 76 in 2007 and 252 in 2008. Further, FDIC-insured commercial banks reported that net charge-offs—that is, losses that have occurred—increased to 2.9 percent as a share of loans and leases in the third quarter, up from 0.6 percent before the recession. And delinquencies of commercial real estate loans were nine percent in the third quarter and increasing.

Banks' willingness to lend also has a significant impact on consumer spending and, consequently, economic growth. Macroeconomic Advisors, a consulting firm, found that a 10-point increase in bank's willingness to make consumer installment loans yields a 0.3 percentage point increase in personal consumption expenditures.[2]

[2] Macroeconomic Advisers, "Banks' Willingness to Lend and PCE Growth," Oct. 8, 2008.



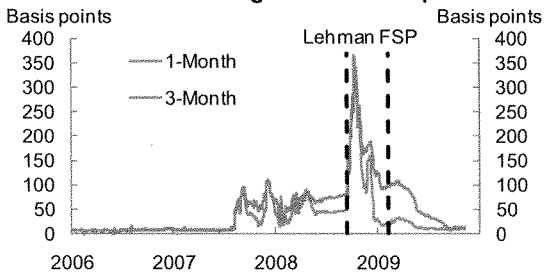
Testimony of Treasury Secretary Geithner for the Congressional Oversight Panel December 10, 2009

U.S. Credit Conditions and Financial Performance of the Troubled Asset Relief Program (TARP)

Stress in the Financial System Has Eased Significantly

- Interbank lending rates have returned to pre-crisis levels.
  - These rates are benchmarks for bank lending rates to consumers and businesses.

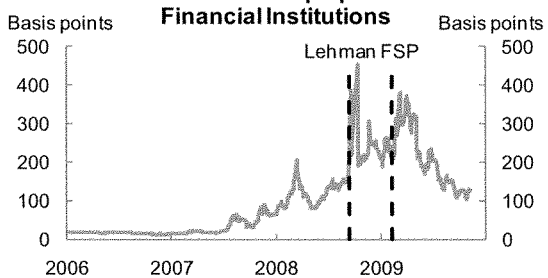
Interbank Lending: LIBOR-OIS Spread



Source: Bloomberg. Note: "FSP" is Financial Stability Plan.

- Credit-default swap spreads for financial institutions are one-quarter of where they were last fall.
  - This measures confidence in the health of U.S. banks.

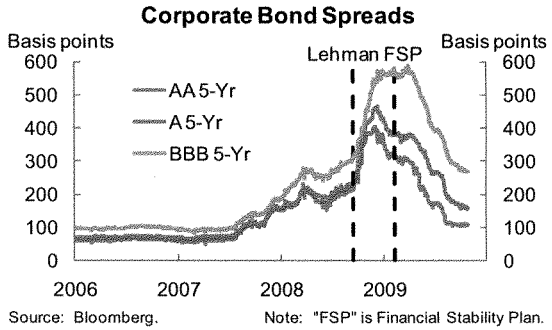
Credit-Default Swap Spreads for Financial Institutions



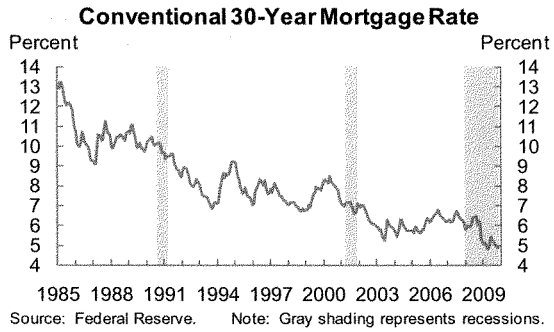
Sources: Bloomberg; Treasury. Note: "FSP" is Financial Stability Plan.

Borrowing Costs for Businesses and Homebuyers Have Fallen

- Businesses' cost of raising funds through the bond market has fallen substantially since the fall.

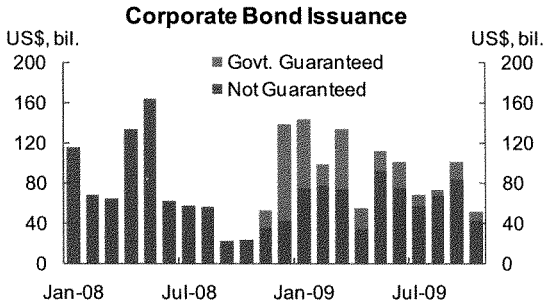


- Home mortgage rates have reached historic lows.



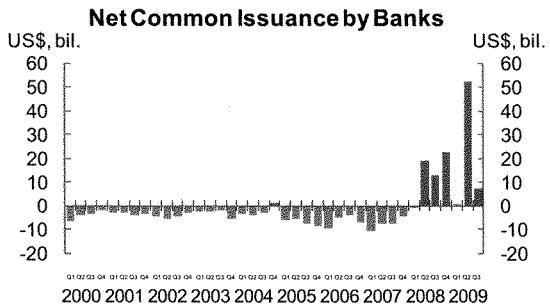
Businesses Have Raised Substantial Funds in Markets

- Businesses have raised over $1 trillion through bond issuance this year.
  - Most recent new issuance is occurring without government support.



Source: JPMorgan.

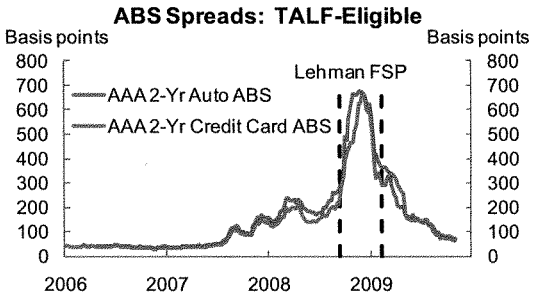
- Banks have also raised substantial capital from private sources this year in the wake of the government's "stress tests" of major financial institutions.



Source: SNL Financial.
Notes: Excludes equity generated through asset sales and preferred conversions. Negative figures represent net repurchases of equity

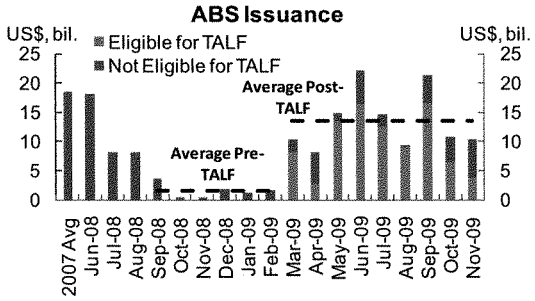
Securitization Markets That Provide Important Channels of Credit for Consumers and Small Businesses Have Also Improved

- Announcements and operations of the government's Term Asset-Backed Securities Loan Facility (TALF) are helping to narrow ABS spreads to pre-crisis levels.



Source: JPMorgan. Note: "FSP" is Financial Stability Plan.

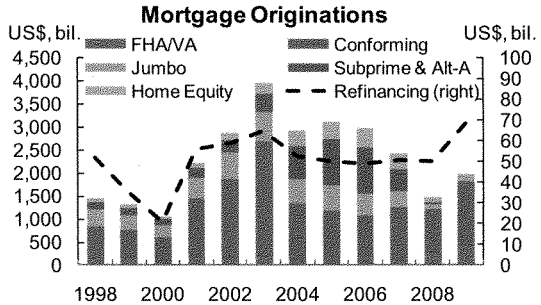
- New issuance of ABS has averaged $14 billion per month since TALF was launched, compared with $2 billion per month in the previous six months.
  - The majority of new ABS issuance in November was not supported by the government.



Source: Federal Reserve.

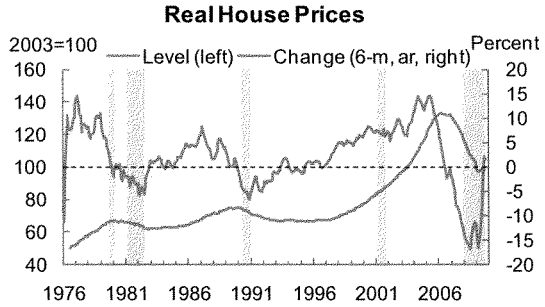
The Housing Market Is Showing Some Signs of Stabilizing

- Mortgage originations are rebounding.
  - Government guarantees remain crucial to this market. Fannie and Freddie conforming mortgages, and FHA and VA-guaranteed mortgages account for most of the improvement.



Source: Mortgage Bankers Association.

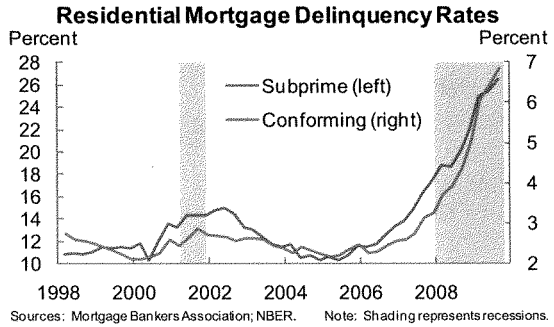
- Housing prices are increasing for the first time since 2006.



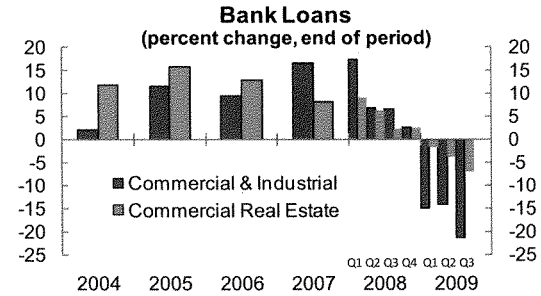
Sources: LoanPerformance; BEA. Note: Gray shading represents recessions.

But Conditions Remain Difficult for Homeowners and Small Businesses

- Residential mortgage foreclosure and delinquency rates remain high.



- Bank lending that small businesses rely on continues to contract.
  - However, the pace of contraction moderated in November.

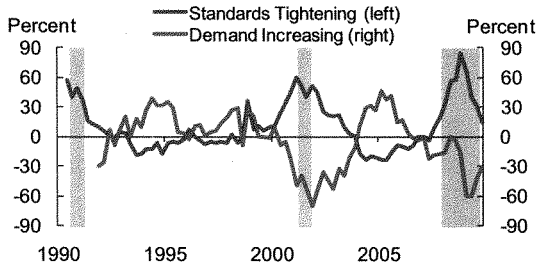


Source: Federal Reserve.

Why Are Most Categories of Bank Lending Contracting?

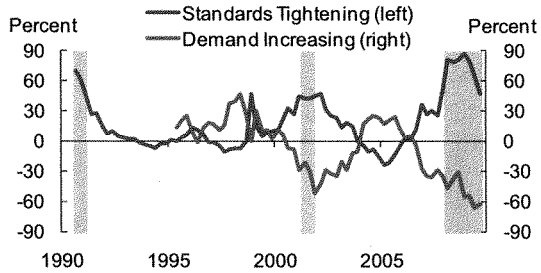
- The Fed's Senior Loan Officers Survey (SLOS) shows material moderation in the number of banks reporting that they are tightening lending standards, suggesting that pressures on banks are easing.
- But the National Federation of Independent Business Survey indicates that small businesses believe that credit is still hard to get.
- At the same time, the SLOS continues to show little evidence of a pick up in the demand for credit from either large or small businesses, despite the improvement in the economic outlook.

Supply and Demand Changes in C&I Loans



Sources: Federal Reserve; NBER. Note: Gray shading represents recessions.

Supply and Demand Changes in CRE Loans

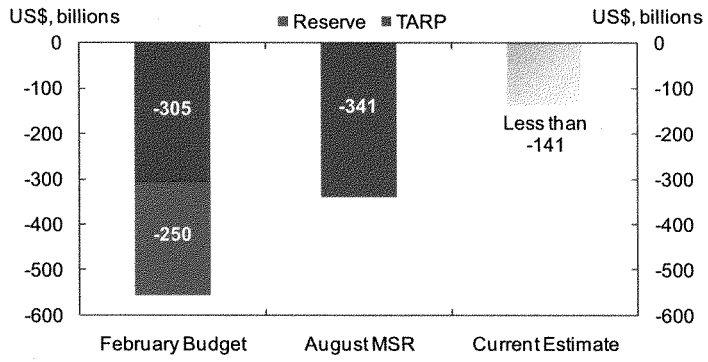


Sources: Federal Reserve; NBER. Note: Gray shading represents recessions.

Projected Deficit Impact Down At Least $200 Billion from MSR

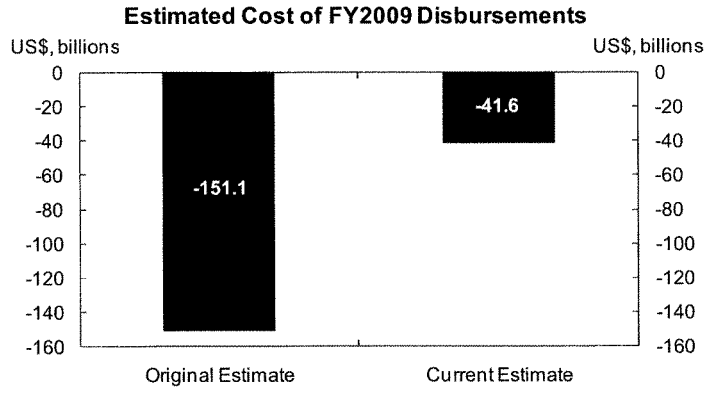
- In the President's February Budget, the projected impact of financial stabilization efforts on the deficit was over $550 billion, including a reserve in case of continued instability
- In the August Midsession Review (MSR), the projected impact of TARP on the deficit was $341 billion
- Today, Treasury and OMB expect the cost to the taxpayer and the deficit of TARP over its life to be at least $200 billion less than projected in the MSR just in August

Projected Deficit Impact of Financial Stabilization



Expected Cost of Disbursements in FY09 Significantly Lower

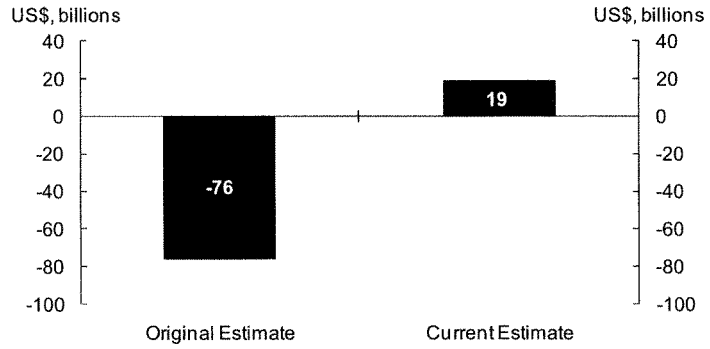
- Improvements in the expected cost of TARP can be seen in the performance of disbursements in FY2009
  - In FY2009, $364 billion was disbursed under TARP
  - Originally, the Administration projected that those disbursements would cost taxpayers $151.1 billion
  - Today, we estimate the cost will be about $41.6 billion



Positive Return Now Expected on Bank Programs

- In FY2009, $245 billion in TARP funds was disbursed to banks
- Originally, the Administration projected that those disbursements would cost taxpayers $76 billion
- We now project that they will generate $19 billion in gains

Estimated Cost/Return of FY2009 Disbursements to Banks



Banks Have Repaid Nearly Half of Their TARP Investments and Raised Significant Private Capital Since the Stress Tests

TARP Investments in Banks (US$, billions)

	Commitments			
	Pre Jan 20th	Jan 20 - Present [1/]	Total [2/]	Repayments
Existing Programs				
Large Banks [3/]	230	2	232	114
Small Banks [4/]	9	5	14	2
Total	239	7	245	116
Common Equity and Other Regulatory Capital Raised by the Largest Banks Since Stress-Test Results Were Announced in May				114

[1/] Estimates as of December 9, 2009.

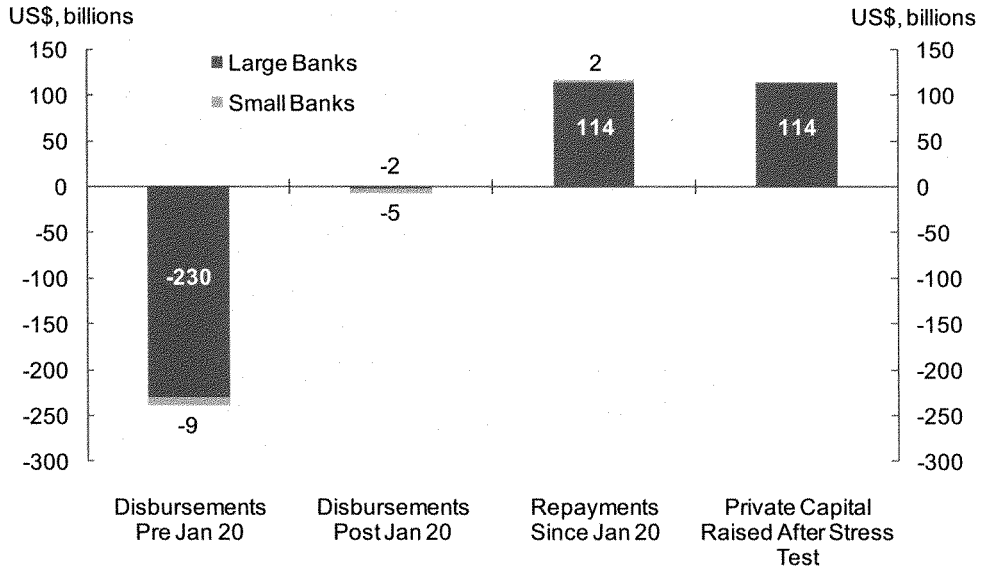
[2/] Estimates may not sum to total due to rounding.

[3/] CPP, AGP, TIP. Large banks are defined as banks with total assets of over $10 billion.

[4/] CPP.

Banks Have Repaid Nearly Half of Their TARP Investments and Raised Significant Private Capital Since the Stress Tests

TARP Investments and Private Capital Raised by Banks



Notes: Large financial institutions that participated in the "stress test" have raised approximately $114 billion in common equity and other regulatory capital from private sources since the test results were released in May.

TARP Has Generated Substantial Income for Debt Reduction

TARP Income (US$, millions) [1/]	
Dividends and Fees	11,656
Interest	342
Proceeds from Sales of Warrants and Stock	2,906
Additional Notes	15
Total	14,919

[1/] Estimates as of December 9, 2009.

TARP Current and Future Commitments

(US$, billions)

	Commitments to Date	Anticipated Future Commitments [1]	Total
Targeted Investment Program (Citi, BofA)	40	-	40
Special Assistance for AIG	70	-	70
Automotive Industry Financing Program	87 [2]	-	87 [2]
Asset Guarantee Program	5	-	5
Capital Purchase Program	205	3	208
Large Institutions [3]	*191*	- [4]	- [4]
Small Institutions [3]	*14*	- [4]	- [4]
Consumer & Business Lending Initiative [5]	20	40	60
Public-Private Investment Program	27	3	30
Housing Initiatives [6]	29	21	50
Total [7]	**482** [2]	**68**	**550** [2]

[1] We anticipate future commitments for CPP and PPIP to take place in 2009.
[2] Includes $5.6 billion in maximum additional commitments to GMAC to meet the capital requirements specified by the Supervisory Capital Assessment Program or "stress test" on May 7, 2009. The exact amount to be committed will be determined after consultation with the company.
[3] Large institutions are defined as institutions with total assets of over $10 billion at year-end 2008.
[4] We anticipate committing up to $3 billion in CPP for small banks and/or insurance companies by the end of this year.
[5] Includes Term Asset-Back Securities Loan Facility (TALF), and reserve for small business and community bank initiatives.
[6] Includes Home Affordable Modification Program (HAMP) and $1.244 billion in obligations for the Helping Families Save Their Home Act.
[7] Estimates may not sum to total because of rounding.

Chair WARREN. Thank you, Mr. Secretary.

So, let's start with your statement. You say, as part of the extension, that you want to focus any new spending on housing, small banks, and supporting credit to consumers. Let me focus on the small business initiative. I understand the importance of the initiative. This is the one part of TARP that may have a direct effect on unemployment, or maybe the most easily traced effect on unemployment. And, that is, if small businesses can borrow money, then they'll be able to stay in business, they'll be able to keep their employees or hire more employees.

So, I understand the importance of this, and applaud that approach, but my concern is that last spring Treasury launched the TALF program to stimulate small business lending. I think it was not a success. Later, Treasury announced a program to purchase up to $15 billion in securities backed by SBA loans and I believe it's the case that, so far, Treasury has not spent a single dollar under that program. And two months ago, Treasury announced a third program to support small business lending by providing low cost capital to community banks. And, as I understand it, so far nothing has happened.

So, you know, it's not news to anyone that small business lending is important. Small businesses are closing every day. But, Treasury has now announced three plans, and clearly has not gotten the job done. What's going to be different now, Mr. Secretary?

Secretary GEITHNER. Let me just start by saying the economy would not be growing today without TARP. Unemployment would be dramatically higher today without the actions we took to help stabilize the financial system and open up the markets that were so broken.

Let me walk through those specific programs you pointed out.

Small businesses, as you know, depend on banks, overwhelmingly, for credit. And small banks provide about half the credit small businesses get from the banking system as a whole. Small banks are among the most affected, still, by the challenges facing the economy as a whole. Many of them are going to need more capital. Those that need more capital are cutting back on lending and commitments; and, as you said, that's affecting small businesses.

In our judgment, to address this requires a set of different approaches. We actually have been quite successful in bringing liquidity back to the securities markets that are important for small business lending. The TALF program has actually been very helpful; that's one reason why small business—SBA loans have increased so much. The SBA program, providing temporarily higher guarantees, lower fees, is also helping, although those programs are small in total magnitude. But, for this to work, we have to make it possible for banks to come get capital from the government so they can support more lending.

Banks are, and have been, very reluctant to come. And the reason the 7(a) program you referred to has not yet been launched is because the institutions necessary to make that work have been very reluctant to come and do business with the government. And they're concerned that if they come, they will be stigmatized and they will be subject to the risk of conditions, in the future, that might make it harder for them to run their businesses.

So, if we're going to be effective in dealing with this, we have to find some way to mitigate both the stigma of coming and the fear of changes in the future rules of the game that are going to apply to them. It is something we cannot do on our own. It's going to require some help from Congress, to help deal with those basic concerns.

But, I think you're right to say that, unless banks have access to capital, this is going to be a harder problem to solve.

Chair WARREN. Well, let me just follow up though, Mr. Secretary, because I'm afraid I'm a little confused here. You were talking about small banks as the most effective lenders to small businesses. And we know this to be true. We've——

Secretary GEITHNER. About half are lending——

Chair WARREN [continuing]. Written a report about this.

Secretary GEITHNER [continuing]. Half of banks——

Chair WARREN. That's right.

Secretary GEITHNER [continuing]. Are lending to small businesses——

Chair WARREN. But, I thought you started by saying you were going to terminate and wind down the Capital Purchase Program. And then I thought I just heard you say you were talking about putting more capital into small banks?

Secretary GEITHNER. Yes, as a——

Chair WARREN. I'm just a little confused on this.

Secretary GEITHNER. Again, the emergency programs that were necessary to break the panic and the capital programs for large banks can be wound down and put out of their misery.

But, as you said, the President announced a program for capital for small community banks——

Chair WARREN. Right.

Secretary GEITHNER [continuing]. A few months ago, and we're going to preserve that, and we're exploring ways to build on that. But, for it to work, Chairman, we need to make it more comfortable for banks to be willing to come.

Chair WARREN. So, let me just, if I can, pinpoint—how can it be that we can manage to put hundreds of billions of dollars into the hands of very large financial institutions, in what was effectively a matter of days, and 14 months into TARP, we're still talking about trying to figure out how to put much, much smaller amounts of money into very small financial institutions?

Secretary GEITHNER. Let's go back a little bit. We actually did not give the large banks a choice, because it was necessary for the country that they have capital put in right away.

Chair WARREN. So——

Secretary GEITHNER. But, let me say that small banks, and we made the capital quite attractively priced, as many of you pointed out, are reluctant to come. They don't want to come to do business with the government, they think it's a sign of weakness, not strength. Even though capital is the best way to help get lending going again——

Chair WARREN. So——

Secretary GEITHNER [continuing]. They're reluctant. And so——

Chair WARREN. So, let me make——

Secretary GEITHNER [continuing]. It's not——

Chair WARREN [continuing]. Sure, then, that——

Secretary GEITHNER [continuing]. It's not about us or our willingness to do it, and as you said, we've tried, quite creatively, many different ways to design these things to make them more attractive, but we can't force them to come.

Chair WARREN. So, your statement here today is, the reason we're having a problem with small business lending is that you're making the money available to the small banks and they just won't come——

Secretary GEITHNER. That is one——

Chair WARREN [continuing]. Pick it up?

Secretary GEITHNER. That is one of the problems, and is absolutely a central problem in this area. The basic credit crunch you see across many small businesses across the country today is partly as a result of banks pulling back who don't have capital. To solve that, which is not the only thing you can do, banks have to be willing to come get capital.

Chair WARREN. All right. Thank you, Mr. Secretary. Mr. Atkins.

Mr. ATKINS. Okay, thank you, Madam Chair.

Well, I salute you very much for producing an audit of the TARP program. I think that's great, and—as something that we've been, obviously, expecting, and that's super. So, I look forward to seeing that, later today.

Again, I disagree with you, as far as how important TARP was for the situation with the economy today. That's basically the sine qua non of where we are with our meager recovery and whatnot. It's hardly, anyway, an approbation of the program.

But, I want to focus on—with all this talk from the White House and elsewhere about—job creation initiatives coming out of TARP. What troubles me is what sort of parameters are you going to put around this? When you're talking about injecting money in the small banks that are not really troubled, but you're doing it for some other reason, I think you're very much drifting away from the intent of Congress in passing EESA. And I wonder, how are you going to analyze this and come to these determinations?

Secretary GEITHNER. TARP was essentially about credit, recognizing that there is no growth without credit. The banking system is critical to the provision of credit. What we've designed for small banks, for community banks, is to help get small business lending going, securitization markets to open up, and housing more stable. These items are central to the basic objectives of TARP and fully consistent with the authority that Congress provided us.

Mr. ATKINS. Okay, well, I guess one thing I want to disagree with is that EESA was enacted in a crisis atmosphere where people were afraid that banks were going to go under. We're not afraid the community banks are going to go under. And obviously—well, I mean, maybe we are—I mean, it depends on what's going to happen in the future, which is, I assume, why you're keeping TARP alive, to react. But, your rationale of injecting money into them in order to spur lending is not a rational of keeping them from going under. It's for——

Secretary GEITHNER. No, I wouldn't say it quite that way. Again, capital is critical for lending. Without capital, lending will decline. Well, that means that a viable business, that has good demand for

its products, will not be able to grow. The risk is, its oxygen will be deprived and it will risk failure e.g., having to cut back on payroll, et cetera.

Mr. ATKINS. But, you're talking about the business, the lendee——

Secretary GEITHNER. That's why——

Mr. ATKINS [continuing]. The borrower, right?

Secretary GEITHNER. That's why credit——

Mr. ATKINS. But, we're talking—I'm talking about the bank——

Secretary GEITHNER. No, exactly. But, again, banks are critical to that. They're not the only thing, but they're critical to that. And, you know, if you're a small business, and you were unlucky in your choice of bank, and your bank got exposed to a bunch of commercial real estate exposure, that bank's going to cut back on your credit. You're going to have to cut back on payroll and employment, and it takes time to find another bank, particularly in a system so traumatized by the crisis. But——

Mr. ATKINS. Well, I think, part of that is examiners and other people who are, through their scrutiny—and this is a natural human reaction, overreacting to a crisis——

Secretary GEITHNER. You're exactly right.

Mr. ATKINS [continuing]. And to ask——

Secretary GEITHNER. Right.

Mr. ATKINS [continuing]. Questions that maybe need to be asked, but through that sort of process, it then causes banks to recoil a bit and not be so ready to lend.

Secretary GEITHNER. As Superintendent Neiman knows, this is a very important balance to get right. And you're exactly right to say, what happens in recessions after financial booms is everybody tends to overreact the other way. Banks may pull back more than is rational and supervisors may tend to overreact. These are independent supervisors, independent of Treasury——

Mr. ATKINS. Right——

Secretary GEITHNER [continuing]. But we've been encouraging the supervisors to try to provide some more balance in the guidance they give through examiners across the country, so they don't overdo it. They issued some guidance on commercial real estate lending valuation standards a few weeks ago. I think that's very helpful. They're looking at additional steps. And you're right to emphasize the importance of trying to lean against overreaction by supervisors.

Mr. ATKINS. Okay. I want to go back to GMAC. Evidently, you all have decided that GMAC deserves some more funds from TARP.

Secretary GEITHNER. Well, no——

Mr. ATKINS. And——

Secretary GEITHNER. GMAC is part of the institutions we put through the stress test early in the spring.

Mr. ATKINS. Okay.

Secretary GEITHNER. As for many institutions, we identified a significant capital need. And for all those institutions, we said, "If you do not go raise capital from the private markets, if you're unable to, we will put capital into you, because it's important to the stability of the system." So, the only thing you had for GMAC is what we committed to do back then. And I think the ultimate esti-

mates will be a little lower than we anticipated back in June when we were——

Mr. ATKINS. But, apparently, you've decided to inject more capital into——

Secretary GEITHNER. No, actually somewhat less than we estimated in June.

Mr. ATKINS. But, the more recent round, where they've come back——

Secretary GEITHNER. No it's——

Mr. ATKINS [continuing]. And asked for——

Secretary GEITHNER. Just like in June, when we released the estimates in the stress tests, the estimated capital needs for these institutions, we gave them a period of time to go out and raise capital from the private markets. Overwhelmingly, banks were able to do that. In fact, it's much better than that, because you see private investors wanting to come in and increase their stakes in banks across the country now, allowing the taxpayer to get out of those investments. It was never going to be possible for GMAC. They're in a uniquely difficult situation. All we're doing is——

Mr. ATKINS. I'll say.

Secretary GEITHNER [continuing]. Committing to put the capital in we committed to do back in June, probably at a slightly lower level than we thought back in June.

Mr. ATKINS. I'll follow up later.

Thank you.

Chair WARREN. Thank you.

Mr. Silvers.

Mr. SILVERS. Mr. Secretary, when EESA was enacted and TARP began, my read of the statute was that the purpose of TARP was not to rescue particular institutions, even particular firms. It was to preserve the system. And for the purpose—and the statute was, I think, pretty clear about this—not because the system was a thing of beauty or because of our particular concern for those businesses, but because of the role the financial system played in providing the resources necessary for the real economy to function.

In that regard—and stop me if I've got it wrong—in that regard, it seems to me that you appear to be identifying—you and the President appear to be identifying that aspects of this system continue not to be working adequately and continue to need more support, particularly small business credit. Am I reading your own words back at you correctly?

Secretary GEITHNER. Exactly. There has been a dramatic improvement in the overall stability and functioning of the U.S. financial system. But, parts of the system are still very damaged and broken. I'll mention just three. Housing markets are still overwhelming dependent on the temporary programs put in place by the government. Commercial real estate financing is still very difficult, as you would expect with an economy coming through such a large basic adjustment. And there is a significant risk of a credit crunch across small businesses; in part, because of the small banks that are still somewhat exposed to the risk of losses ahead.

I don't really know anybody who would look at our system today and not say that those parts of our system are still significantly im-

paired. And it's not a surprise, given the scope of the damage caused by the crisis.

There is a very strong economic case to use the authority provided, and it was perfectly consistent with the objectives of the authority, to continue to work to do that. But, that's not the only reason we're extending TARP. Mr. Silvers, as you understand, we still need to keep in reserve some ability to respond if we were to face again a serious escalation of systemic concern. It would be deeply irresponsible and imprudent, at this stage, only a year into this recovery process—only three months after we have the first period of growth—to stand back and walk away from those challenges ahead. That would leave the taxpayer at much greater risk of future losses. Ultimate costs of the program would go up, not down. That's why we've judged it would be prudent to put in place this limited qualified extension.

Mr. SILVERS. Now, if I may pick up on your exchange with the Chair, there are, under the TARP, two types of programs. You have programs where capital has been provided to firms who are then TARP recipients. And you have programs where TARP funds have been injected into markets in ways—such as the TALF and the PPIP—in ways in which the various private parties that may touch those funds are not actually TARP recipients. Is that a fair characterization of the—of one way of understanding the two—the range of programs you have?

Secretary GEITHNER. That's right. Programs for individual institutions. The institutions are TARP recipients. Although, as you said, they're not for the benefit of the institutions; they're because of the importance of the system. Programs that are about marketwide support to capital markets, securities markets, are designed differently.

Mr. SILVERS. Now, in light of the concern that you stated that small banks have with receiving TARP money, particularly the issue of reputational risk, which I find that an understandable concern, and I'm not sure how congressional action can change that—in light of that, and in light of your description of the small business problem as a market problem, not a—it's not a particular firm that's weak, here, that's the issue—in light of that, why not take the market-support approach rather than the firm-support approach in the small business area?

Secretary GEITHNER. Our view, from the beginning, is, you have to work on both channels of credit. You have the bank channel and you have the capital markets, and you need both. If you can make a capital-market channel work better it creates competition for banks. It might pull the banks out of their concern and uncertainty. You need both to work. But, these are small business credits. They are very small loans. The capital markets were never going to be called a significant provider of——

Mr. SILVERS. Mr. Secretary, can I——

Secretary GEITHNER [continuing]. Support—in the future, so you have to work on both.

Mr. SILVERS. My time is running out, so I just want to be clear of what I'm saying to you. I'm not suggesting that you can have a public capital-market solution here.

Secretary GEITHNER. Right.

Mr. SILVERS. I'm suggesting that, if you want to move this money to small business quickly, that, both from the perspective of getting the banks involved without making them into TARP recipients and from the perspective of tapping small bank expertise, that you should be looking at structures that move money; and, thirdly, to avoid the problem, that's been present in TARP from day one, of handing money to banks and not knowing what use is made of it, that the right way to do this is to do this through a conduit that moves TARP money more or less directly to small firms, with banks as a manager of the process rather than as an intermediary.

Secretary GEITHNER. I generally agree with you, and I think the most promising ideas out there lie in that realm. Banks still need to have risk on the table——

Mr. SILVERS. No, I agree with you there.

Secretary GEITHNER [continuing]. For that to work, and—because we don't think the government—and we couldn't do it through TARP—should be in the business of providing loans directly to businesses.

Chair WARREN. Thank you.

Superintendent Neiman.

Mr. NEIMAN. Thank you.

I'd like to come back to the foreclosure mitigation program. Over the last few weeks, there's been a lot of media focus on the 25 percent of those individuals who are in trial modifications and who are not current on those trial modifications. In fact, some may not even have made the first payment. I'd like to focus, though, on the 75 percent of those borrowers who are making payments in a timely fashion. And for them, January 1 of this new coming year will not only bring in a new year, but will also be a fateful day for almost 400,000 homeowners whose trial modification period expires. Most of these homeowners have made at least 3 months of timely payments and, in some cases, four, five, or even greater, as required under the program. However, less than half of these homeowners have submitted all the required documentation. And, by some estimates—and I've talked to some of the largest servicers directly—half of this group, the group that has submitted all of their documents, have yet to have their documentation validated by the servicer.

Now, given these numbers that I've stated, it looks as if possibly over 75 percent of the homeowners who have demonstrated a willingness and ability to make timely payments on their trial modifications may be eliminated from their program and once again face foreclosure.

Now, you have recognized the urgency of this situation by implementing SWAT teams at the largest institutions, among other efforts, to engage homeowners and servicers to facilitate both the submission of documents by borrowers and the validation of that documentation by the servicers.

So, fundamentally, my question is, does this expected low conversion rate imply that the original documentation standards are not set correctly and are too onerous? Or do you think that the standards are correct and any liberalization would impact the integrity of the program?

Secretary GEITHNER. Well, as you said, we're working on this on many, many fronts. We've taken a careful look about whether we can streamline the documentation requirements to help address this. We've tried to mobilize a huge amount of resources to make sure services are processing these and convert to permanent modifications as quickly as possible. We're working very closely with counseling agencies across the country to assist them in doing a better job of helping people benefit from a permanent modification. And I think we're going to be able to make some substantial progress in the area, although there's a lot of challenge in here.

I just want to emphasize, though, what we've achieved so far. Almost three-quarters of a million Americans now are benefiting from modification programs that reduce their monthly payments dramatically—on average, $550 a month, $6,000 a year. That is a meaningful amount of support for income for some of the people hurt most by this crisis.

Now, we want those modifications made permanent. And banks will not get a dollar from the Treasury unless they convert to permanent modifications. And we are using a tremendous amount of force and persuasion to try to make sure we get those conversion rates up to a reasonable level.

Mr. NEIMAN. But, if those—and I agree with you, those reductions in monthly payments are significant—but if, at the end of the year, this first group cannot convert to permanent modifications, they will lose those monthly payments and now be faced with the same situation of being offered a non-HAMP modification by the servicer, which will likely increase those payments or foreclosure actions proceeding.

So, are you considering extending again the opportunity for the trial modifications so that borrowers who have not had documentation validated——

Secretary GEITHNER. We're going to work very hard to avoid the outcome you describe. We have a huge stake in trying to make sure this program reaches as many eligible homeowners as possible in order for them to benefit in real economic terms from this program. We're not there yet. But, I think we're going to be able to make substantial progress.

Mr. NEIMAN. Okay. We look forward to some of your performance numbers being issued today, and I note that——

Secretary GEITHNER. I think we issue them today. And, you know, one of the benefits is that you can see performance, servicer by servicer. Everybody can look and see how many eligible homeowners they are reaching, and a number of them need to get their numbers up and do a better job. And they have the ability to do that.

Mr. NEIMAN. There are two other big issues——

Secretary GEITHNER. It's about will and effort.

Mr. NEIMAN. There are certainly two other big issues around both negative equity and unemployment. You mentioned unemployment in your opening remarks. I appreciate the response from Mr. Allison as a follow up to our last hearing, promising to review some of the proposals that I have been promoting for quite some time, with regard to emergency mortgage assistance programs. And I

look forward and thank you all for agreeing to meet separately on those issues.

Secretary GEITHNER. Well, you're right that those are two areas where there're a lot of ideas out there of ways we can help modify this program. And you're also right to emphasize that this program was not designed to start with a principal reduction. And we made that choice because we thought it would be dramatically more expensive for the American taxpayer, harder to justify, create much greater risk of unfairness, and our program was not designed to do that. Our program, though, is doing what it was designed to do: to reach many, many people across this country and to substantially reduce monthly payments. And we are always looking at ways to try to help make sure this program reaches as many people as possible.

Mr. NEIMAN. Thank you. My time's expired.

Chair WARREN. If I could, Mr. Secretary, I'll just pick right up on that point. And that is the deliberate decision not to deal with negative equity, because it's created an irony against the backdrop of the subprime mortgage crisis that started with zero-down loans and 100-percent financing. We now are creating modified loans, supported by the United States Government, that have 110-percent loan-to-value ratios, 120-percent loan-to-value ratios, 125-percent loan-to-value ratios. We have no experience with long-term payment of deeply underwater mortgages, but the little bit of data that we do have available about even modestly underwater mortgages suggests that, over the long term, second only to the question of affordability of the payment, being underwater on a mortgage means that people are unlikely to continue to make their mortgage payments.

So, I want to push back on this a little bit. Are we creating a program in which we're talking about potentially spending $75 billion to try to modify people into mortgages that will reduce the number of foreclosures in the short term, but just kick the can on down the road so that we'll be looking at an economy with elevated mortgage foreclosures, not just for a year or two, but for many years? How do you deal with that problem, Mr. Secretary?

Secretary GEITHNER. Our program reduces the basic overall obligation of these mortgages. It does not increase it. And we have people in these programs with very, very high LTV's, substantial amounts of negative equity, able to qualify. And it does bring down the overall burden.

Chair WARREN. I'm sorry, are you saying that you are doing principal reduction?

Secretary GEITHNER. No, but the change in payment schedule does reduce the basic value of the obligations in the mortgage. But, I think that it's more helpful for me to say it this way—I think you're right to point out the huge problem the amount of negative equity across the system presents for us. The question is what to do about it?

The whole foreclosure crisis across the country now is really driven by what happened to unemployment and what happened to the income of Americans. The best things we can do now to help mitigate that risk is to help get the economy growing again, bring unemployment down as quickly as we can, put people back to work,

and continue to make sure we're providing overall stability to the housing market. And we've seen, actually, better results on prices, and expectations about future prices, than many of us expected. We've brought interest rates down to a very low level so that houses are much more affordable now. And housing demand is actually picking up a bit.

The question is not whether what you've described is a problem; you've been eloquent and persuasive about the scale of the problem. The question is whether, in addition to those actions, we should embark now on a program that would be a dramatic additional cost to the taxpayer, helping relieve people of that obligation. And the problem in doing that, apart from its expense, is the basic sense of fairness and what it does to incentives in the future.

But, I think you've got—you're asking the right question, the question is do we have a solution that's fair?

Chair WARREN. Well, you know, I really would like to push back. You talk about relieving the homeowner. Let's keep in mind this is about whether or not the investors in these mortgages, some of whom made substantial profits during the glory days, should be required to take the losses when the mortgages that they invested in turn out not to be worth——

Secretary GEITHNER. Through what——

Chair WARREN [continuing]. Nearly so much as they had promised. You know, the——

Secretary GEITHNER. Through what means is the issue.

Chair WARREN. Well, one means would be bankruptcy, which doesn't——

Secretary GEITHNER. That——

Chair WARREN [continuing]. Cost the American taxpayer any money.

Secretary GEITHNER. That would be one option. And we've——

Chair WARREN. Another that I am deeply concerned about is the extent to which the current programs that Treasury advances send a signal to investors in mortgages. And the signal is, "Sit on the sidelines. You know, there's no reason to come to the table and negotiate these mortgages. You can wait for the U.S. Treasury to offer a bribe to get you to the table to do what should have been in your interest to begin with." We all understand that foreclosures don't just destroy value for homeowners, they destroy value for the investors themselves. And yet, investors are hanging back. They are not engaging in rational write-downs that would keep a good stream of payments coming from these businesses. Instead, holding out for larger streams of payment and holding out for help from your Treasury Department.

Secretary GEITHNER. Well, I don't think I quite agree with that. You're right that bankruptcy reform is one option that might help change the incentives a bit. And you've been an eloquent advocate of those reforms. As you know, the President of the United States did propose, and was supportive of this option, but Congress was unwilling to act, in part, because of concerns that it would make it harder for capital to come back into the banking system and help support improvement in housing markets that have broader returns. Congress considered this, but chose a different strategy.

I don't agree that the programs we have in place are working against this process of repair that you're—we all support. I think, actually, they're helping. And, we're seeing quite a lot of new interest and willingness from investors, people who hold these things to renegotiate and write down. We're seeing much more of that than you saw before, and I think that's encouraging. I don't think we're deterring that.

Chair WARREN. You know, I have to say, Mr. Secretary, I lived through a big housing boom and bust down in the Southwest, during the late 1980s. In fact, I lost money on the house we had to sell during the bust. But, the government didn't step in and help in the same way. The lenders had to eat the losses for bad investments that they got involved in, and so did the homeowners. This was not a question of taxpayer support there.

Secretary GEITHNER. This crisis simply is not like that crisis. It's much more dramatic in its scale and impact, much broader effects on people across the country. And I don't think there's anything from that basic crisis in the past that would have been helpful now.

One could take the view that it was a mistake to try to give Americans the ability to see a substantial reduction in their monthly payments and therefore improve the odds they get to keep their house. I don't agree with that. I don't think you do, either. And I think, actually, this is a program that's doing quite well in delivering a very meaningful improvement in the basic financial economic position. As I said, it helps almost three-quarters of a million Americans now. And I think it's been part of what has actually been a successful effort to bring some modicum of stability to housing prices much earlier than many people would have thought.

Chair WARREN. Thank you, Mr. Secretary. I apologize to my fellow panelists for going over my time.

Secretary GEITHNER. I ask for——

Chair WARREN. No. I apologize to my fellow panelists for running over by two minutes, and I'm going to skip my next round of questions.

Mr. Atkins.

Mr. ATKINS. Thank you very much.

Actually, I think you had some good rationale there with respect to negative equity. I think it would be a mistake to start dumping money into that. I don't know that there's enough money around to, once you start getting to that and the issues of fairness and everything else. I agree with you on that.

I wanted to turn to, as far as TARP goes, the exit that we were talking about earlier, that you alluded to. The recent Capital One warrants auction, I guess you can call that a success of some sort. I was wondering how you foresee this going forward in the future. Are you still planning on engaging in negotiated price buybacks with TARP banks before establishing an auction? What is the current view of Treasury as to how you're going to unwind this?

Secretary GEITHNER. I think it's possible that we're going to still see a mix of approaches, going forward; in part, because, for many small banks, an auction is not going to be a realistic approach. But, an auction is a good approach for many cases and that gives a way to let the market determine the best price. We think that'll help maximize the return to the taxpayer.

In the recent one you refer to, it was oversubscribed by about a factor of 12. And, the ultimate test as to what these things are worth is established by what people are willing to pay for them. So, I think it's an approach that is going to deliver better returns than the alternatives in this case. But, it won't be possible for all the institutions in which the government took warrants.

Mr. ATKINS. So, then, as we go forward, and you talk about putting money into all sorts of community banks and others, what is the approach? What is actually the decisionmaking process of, you know, how the money goes in and what is received by the Treasury in return for a myriad—we already have 600-and-some banks that are participants.

Secretary GEITHNER. Well, the program, at its beginning—and I was not the Secretary of the Treasury then, but I agree very much with this basic design—was—to make capital available on the same terms to all institutions. So, the same capital that was provided to some of the largest institutions was made available to any other institution that made similar standards for eligibility. And my predecessor and the supervisors put in place an elaborate process for determining viability to try to screen institutions. That process is in place today, and it will be used going forward.

We're changing strategy in some important ways. We do not believe it's necessary to keep Capital Purchase Program open for large institutions. So, the remaining programs we're going to provide, that provide capital, will be for institutions below a certain threshold.

We're trying to design these programs in a way that's going to maximize the chance that they spur lending. We want them to come as a sign of strength, not a sign of weakness, as we just discussed with the Chair. But, we're going to leave in place a basic viability standard, to make sure that we're not supporting nonviable institutions.

Mr. ATKINS. Sir, how do you determine that?

Secretary GEITHNER. Well, the bank supervisors have a process in which they look at——

Mr. ATKINS. Capital ratings or——

Secretary GEITHNER [continuing]. All sorts of measures of financial strength. And, this is a highly imperfect process, but it's better than the alternatives.

Mr. ATKINS. Okay. Well, then, to go back—I'm sorry to go back to GMAC again—so, I understand, at least on the call I listened in on, that there is a negotiation going on. And I guess I want to try to understand how—I mean, who is actually the decisionmaker—is it Assistant Secretary Allison, or is it you—as far as determining, you know, under what terms a further extension of credit is given, viewing the particular facts——

Secretary GEITHNER. Well, the financial terms will be as defined in the other programs. They're not differentiated financial terms. The question ahead is what plan for restructuring will the new board and management of this firm embark on? We want to be confident that there is some basic path to exit and viability; and what are the incremental capital needs, relative to what was identified back in June under the stress test.

Mr. ATKINS. And so——

Secretary GEITHNER. Those are the issues ahead.

Mr. ATKINS. Okay. And so, two of those board members are Treasury picks. How much interaction do you have with people on the board?

Secretary GEITHNER. Well, we have just about what you'd expect and hope, and not more than you fear, in the sense that—again, our obligation——

Mr. ATKINS. Our fears are rampant. But, anyway——

Secretary GEITHNER. I'm not sure what your fears are, but our obligation is to make sure that this institution has a plan in place for getting back to viability without government assistance, that has a reasonable prospect of working. And we want the plan to be as strong and robust as possible. At the same time, of course, we need to reassess what the incremental capital needs would be, and that's the process we're undertaking now.

Mr. ATKINS. Okay. My time is up.

Chair WARREN. Thank you.

Mr. Silvers.

Mr. SILVERS. Mr. Secretary, I'd like to shift, in terms of the wind-down discussion, to the large banks, which we've mentioned a couple of times. My New York Times this morning tells me that—something that I think we all kind of already knew—which is that Citi would very much like to return its TARP money. Citi argues that they have lots of cash—at least that's an argument they've made to this panel—and that having lots of cash means they should be able to return the TARP money. I don't have your experience with banks, but that doesn't strike me as exactly the right argument.

Secretary GEITHNER. I think you're right.

Mr. SILVERS. Can you explain to me what the criteria is for being able to return the money, and what relevance, if any, having lots of cash has?

Secretary GEITHNER. A few critical points.

One, it is a good thing for the country that banks are eager to get out of the investments the government was forced to put in.

Mr. SILVERS. Oh, I agree.

Secretary GEITHNER. That is healthy, necessary, and desirable.

Two, it is a very good thing for the country that private investors are willing to come in and, in effect, take the government out of those positions. We are not prepared to have this money come back in a way that would leave the system or these institutions with inadequate capital to face their challenges ahead. If we did that, that might seem good, near term, but it would be bad for the country as a whole, because it would leave the system with too little capital.

So, what we've done is to say, "We want you to go out and raise capital—raise capital for the markets so you can repay the taxpayer with interest." And that's what's happening.

Mr. SILVERS. Mr. Secretary, do I have it right that the requirement is that you should be able to raise the entirety of your TARP money, that we're not allowing repayments in stages? Is that correct?

Secretary GEITHNER. I don't think I would say it quite that way. And this is a difficult thing for me to do, because, under the laws

of the land, the supervisors are responsible for setting the terms of exit. But, effectively, all——

Mr. SILVERS. Surely you know a few things about how they're doing it.

Secretary GEITHNER. I do know a few things about it, and I have some views on that. But, the basic objective is to make sure that, as we exit, which we're going to do as quickly as is prudent, we're leaving the capital position of the institutions stronger, not weaker.

Mr. SILVERS. Very good. In this regard, Mr. Secretary, obviously Bank of America has repaid—is now in process. It can be a little hard to follow the steps in which they're doing it. Can you explain, are they repaying all of the TARP money, and have they raised equity capital to do that repayment in an amount that is equivalent to both the TIP and CPP?

Secretary GEITHNER. Well, the good news is that I got a check for $45 billion last——

Mr. SILVERS. That's nice. I'm interested what the source of funds for that check is.

Secretary GEITHNER. And, as you said, they raised a predominantly common stock. But, I'd be happy to respond in writing or have the Fed respond in writing with the details of that.

Mr. SILVERS. All right. But——

Secretary GEITHNER. Actually, I think the details are out there clearly in the market, because——

Mr. SILVERS. Yeah.

Secretary GEITHNER [continuing]. That should be a public offering.

Mr. SILVERS. Right. But, the policy appears to be—judging from what one reads out in the public, the policy appears to be to raise all the equity, in preferred or common stock, all of the money necessary to repay, not a portion. Is that your understanding?

Secretary GEITHNER. I think that is generally a desirable approach, because a cleaner exit is better than a staged exit. I'm not sure that's going to be possible in every circumstance, but I think it's very desirable that these institutions are——

Mr. SILVERS. Yes.

Secretary GEITHNER [continuing]. Eager to go out and have private investors come out and take the government out of it.

Mr. SILVERS. Mr. Secretary, Andrew Ross Sorkin, a reporter for the New York Times, who, judging by his book, seems to often know more than we do, has written about the Bank of America repayment, that, quote—well, actually, I'm not going to quote, because it'll take too long. He said, basically, two things. He said, one, the FDIC didn't think they should be allowed to repay. And, two, that the reason why they were so eager to repay was so that they could increase their executive compensation that could be offered to a successor to their current CEO, Mr. Lewis. Can you tell me, are either of those statements true?

Secretary GEITHNER. I don't want to speak to the first question. I think it would be inappropriate for me to do that.

On the second question, I think you're absolutely right, that the compensation restrictions that we put in place for firms that took exceptional assistance were very tough restrictions. And they were appropriately tough restrictions. With these and other restrictions,

you're going to be viewed as stronger, in the eyes of the market, if you're an institution without public capital. These banks were eager to come and repay. And I think we should welcome that, encourage it, and I expect to see substantially more repayments.

Mr. SILVERS. I'm not going to press you to reveal, perhaps, what you view as a confidence, but it strikes me that it's a matter of deep concern if the FDIC doesn't agree with allowing the repayment because the bank is too weak. My time is about to expire, so I'm going to express a further thought rather than pressing you on this.

Effectively, the strength with which Treasury and the regulators sense that the premature repayment, when these banks are weak, is bad for the country. That is an extremely important thing. And——

Secretary GEITHNER. Right. And we would not——

Mr. SILVERS. And——

Secretary GEITHNER. And we would not allow that or support it.

Mr. SILVERS. Right. And I want to encourage and bolster your viewpoint there, and I would be concerned, deeply concerned, if those kinds of considerations were overridden by, no matter how well meaning, any desire to increase people's executive pay.

Secretary GEITHNER. No, I agree. Again, we would not support that. And I think that the agreement you saw reached in that context strengthens the institutions. The best test of that is what happens, going forward. But, to have private investors come in and willing to put substantial amounts of capital is a sign of confidence and strength.

Chair WARREN. Superintendent Neiman.

Mr. NEIMAN. Thank you.

Now, we all acknowledge the crisis that was avoided by the impressive efforts of the multi-prong efforts by the administration and other agencies. And we hear words, some of which you used this morning—last week, Chairman Bernanke characterized what we avoided as a "global financial meltdown of a magnitude unseen for generations, a second Great Depression, cataclysm."

As I stated in my opening, I think it really is imperative that the American public understand the linkage to the real economy, as well as what really was avoided. Could you share with us your descriptions of the sequencing of what could have played out with the failures of large interconnected firms and the direct linkage to the real economy? Because I think that really is at the heart of assessing the effectiveness of the program.

Secretary GEITHNER. In September of last year, for the first time, I think, in almost 70 years, Americans across the country were starting to take their money out of banks, banks that were strong with no connection to the weaknesses in the subprime crisis, because they were scared about the security of their savings. Economic activity around the world come to a stop. Markets froze around the world. The value of American savings fell by more than 40 percent. People were faced with the prospect of having to work 10 years longer than they expected because of the loss of the value of their savings. Millions of Americans lost their jobs, thousands of businesses failed that did not need to fail, deeply unfair and unjust damage to the basic confidence of Americans in the fairness and

justice of our system. Deep loss of confidence around the world in our basic financial stewardship of this country.

It is not something that is about a set of individual institutions or Wall Street, it is about the basic fabric of confidence in America, basic security Americans have in their future. When you allow that to suffer so—cause as much damage as you're seeing, it takes a huge amount of time to repair that basic damage.

So, financial crises are unjust and traumatic, because they cause deep damage to people who were careful and prudent and had nothing to do with the crisis. And the scars that creates are long-lasting, and we are going to live with, for a long time, the challenge of trying to repair that damage.

Mr. NEIMAN. Thank you for that. You know, one issue that is also addressed in our report, issued yesterday, are issues around moral hazard. And we have debate, among the panel itself, as to the extent that TARP increased the risks and costs of moral hazard. I think moral hazard was almost built into the fact of the emergency efforts. The question is, will government always be there? I think you just explained the criticality of why the government had to step in and why—I think your position, which I also agree with, is that we have to address "too big to fail," and that is an imperative for our Congress, which they are debating currently.

I strongly agree with the need for a systemic regulator and a resolution authority. But, I'd like your views on whether we should be, in effect, allowing institutions to grow to such largeness and complexity to be characterized as "too big to fail." And isn't it time to engage in a debate in this country, now that we all recognize the safety net that there is for financial institutions, the benefits that financial institutions, particularly depository institutions, have from FDIC programs, from Fed as a lender of last resort? Isn't it time to debate what we want our institutions to be? Are they social utilities that should be able to engage in speculative and high-risk activities?

Secretary GEITHNER. Well, I think I agree with everything you said. The tragic choice in financial crises is to solve the problem, put out the fire, protect the innocent, and limit damage. You have to act. You can't sit there and hope it's going to burn itself out. And if you worry about moral hazard too much, which was an issue for the first 18 months of this crisis, you can see enormous pain and damage. And what it takes to clean that up will cause even more moral hazard. So, if you care about moral hazard, you have to care about having basic protections to prevent panics from spreading.

It's a paradox. People tend to think that if you care about moral hazard, you should be against the fire station. But, if you don't have the ability to act, the damage is so sweeping and traumatic, governments will have to do so much more, on such broader scale, with much greater cost to future incentives. So, there is a good case for emergency authority.

We are having a debate about "too big to fail." And we have proposed a sweeping set of new authorities and constraints that reduce the risk that banks in the future take on so much risk that they could imperil the system. And we're offering a proposal whereby banks would be allowed to fail with less damage to the system

and less risk to the taxpayers as a whole. It's very important to have this debate and we're having it now in Congress.

Chair WARREN. Thank you.

Mr. Atkins.

Mr. ATKINS. Well, that's great. I wanted to, actually, pick up that thread. So, this is a good segue to talk about ways in which, in remaining months of TARP, you intend to use them.

My friend from the United Auto Workers here has been very supportive of TARP, because, I guess, $80 billion went into GM, Chrysler, and GMAC. And we heard——

Mr. SILVERS. Paul?

Mr. ATKINS. Yes.

Mr. SILVERS. I don't work for the United Auto Workers.

Mr. ATKINS. Well—I'm sorry.

Mr. SILVERS. I don't know who you're talking about.

Mr. ATKINS. Okay. The socialization of small business lending that you were suggesting—one thing I wanted to focus on was the Treasury's use of the funds, going forward, and how it's going to be allocated. I think that has implications. You mentioned the proposals, the administration's proposals, for new statutory authority for resolution and for a systemic risk regime. And basically, I guess the way I view the resolution authority is really just a codification of TARP, for years to come, because of the flexibility it builds in.

And when we view how Treasury has interpreted TARP, over the last year and now, by the sounds of it, if we're talking about job creation or whatever else is coming out from the administration, exactly what sort of uses are you going to put these funds to? Because you've said, sort of, both sides, now. You want to keep some in reserve, you want to put some in the community banks. And I guess I don't really understand what——

Secretary GEITHNER. All right. Let me start with the——

Mr. ATKINS [continuing]. The process is.

Secretary GEITHNER. Let me start with the job creation question. Because of what we've been able to achieve, in terms of stability in the system, there are at least $200 billion in lower costs ahead. That——

Mr. ATKINS. Because of?

Secretary GEITHNER. Because financial stability has improved, we do not believe it's going to be necessary to spend a substantial amount of resources. Also, since the expected value of these investments has gone up substantially, those savings reduce the budget deficit.

You cannot use TARP to fund an infrastructure program. You can't use TARP to provide a tax cut to small businesses. You can't use TARP to incent green energy efficiency products. Those are choices Congress is going to have to make.

What we've done, though, because of the careful financial stewardship of this program, is dramatically reduce the expected costs—much, much lower than anybody anticipated. Not just at the beginning of last year, but in August. That gives the Congress and the President some choices to make about how to use those resources. There will be a very strong case for using some of those resources to support targeted measures that can help get job cre-

ation back quickly. But, there's going to be substantial resources also to reduce our long-term future deficits.

Now, I want to come back to where you've begun, though. The resolution authority we proposed is nothing like a permanent TARP. And I want to make this very clear. And I would not support that, for reasons I think you would agree with. What resolution authority does is allow the government to, in effect, take an institution that has mismanaged itself, put it in receivership, and wind it down. Not save it, not give it a chance for redemption, but to sell and wind it down safely, at less cost to the taxpayer, less damage to the public.

Mr. ATKINS. Well, the problem is, though, there is so much flexibility built into that, it'll——

Secretary GEITHNER. No, I don't think so. In fact, this is very important. The challenge with this proposal is giving the government some authority to contain financial panics. That has to be very constrained——

Mr. ATKINS. They have plenty of authority right now.

Secretary GEITHNER. No, it doesn't, actually.

Coming into this crisis, the only emergency authority the President had to contain the panic, in this case, before TARP was passed and the Fannie and Freddie legislation was passed—was to, in effect, declare a bank holiday and close markets. That was it.

Mr. ATKINS. But the other——

Secretary GEITHNER. A tragic——

Mr. ATKINS [continuing]. Has a lot of power.

Secretary GEITHNER [continuing]. A tragic mistake for the country. No, actually very limited. But, the panic-containing authority——

Mr. ATKINS. Eight? Okay.

Secretary GEITHNER [continuing]. Reserved for emergencies, we think we need to limit the discretion, in that case.

Mr. ATKINS. Well, I—okay. I think that—going back, then, to—basically, this goes back to the issue of TARP as a revolving—a revolving——

Secretary GEITHNER. Well, let's talk about that.

Mr. ATKINS. I would like to have an opinion, from the general counsel of the Treasury, addressing that issue, which we have—I've asked for, back in September, and we haven't gotten yet. Because I think that is really germane to what you're talking about, as far as how much money has been saved and is going to be reallocated.

My time's up.

Chair WARREN. Okay.

Secretary GEITHNER. Happy to provide that. And——

Chair WARREN. We're at time, here.

Secretary GEITHNER. We've provided that many times to a number of the sitting Members of Congress that have asked, but happy to copy you on those opinions. But, Congress designed the resolution authority with that basic feature. It was wise to do it, at that time.

Mr. ATKINS. Well, you read the statute differently, because I disagree with that. I think, it really calls on the question of support.

Secretary GEITHNER. Actually, there's been no challenge from the Congress——

Mr. ATKINS. Not yet, maybe.

Secretary GEITHNER [continuing]. Who wrote the law to——

Mr. ATKINS. Not yet.

Chair WARREN. All right, gentlemen.

Mr. Silvers.

Mr. SILVERS. I'd like to just make an observation, because my colleague mischaracterized whom I work for. I work for the AFL–CIO, the United Auto Workers is a member of the AFL–CIO. I do not work for the United Auto Workers. I don't have that honor. And, I feel very, very strongly about the dignity of people who work hard, physically, for a living. And I think that is often not properly honored in Washington.

Mr. Secretary, I'd like to come back to the big-bank issues. I'm just confused about something, and perhaps it's just I'm not reading closely enough, but we passed notes back and forth with the staff here, and the staff is confused, as well. The government holds $45 billion in preferred stock of Bank of America.

Secretary GEITHNER. Held.

Mr. SILVERS. Held. Bank of America had a public offering of $19 billion. What is the source of funds for the remainder of the $45 billion the federal government received from the Bank of America?

Secretary GEITHNER. I should give it to you in writing, which I'd be happy to do.

Mr. SILVERS. There isn't any other equity offering, is there?

Secretary GEITHNER. It's a little more complicated than that.

Mr. SILVERS. Okay.

Secretary GEITHNER. The bulk of it was raised in common equity. That leaves the capital position of the institution stronger than it was before this, not just in the eyes of the banking supervisors, which they all agreed on, but also in the eyes of the market and their creditors. And that's the ultimate test. But I'll be happy to provide——

Mr. SILVERS. Are you saying that Andrew Ross Sorkin's comment about the FDIC isn't correct? Because you said they all agreed on it.

Secretary GEITHNER. Well, I was trying to stick to my line, which is I'm not going to comment on the discussion.

Mr. SILVERS. But, you just did.

Secretary GEITHNER. And it is there. But, I know the banking supervisors believe that it is important to make sure that, as we exit, the institutions are stronger, not weaker. I think that they share that view. I'm glad they do.

Mr. SILVERS. Okay. Well, perhaps Mr. Sorkin is wrong.

I don't have all the numbers in front of me, or can run them in my head, but, to what extent, if any, are the funds for the repurchase of the Bank of America preferred stock coming from internal earnings?

Secretary GEITHNER. I don't think they are. But, again, I need to go back and give you the numbers in detail.

But, let's focus on the stuff that is critical to the financial position of the firm. So, the best way to do this is, look at their common equity ratio to assets before the repurchase and after. That measure, which is probably the most valuable measure of financial strength, is stronger with repayment, not weaker.

Mr. SILVERS. What I'm concerned about—and I think I've——

Secretary GEITHNER. So, the quality of capital that has the strongest source of confidence to markets——

Mr. SILVERS. Well, now, if it's a common equity ratio—of course it'll be stronger, because you're——

Secretary GEITHNER. Yes.

Mr. SILVERS [continuing]. Because they raised common and paid off preferred.

Secretary GEITHNER. That's it. That's the basic nature of the strategy. And it's a good strategy.

Mr. SILVERS. But, that would, of course, happen even if the bulk of the funds were raised by something other than a public offering. It concerns me that the basic standard appears to be a good one, which is that if you want out of TARP, you've got to be able to raise the equivalent in new equity as the TARP funds you are paying back.

Secretary GEITHNER. That's not quite the standard.

Mr. SILVERS. Well, it's not——

Secretary GEITHNER. I'll be happy to explain.

Mr. SILVERS. Well, explain the standard then.

Secretary GEITHNER. Well, again, this is really a discussion you should have with the banking supervisors, because under the laws of the land, the banking supervisors set the terms for repayment.

Mr. SILVERS. Yeah, I know. But, you seem to——

Secretary GEITHNER. I'm sure they'd be happy to——

Mr. SILVERS [continuing]. Know a fair amount about it, and you're the only one here today.

Secretary GEITHNER. I don't think it's as complicated as you're making it. It's a simple thing. Common equity is higher after repayment. It's good for the system.

Mr. SILVERS. It's not clear to me that if you raised a little bit of common equity, but mostly allowed preferred to be paid back with cash that comes out of earnings——

Secretary GEITHNER. I don't think that's right. But, again——

Mr. SILVERS. All right.

Secretary GEITHNER. Again, I'd be happy to ask the banking supervisors. I'm sure they'd be responsive and willing to lay it out in detail. But, I think it is in the market now. But, we're happy to provide an authoritative report on that.

Mr. SILVERS. I just hope you keep insisting on that in the future. I can't change what you've done with Bank of America, but I hope you keep insisting in the future that you have to be able to have the strength to raise the equivalent amount in the public markets in equity, common or preferred, that you're paying back in TARP money.

Chair WARREN. Okay, that's it on time.

Superintendent Neiman.

Mr. NEIMAN. I'd like to go back to a dialogue regarding supporting small business lending through expanding capital investments in community banks. And I am on record strongly supporting those initiatives. And I also agree with your assessment of the reluctance of community banks, in particular, to participate. And I think you identified the primary reason for that reluctance being a stigma.

One way to address that reluctance and stigma is to issue those details regarding the program, focusing on eligibility requirements, criteria for approvals, details about the approval process. I think greater transparency in the program—and the program was announced, I believe, October 19th, so we're approaching almost two months before the details are issued—I think greater transparency, full disclosure of the eligibility requirements—Is there a black box that's going to determine eligibility?—would go a long way in addressing those concerns and reluctance on the part of the banks.

So, any further insight on how you intend to address those concerns of the banking community, as well as any projections as to when we may see more details about the application and approval process?

Secretary GEITHNER. I am happy to try and do that. You're a supervisor, so you know that some of this is going to have to be about judgment, too. You can't reduce it to a clear, simple set of criteria.

It's not just about stigma, though. Again, it's partly the concern about what future conditions might be, how they might change. Because they have changed over time. And that's a big part of the deterrence.

Mr. NEIMAN. Let's talk about lessons learned in developing those details for the program. What are the lessons learned from the large-bank capital investments that can now be employed to the smaller-bank program? I was glad to see that the outline of the program would include detailed lending programs to be submitted as part of that application, as well as ongoing reporting requirements.

Secretary GEITHNER. We think that would help. I can't tell you, though, whether that's going to be sufficient. We don't want to have the government in a position of forcing banks to lend or meet quantitative criteria for lending; it's just not a feasible way to do it, particularly with loan demand falling so much in the aftermath of the recession. But, we think it's a promising approach.

I think we are improving substantially. The survey we've put in place that allows banks to report on how they used the funds and what actually happened to different categories of lending and asset growth should help, too. And we're open to other suggestions.

Mr. NEIMAN. That raises another important point. Can you share with us your assessment or evaluation of bank lending in terms of both originations as well as bank balances?

Secretary GEITHNER. You have to look at overall credit to have a good sense of the risk and credit crunch now. Overall credit, the price credit, has come down a lot. Bank lending is still falling. Borrowing from the securities markets, for those who have access, is increased very, very dramatically. On net, credit is still falling. No surprise in that, of course, because, in the recession the economy slowed and contracted so much, demand would fall as well. But, the pace of decline is slowing a bit. And if you look at surveys of what businesses say they're seeing, they do not cite credit as the principal problem they face; instead it is lower demand for their products, going forward.

Mr. NEIMAN. So, when we hear about banks maintaining large balances at the Federal Reserve, earning a spread, is that some-

thing that the public should be concerned about or are we looking at——

Secretary GEITHNER. No, I don't think so. I think that's just a necessary consequence of the actions the Fed's taking to help bring growth back, bring unemployment down. And banks are still somewhat cautious. But, there is much more capital in the finance system today, and the overall system is a much stronger position to support recovery as recovery takes hold.

There are a number of charts in my testimony that report on these survey-based measures of credit conditions and I think they provide some other helpful indications of the broad trends we see.

And so I would say, the credit conditions are dramatically better than they were and recovery is quicker than we would have hoped, but there are still pockets of the country that are very vulnerable to a damaging contraction in credit.

Chair WARREN. Okay. Thank you.

So, Mr. Secretary, we're talking a great deal here about systemic risk. And, of course, systemic risk is what we were talking about a year ago when we got into the business of bailing out large financial institutions. And particularly with AIG. That's why I read the November 17th report of the Special Inspector General for the Troubled Assets Relief Program. As you know, he was quite critical of the actions that you took in negotiating with, ultimately, the counterparties for the AIG financial instruments.

Now, I was struck by two quotes in there. He says that the Federal Reserve and Treasury officials defended the rescue of AIG on the grounds that the company's failure, quote, "posed considerable risk to the entire financial system and would have significantly intensified an already severe financial crisis and contributed to a further worsening of global economic conditions," which I think has been the standard story for well over a year.

But, the report also states that you told SIGTARP that, quote, "The financial condition of the counterparties was not a relevant factor in the decision to see to it that Goldman Sachs and other counterparties were paid 100 cents on the dollar."

I have to say that these two statements appear to be at odds with each other.

Secretary GEITHNER. Let me try to explain.

Chair WARREN. Please.

Secretary GEITHNER. Systemic risk, you know, is complicated and difficult to assess and measure. The risk to the system from AIG's collapse is not particularly reflected in the direct effects on its major counterparties, the banks that bought protection from AIG. The direct effects of failure—this is true for Lehman and for all the other financial failures in that period of time—would not have been particularly significant. What was significant for the system as a whole was the broader collateral damage that would've happened in the event of failure. So, what you saw after Lehman, for example, was a general pullback or a classic run on the entire system. AIG presented exactly that type of risk but, in some ways, on a much greater scale. AIG, unlike Lehman, unlike Bear Stearns, had written a bunch of different types of insurance products—savings, protection, vehicles—to the retail community across this country and around the world. And if those policyholders had lost con-

fidence in the system as a whole, then the damage could've been much greater.

So the entire system was at risk. And if the system had collapsed, no institution in the United States or around the world would have been invulnerable to that collapse.

Chair WARREN. I'm losing the logic here, Mr. Secretary. If Goldman Sachs could have withstood these losses, and the——

Secretary GEITHNER. Only the direct——

Chair WARREN [continuing]. Other counterparties——

Secretary GEITHNER. Only the direct effects of that—it's not the right way to capture——

Chair WARREN. So, they still could have paid off all the parties that they owed money to. This would not have caused Goldman Sachs to collapse——

Secretary GEITHNER. No, but that——

Chair WARREN [continuing]. This would not have caused the direct counterparties to collapse.

Secretary GEITHNER. But, Madam Chair, you understand this. When you decide it is necessary to prevent default, you prevent default. If AIG had not met its contractual obligations to its counterparties——

Chair WARREN. But, this is——

Secretary GEITHNER [continuing]. It would have defaulted, it would have been downgraded, and the company would have collapsed and happened to be liquidated in the midst of the worse financial storm in generations. There was no feasible way to selectively default on its counterparties without bringing the whole thing down.

Chair WARREN. Mr. Secretary——

Secretary GEITHNER. That was the choice.

Chair Warren. But, Mr. Secretary, we did not step in and back up all of the counterparties, all of the trades. We picked AIG, and AIG alone.

Secretary GEITHNER. No, no, that——

Chair WARREN. And we moved in——

Secretary GEITHNER. Well, that's not——

Chair WARREN [continuing]. And backed up——

Secretary GEITHNER. But, that's not——

Chair WARREN [continuing]. A 100 cents on the dollar repayments.

Secretary GEITHNER. No, that's not true at all. We acted to prevent AIG's default, because there was no other way to protect the system from the damage of that. The consequence of preventing default was that AIG met its contractual obligations. You cannot selectively default on contractual obligations without courting collapse and downgrade. Now, what we did——

Chair WARREN. But, Mr. Secretary——

Secretary GEITHNER [continuing]. For the rest of the system——

Chair WARREN [continuing]. The consequence of what you have just described is that these counterparty obligations, these financial instruments that are bought by very sophisticated parties, are going to be treated, effectively, like deposits in checking accounts——

Secretary GEITHNER. No——

Chair WARREN [continuing]. And saving accounts.

Secretary GEITHNER. Absolutely not.

Chair WARREN. They ended up——

Secretary GEITHNER. Absolutely not.

Chair WARREN [continuing]. Effectively, with 100-cent-on-the-dollar government guarantees——

Secretary GEITHNER. They did, because there was no——

Chair WARREN [continuing]. For which they had never paid.

Secretary GEITHNER. No. You have to distinguish two things. First of all, there is no other way, in the context of that storm, to protect the economy from that failure. Now, looking forward, we need resolution authority, a strong package of reforms. We do not want investors, in the future or these particular firms to live with the expectation that the government bail them out. That is the challenge. That's why financial reform is so necessary.

Now, Madam Chair, nothing would have made me happier, in that basic context, to have a different set of choices. But, given the laws of the land, the authority we had, a tragic mistake for the country, we had no other choice in that circumstance.

Chair WARREN. AIG believed that it had a choice, until you moved in, and that was that they could pay 90 cents on the dollar——

Secretary GEITHNER. I don't understand why——

Chair WARREN [continuing]. 85 cents——

Secretary GEITHNER [continuing]. This is——

Chair WARREN [continuing]. On the dollar, 80 cents on the dollar.

Secretary GEITHNER. I don't understand why this is so complicated. You either prevent default——

Chair WARREN. I don't think it is complicated Mr. Secretary.

Secretary GEITHNER. No, but it's come down to two choices. You either prevent default, because default would be cataclysmic, or you don't. And when you prevent default, you're doing it so that institutions can meet their obligations to everyone they have contractual obligations to. If you selectively default on any obligation, the institution will come crashing down. That is the consequence of the system we had, going into this crisis. That's why we want to change the system.

Chair WARREN. Mr. Secretary, I come from a world of Chapter 11. People default all the time. They negotiate down on their obligations.

Secretary GEITHNER. Right.

Chair WARREN. And they do not bring down——

Secretary GEITHNER. But——

Chair WARREN [continuing]. The entire——

Secretary GEITHNER. You're exactly——

Chair WARREN [continuing]. Financial system.

Secretary GEITHNER [continuing]. Right. And you're a national expert on this basic issue. But banks are different. AIG is effectively a bank.

Chair WARREN. AIG was not a bank.

Secretary GEITHNER. It——

Chair WARREN. I'm out of time, and I've done it to myself again. I apologize.

Secretary GEITHNER. Can we do it a minute longer? It's a very important debate to have.

Mr. NEIMAN. Fine. I think that's fine.

Chair WARREN. Go ahead, Mr. Secretary.

Secretary GEITHNER. You can borrow my time.

Chair WARREN. Go ahead, Mr. Secretary.

Secretary GEITHNER. Financial institutions, which Congress has recognized for a long time, need a different type of bankruptcy regime than we have for other companies. Now, AIG is not a bank, but, in effect, it operated as a bank. It borrowed money, it operated on leverage, it did not have capital to support that. We've had in place a different type of bankruptcy for banks for many, many decades, however, we need one for complex finances that operate just like banks.

Now, in bankruptcy, you have lots of choices. You can negotiate all sorts of different treatments, in this context, and in ways that would be helpful for the country. What we want is a bank-type resolution regime that gives us the choices that we've had for banks. But, we did not have that for complex, large financial institutions. And that's what limited our choices.

Chair WARREN. Well, we may disagree about whether or not we had it, but we would certainly agree that we do need a system in order to be able to liquidate large financial institutions. Where we may draw a very sharp difference is whether or not we should ever be in the business of doing that after the fact, and going back and effectively guaranteeing transactions with nonbank institutions——

Secretary GEITHNER. Do you feel the same way?——

Chair WARREN [continuing]. With taxpayer dollars behind it.

Secretary GEITHNER. Just so I understand, do you feel the same way about the FDIC guarantees put in place in September?

Chair WARREN. I——

Secretary GEITHNER. You would never, ever want a country to be in a position where you have to do guarantees—temporary, effective, whatever price—because of the moral-hazard risk. But, in a financial panic, there is often no other way to stem the risk of much greater damage to the innocent.

Chair WARREN. Mr. Geithner, there are, though, real consequences to doing that, because now markets understand that you may, at any point, decide that anyone is large enough and that their debts should therefore be backed up by the U.S. taxpayers.

Secretary GEITHNER. Well said, and no one feels more strongly about that. And that is why, even in the midst of this deep crisis, we propose sweeping reforms that would give us better choices in the future.

Chair WARREN. In the future.

Secretary GEITHNER. We could not feel more strongly about that.

Chair WARREN. Good. Thank you.

I apologize to my fellow panelists.

Mr. Atkins.

Mr. ATKINS. No, that was a very fruitful discussion, I thought. And I note that next month we'll be drilling into AIG as a topic so I look forward to that, as well.

But, I just wanted to turn back to—I think part of the problem, especially last year, was predictability, transparency of what the

government's actions were, and also with respect to what balance sheets and other things were consisting of, and that sort of made the marketplace itself uneasy. I think that's part of the same thing that I wanted to discuss here now which is the predictability of who gets what and who does what to whom. And that's what I was trying to refer to earlier, as far as the auto programs. I wasn't, certainly, disparaging the working man, but there is a huge perception out there that other unions got a great deal out of that audit rescue package that was negotiated earlier this year.

That dovetails into the situation with small businesses that we've been talking about. A lot of the problem in today's business environment is an uncertainty as to what the future holds. The administration is talking about—and Congress—huge tax increases, a huge new expensive healthcare plan, new onerous environmental regulations, and then looming deficits far into the future, not even counting the off-balance sheet obligations of the United States Government, which some people have put at $100 trillion or more. So, nobody, basically, can plan for anything, and that affects borrowing, and that obviously then affects lending.

At the same time, we're talking about the stigma of participating in TARP among some small banks. And people have been leery to participate in the Public-Private Investment Partnership, and others, because they don't want to get close to any sort of government control of their business or influence.

So, my main question is, how are you going to inject more predictability into the system? You're talking about this vague notion of limiting TARP to $550 billion or so, and then focusing on small businesses and housing and other and—I can't remember the last part. How exactly are you going to put these funds to work? What is the general plan?

Secretary GEITHNER. Well, there's a table attached to my testimony that gives very detailed estimates on what we think a reasonable estimate is of future programs. It's very clear, and those programs have very clear, transparent conditions. And one of the things we did right from the beginning was make sure we put the specific terms of any contracts in the public domain for everyone to see. So, I think that we'll be very effective and very clear in making sure what the limits are going to be in these programs and what the precise terms are going to be.

Now, you're right that businesses across America still face a lot of uncertainty. They face a lot of uncertainty about how strong the recovery is going to be. And they face some uncertainty about what the rules of the game are going to be, going forward. And I think that that's one good reason why we hope that Congress can bring to closure the healthcare reforms moving through the system and the broader changes ahead on energy policy, things like that. I think that will help reduce uncertainty, help improve confidence. Businesses want to know what the rules of the game are. And so, I think I agree with you on that. You want to bring clarity as quickly as we can.

Mr. ATKINS. Well, again, going back to the resolution authority that you're asking for, I think that will just perpetuate the lack of clarity, because——

Secretary GEITHNER. Relative to what? Let's think about the choice ahead. Do you want to go back to a situation in which the United States comes into the worst crisis in generations with no authority, no ammunition, no ability to contain the damage? It cannot be good for us to court that disaster again. We're describing——

Mr. ATKINS. But, it cannot be good to ascribe these particular undefined powers to either——

Secretary GEITHNER. No, they're very well defined, and they're——

Mr. ATKINS. Are they?

Secretary GEITHNER [continuing]. Carefully limited. They're more limited, in some ways, than those that exist today. And the ones that were created that are new are modeled on a resolute regime established and tested for banks over the decades.

Mr. ATKINS. Well, I agree with the Chair that bankruptcy is probably the best——

Secretary GEITHNER. Bankruptcy itself or a quasi-bankruptcy for banks?

Mr. ATKINS. Well, a bankruptcy—I'm talking about even beyond the banking system, about firms that are not necessarily banks, but are deemed to be, for some reason, too big to fail or a systemic risk. And I think that's the thing that we're concerned about.

Secretary GEITHNER. Well, again, you know, these are all about choices, because I think many of us would share the basic objectives. It was not good for the country to allow very large, very risky, complex institutions to operate effectively as banks, outside all of the protections we put in place for banks in the wake of the Great Depression and the crisis that preceded it. That was a terrible mistake.

So, institutions that effectively are banks, which take risk and could imperil the system, need to have constraints on their operations.

Chair WARREN. I'm going to do time.

Mr. ATKINS. Oh.

Chair WARREN. And that way——

Mr. ATKINS. All right.

Chair WARREN [continuing]. We'll get another round.

Mr. ATKINS. Okay. All right.

Chair WARREN. Okay?

Mr. Silvers.

Mr. SILVERS. Mr. Secretary, why don't you finish that sentence? Maybe you've lost it in the interim, but——

Secretary GEITHNER. Well, it's one of the hardest problems to solve. Again, people want to know what the boundaries are, what the scope of this is. But, again, what caused this crisis, what made it so severe, was that we allowed an entire separate system of, effectively, banks operating without adequate constraints on risk-taking and without the protections we put in place to mitigate runs and panics.

Mr. SILVERS. Now——

Secretary GEITHNER. That was the classic mistake of the government, that's something we have to fix. As part of that, we need to

be better tools to manage failure with quasi-bankruptcy-type regimes for those type of institutions.

Mr. SILVERS. And, Mr. Secretary, is it your view that the bill currently in the House, which I understand the administration supports, that that bill provides this FDIC model, quasi-bankruptcy process, with no provision for TARP-like equity infusions, other than to transition a failed firm into an FDIC-like resolution process? Is that——

Secretary GEITHNER. That's correct.

Mr. SILVERS. Is that a——

Secretary GEITHNER. Yeah.

Mr. SILVERS [continuing]. Fair statement?

Secretary GEITHNER. That's a fair statement.

Mr. SILVERS. Fine. Let me just say that this issue is of great concern to me. I've looked closely at that bill. I thought earlier drafts were inadequate with respect to this and did run the risk of another TARP. I think the bill that's in front of Congress today is the right one, and I think that your leadership on this has been very helpful.

Let me return to the broader discussion, about panics and runs and so forth, in the context of AIG. I want to better understand the argument that you're making. Are you saying that the reason that the counterparties to AIG had to be made whole was not because of the threat that, were they not made whole, they would fail, but because of the threat that, if anybody was not made whole in a credit derivative transaction, that there would be a broader, sort of, disintermediation of derivatives markets? Was that your concern?

Secretary GEITHNER. I think you have most of it right, but let me say it slightly differently.

Mr. SILVERS. Okay.

Secretary GEITHNER. If AIG had defaulted on any single counterparty, derivatives or any other contractual obligation, that would have forced a generalized default.

Mr. SILVERS. All right. Well——

Secretary GEITHNER. The system would have collapsed.

Mr. SILVERS. Right. Now——

Secretary GEITHNER. The consequence of that collapse would've been cataclysmic for the system as a whole.

Mr. SILVERS. Well, "default" is an interesting term here. "Default" is a formal legal term, it's where the person who has the obligation asserts that the party hasn't paid. And in that circumstance, the—in that circumstance, perhaps can try to insist on payment and force a bankruptcy. Is it your view that a negotiated haircut would have had same impact? I mean, because that would not have been a default. People——

Secretary GEITHNER. Let's——

Mr. SILVERS [continuing]. Negotiate haircuts all the time——

Secretary GEITHNER. Let's just——

Mr. SILVERS [continuing] Between commercial parties——

Secretary GEITHNER. They do. But that's the point. Remember, this is not like there were three people that had the total exposure of counterparties and derivatives to AIG. There were tens and tens of counterparties on the derivatives side, maybe hundreds; there were thousands of other counterparties at stake in this context. No

one would have been willing to individually volunteer a concession without it being extended to all of the counterparties in similar positions.

It's a simple thing, it's like flipping a switch. Either the firm is able to pay and avoid default, or it courts default——

Mr. SILVERS. So——

Secretary GEITHNER [continuing]. And downgrade and collapses.

Mr. SILVERS. Is your view that SIGTARP is wrong—Mr. Barofsky and his staff, seem quite convinced that there was an opportunity to negotiate, not a default, but a concession on the part of the major parties. And the Chair mentioned——

Secretary GEITHNER. The real world does not work this way. You can't run a strategy on the hope that people will be nice and decide they're going to voluntarily give up a set of contractual obligations, and, if they're unwilling to do it, then your only choice is that you not pay——

Mr. SILVERS. All right. So, your——

Secretary GEITHNER [continuing]. And take the consequences of default.

Mr. SILVERS. So, your concern was that the default of AIG, not a broader run in the derivatives market.

Secretary GEITHNER. It—well——

Mr. SILVERS. Is that right or was it both?

Secretary GEITHNER. I think part of—just I—think about what happened after Lehman. It's the simplest way to think about it. So, what happened to Lehman, Lehman failed, Lehman defaulted——

Mr. SILVERS. All right. But, that——

Secretary GEITHNER [continuing]. On a set of obligations——

Mr. SILVERS. But, then you're saying that the issue was the default of AIG, not a run—I want to understand whether you believe that derivatives markets in a crisis are markets where everyone has to get a 100 cents on the dollar all the time.

Secretary GEITHNER. In a financial panic if you see cascading defaults like this on any type of contractual financial obligation, that will accelerate, not mitigate, the panic. Again, nothing would have been better if there was a solution in place in this case, where you could have negotiated a set of outcomes that left the taxpayer with less exposure to losses. That has no realistic prospect of success in a financial panic of this magnitude.

Resolution authority would make some of the choices a little bit easier, but there are no good choices in a panic like that.

Mr. SILVERS. I would just conclude that if derivatives are the kind of instrument that have the kind of importance in our markets in which 100 cents on the dollar is necessary in a crisis, then we need to regulate them as such.

Secretary GEITHNER. And we have proposed sweeping changes on how derivatives are treated and regulated in our markets, and partly because of that risk.

Chair WARREN. All right. Thank you.

Superintendent Neiman.

Mr. NEIMAN. I'd like to weigh in on the AIG issue, for one reason, just to confirm that there is not necessarily a consensus on this viewpoint on the panel, but also, more importantly, to delve into it a bit deeper, to encourage everyone to read that SIGTARP re-

port, not because of the lessons learned, but because it does outline the sequencing of events that led up to and defined that transaction.

My reading of that report says that, once the government decided that AIG was "too big to fail," they no longer had leverage over negotiating any of those haircuts. That is a very different situation than was faced with the municipal issuers of months earlier. I think it also indicated very clearly the issues around violating the contractual obligations once the government decided to prevent a default.

Also, treating U.S. counterparties differently than the foreign counterparties would have raised significant issues. Utilizing the supervisory powers of the Federal Reserve as leverage to force negotiation, I think, would also have raised significant concerns.

Lastly, the issue that you raised, of downgrades, the impact it would have on the American taxpayer and the global system.

So, I would encourage everybody to read that report, because of the descriptions and details, which, to my knowledge, were not clearly outlined up to the issuance of that report, but take disagreement with the lesson learned. And, in my opinion, the lesson learned is that we did not have the right tools for resolution of an institution of that nature. And that's why it is so critical that we have a resolution authority to deal systemically with institutions.

Secretary GEITHNER. Well said, and I think you said it right. I think it's important to recognize that this is good for our country; it is going to happen for years to come. People are going to pore over every decision we made. They're going to look very carefully at all those judgments. It's, of course, hard to judge, with the benefit of hindsight, what would have been possible. And a lot of it's going to be hard for anyone to appreciate who did not live through, minute by minute, what was happening in that acute series of financial panics, with not good choices for us.

Our job was to make a set of choices among unpalatable, deeply offensive basic choices, and to do what was best, we thought, for the country at that stage. But, I respect the efforts of people to come back and look over this again. A lot will happen in the future. We're going to cooperate with it, because the American people deserve to try to understand that.

But, again, understand that no one really can appreciate the range of choices that were really available at that time. And that's one reason why we have to work so hard to make sure we have better choices in the future. We need resolution authority to allow these firms to fail without the taxpayers being exposed to the risk of loss and that put constraints on risk-taking in the future that can help mitigate the moral-hazard risk.

Mr. NEIMAN. Before moving on to another subject, can you give us an update on AIG, particularly what we're reading in the press about issues of risk of losing individuals resulting from compensation directives from the Treasury?

Secretary GEITHNER. Well, there is risk of that, as you expect, and as you've seen. I would say, in general, the new board, the new management of the institution are working very hard and effectively to strengthen the underlying insurance businesses, improving the prospect of the taxpayer being repaid and bringing down

the risk in the financial products division that took the institution to the edges of collapse. The risk in that has come down very, very dramatically. Overall scale of exposures and derivatives are about half of their peak level. But, that's the basic strategy.

Mr. NEIMAN. Is it something that we should be concerned about at this time?

Secretary GEITHNER. What?

Mr. NEIMAN. The impact to the American taxpayer if there is a loss of critical employees at an institution?

Secretary GEITHNER. Absolutely. I mean, we need people who are capable running these businesses. The interests of the taxpayer, in making sure we maximize return on those actions we took, require there be capable people running these firms, running these businesses.

Mr. NEIMAN. Thank you.

Thank you.

Chair WARREN. Thank you, Mr. Secretary. Our time grows short, so we'll enter the lightning round here and try to get in at least one more question.

Secretary GEITHNER. I have to be——

Chair WARREN. We know you need to leave——

Secretary GEITHNER [continuing]. Somewhere else at 12:00.

Chair WARREN. We understand you're here with us until 12:00——

Secretary GEITHNER. Okay.

Chair WARREN [continuing]. So we will make sure——

Secretary GEITHNER. So, just until five minutes before 12:00, because I need to be at my next thing at 12:00.

Chair WARREN. Then this——

Secretary GEITHNER. I thought we were going to end at 11:45.

Ms. WARREN. Oh, I think I was told we were ending at 12:00, that we had you for 2 hours.

So, let me do ask the question.

Secretary GEITHNER. You'll have me again, I believe.

Chair WARREN. But that's three months off. As the banks we're talking about how to wind down TARP, so here's my question. We've talked about the fact that the guarantees for the money markets expired on September 18th. That's one of the winding-downs of TARP. But, we jumped in—we, the federal government, we, the Treasury Department—jumped in when the money markets were about to break the buck. Now the money markets don't have any official guarantees, they don't pay anything for any guarantees, but most of the market believes that if the money markets started to break the buck again, there would be substantial government assistance.

You described the banks as leaving TARP. They are stronger. Sure they're stronger. They've paid back their debts, they have no restrictions under TARP. But, they also bask in the glow of implicit guarantees. After all, we've held up a big sign that says, "Those folks are worth saving, no matter what."

So my question is, how do we wind out of implicit guarantees? Out of the fact that the market sees and specifically assesses these institutions as stronger, and capital as cheaper for these institu-

tions, for the specific reason that there is this implicit government guarantee.

Secretary GEITHNER. I think the only way to do it is to put in place financial reforms that achieve two outcomes. One is authority for the government to constrain risk-taking, more broadly, more effectively in the future. That is necessary; it's not sufficient. And you need quasi-bankruptcy authority that allows a credible risk that these firms can be failed, unwound, more safely. I don't know a better way to do it.

I worry about the risk you laid out. It's inherent in any successful effort to put out a financial fire. There is no way to put out financial fire, arrest a recession, without taking some risk that you're going to hurt future incentives in the way you described. The only solution to that is to change the rules of the game.

Chair WARREN. Thank you, Mr. Secretary.

Mr. Atkins.

Mr. ATKINS. Thank you very much.

Secretary GEITHNER. Mr. Atkins, you said something very important in the beginning, although you said it in disagreement with me, but I want to underscore it.

Mr. ATKINS. Oh, yes. Right.

Secretary GEITHNER. TARP was only one part of what helped bring growth and stability back to the economy. TARP would not have been effective without the guarantees put in place by the FDIC, without the broad measures of financial market support by the FED, and, most important without the Recovery Act itself. The economy did not improve, or bottom, until you had that full arsenal of policy responses deployed in parallel. It wouldn't have worked without TARP. TARP was necessary; it was not sufficient, and it was a part of that basic strategy. TARP can't claim the credit for all the things that improved, in this case, but it wouldn't have been possible without it.

Mr. ATKINS Yes, well, the Recovery Act is another whole issue, and I don't have time to go into that one, so I'll leave that.

There are two things that I wanted to bring up. One is—you were discussing nonbanking firms before—I do have to note that many of them fared a lot better than the huge banking institutions that had regulators and examiners living in their offices——

Secretary GEITHNER. For example?

Mr. ATKINS [continuing]. Day after day.

Secretary GEITHNER. For example?

Mr. ATKINS. A lot hedge funds and others have a lot less leverage two to one, three to one—than the other sorts of——

Secretary GEITHNER. I make that point a lot myself, and I agree with that.

Mr. ATKINS. Okay.

Secretary GEITHNER. I just might point out, that is in part because we were actually quite effective in making sure the institutions that provide them leverage, that give them financing, were much more constrained than they were in 1998, for example.

Mr. ATKINS. Right. Well——

Secretary GEITHNER. But, I agree with you.

Mr. ATKINS. So, we'll have to pick that one up later. I just want to say that transparency, I do believe, is the answer, ultimately.

There is one last thing I did want to point out. With respect to the housing issues, we had a hearing, not too long ago, with six folks, one of whom brought up an issue as to EESA and the authority of Treasury to do some of the programs that you're doing—HAMP and HARP—because the statute talks about how Treasury will acquire assets, meaning loans or the underlying mortgages or the securitized assets. And some of your programs are not geared towards that. And so, I wanted to ask you——

Secretary GEITHNER. So, you'd like a legal opinion on that?

Mr. ATKINS. I would.

Secretary GEITHNER. I'd be happy to provide it.

Mr. ATKINS. Other homework for that.

Secretary GEITHNER. Happy to provide that.

Mr. ATKINS. Thank you very much.

Chair WARREN. Thank you.

And Mr. Silvers is going to take the last question.

Mr. NEIMAN. No, I think, in recognition of your time considerations and your participation with us this morning, I will waive my last question.

Chair WARREN. Mr. Silvers.

Mr. SILVERS. I've looked at the composition of the revenue—it's hard to look at the composition of the profits—of the four largest banks over the last six quarters, and it appears that there's a trend toward interest income from loans declining slowly and income from securities—again revenue—from securities trading increasing. Are you at all concerned about this—essentially the quality of earnings within the four largest banks?

Secretary GEITHNER. I'm not, at this stage. I think that actually they're getting better, not worse. Most important is that what's happened to earnings across the financial system is not just that the government did extraordinary things to save them from collapse, but that the markets are now opening up, firms are able to raise capital again, and that companies are able to go out and raise equity, raise debt again. This is a substantial source of revenue. That's what banks exist to do. So, I think it's largely a healthy thing. Obviously, we look at this very carefully, because what we don't want to do is have a situation where the same type of risks that brought the system to the edge of collapse start to reemerge again.

Mr. SILVERS. Thank you.

Chair WARREN. Thank you very much, Mr. Secretary.

I want to say our characterization of the past may not always be in agreement, but I think we are very much in agreement—at least I hope we are—that we cannot go this way again. There must never be a TARP 2.0.

Secretary GEITHNER. And this is not over yet. We've got work to do to fix what was broken, not just put in place reforms to prevent the crisis of the future.

Thank you very much.

Chair WARREN. Thank you.

This hearing is adjourned. The record will be held open for questions for the Secretary.

[Whereupon, at 11:57 a.m., the hearing was adjourned.]

[The responses of Secretary Geithner to questions for the record from the Congressional Oversight Panel appear on the following pages.]

Questions for the Record from Elizabeth Warren, Chair, Congressional Oversight Panel

1. According to Treasury's Monthly Lending and Intermediation Snapshot, which measures the lending levels of the top 22 Capital Purchase Program recipients, there have been mixed signals with regards to the lending habits of those institutions that benefitted the most from TARP assistance. There are certain areas of lending that have shown improvement, most notably the 32 percent increase in mortgage originations and the 75 percent increase in refinancing originations since the enactment of EESA. However, precipitous drops in other lending categories have offset these increases. For example, new commitments to commercial real estate loans by these 22 institutions have decreased by nearly 64 percent while commercial and industrial loans have decreased by 26 percent since October 2008. Total originations made by these 22 institutions have decreased by 9 percent since October 2008. Why has lending continued to shrink after these financial institutions took TARP money? What do these trends indicate about the success of the TARP? Do these trends concern you?

The role of the financial sector is to provide credit to our economy. Americans rely on that credit for homes, education, and cars. Businesses rely on it to hire and pay their employees. While U.S. credit conditions and the outlook for economic growth have improved significantly over the past year, bank lending continues to contract. It is vital that banks lend to creditworthy American consumers and businesses.

A major cause of the reduction in lending is the fact that the U.S. banking system entered this crisis with insufficient capital. As credit losses mounted, first because of the correction in the U.S. housing market and subsequently because of the sharp contraction in the economy, banks have had to adjust. That adjustment has come through raising additional capital, reductions in total assets held by banks, and changes in the composition of those assets. The declines in loans held by banks are one part of this process of adjustment. But the economic contraction has also reduced the demand for credit as both consumers and businesses ave pulled back. In addition the contraction has undermined the credit worthiness of many borrowers. In past recessions, particularly those driven by credit cycles, bank lending has tended to lag the recovery of the economy. The fact that bank lending continues to contract is an indication that the adjustment in the U.S. banking sector is incomplete. Without TARP, the contraction in lending would no doubt have been much more severe. But TARP was never intended to solve all the problems of the banking sector. Relative to this historical record, the performance of bank lending in this cycle is not unusual.

However, there has likely been some overcorrection in bank lending practices. And tight bank credit has a particularly severe impact on small businesses, which do not have the ability to raise funds in securities markets. To help mitigate this decline in bank credit, we are seeking legislation to transfer $30 billion from TARP into a new Small Business Lending Fund that would provide smaller and community banks with capital structured to provide an in-

centive to increase small business lending. We are also expanding our community development lending program. Eligible banks will now be able to receive more capital from the government—up to 5% of risk-weighted assets and the Treasury will match private investments in firms in order to increase the number of firms that have access to the program. Finally, we continue to encourage major U.S. banks to expand lending, and we created and publish a monthly snapshot of their lending activity.

As the President has repeatedly stated publicly and privately to these banks: "The taxpayers were there for you to cleanup your mistakes. You now have a responsibility to be there for the community."

2. There were 149 bank failures between January 1, 2008 and November 30, 2009. The FDIC, forced to repay depositors at a growing number of banks, is in the red for the first time in 17 years. In the absence of a robust economic recovery, this problem may worsen. How do you explain this rate of failure? What are you doing now to redress that balance and protect the FDIC against further losses? What implications for financial stability do you see in the FDIC's present level of assets?

The current elevated pace of bank failures is a consequence of the excesses that built up in our financial system in recent years, resulting in large credit losses that many institutions were not equipped to absorb. Among the key lessons of the crisis is the need for more capital and more vigilant supervision of banks to make sure our system is safer and more resilient going forward.

Despite the elevated pace of bank failures, it is clear that the FDIC has the resources and necessary tools to protect insured depositors and resolve failed banks. Throughout the FDIC's 75-year history, no depositor has ever lost a penny of insured deposits. Although the Deposit Insurance Fund (DIF) balance fell to negative $21 billion as of December 31, the DIF balance should be distinguished from the FDIC's liquid resources, which stood at $66 billion of cash and marketable securities. To bolster the DIF's cash position, the FDIC's Board approved a measure on November 12 to require insured institutions to prepay 13 quarters worth of deposit insurance premiums at the end of 2009. These prepayments were collected on December 31 and totaled approximately $45 billion. Additionally, the Helping Families Save Their Home Act, enacted on May 20, 2009, permanently increased the DIF's statutory line of credit with the U.S. Treasury from $30 billion to $100 billion, and increased it to $500 billion through the end of 2010 if certain conditions are met.

To redress the negative DIF balance going forward, on September 22, the FDIC took action to increase assessment rates on the banking industry. The FDIC's Board decided that effective January 1, 2011, rates will uniformly increase by 3 basis points. The FDIC has projected that bank and thrift failures will peak in 2009 and 2010 and that industry earnings will have recovered sufficiently by 2011 to absorb a 3 basis point increase in deposit insurance assessments. The Budget projects the DIF reserve ratio will return to 1.15 percent in 2018.

3. Section 134 of the Emergency Economic Stabilization Act of 2008 (EESA) (P.L. 110–343) states that should TARP realize a net

loss, "the President shall submit a legislative proposal that recoups from the financial industry an amount equal to the shortfall in order to ensure that the Troubled Asset Relief Program does not add to the deficit or national debt." Please explain the plan Treasury is putting in place to recoup any losses.

Due to improved market conditions and the effective performance in the management and use of TARP authority, the projected cost to the taxpayer is now significantly lower than earlier anticipated. In our FY 2011 budget, we estimated that the cost to taxpayers and the deficit will be about $224 billion lower than the estimate of $341 billion projected in the Midsession Review in August. However, as part of our commitment to ensuring that taxpayers do not face the costs of the extraordinary efforts taken to stabilize the financial system, the Administration proposed the Financial Crisis Responsibility Fee on January 14, 2010. This fee—which fulfills the President's commitment to submit a plan to recoup TARP losses three years early—would be levied on the liabilities of financial institutions with over $50 billion in assets, and is expected to raise $117 billion over about 12 years, and $90 billion over the next 10 years.

Our proposed fee fulfills the requirement of Section 134 of EESA—ensuring that taxpayers are paid back in full—while also providing a deterrent against excessive leverage among the largest financial firms. In the coming weeks, we will be developing further details concerning the Financial Crisis Responsibility Fee, and we look forward to working with Congress and members of this Panel in designing it to most effectively recover the costs of TARP.

4. I understand that the regulators' enforcement action with respect to certain very large banks are embodied in memoranda of understanding with these banks, but those memoranda have not been made public. In the past, the regulatory agencies have explained that all such material must be confidential to assure the cooperation of banks with the examination process. The events of the last several years have revealed critical flaws in that process, flaws that have led to a bailout using hundreds of billions of dollars of taxpayer money. In light of the failure of the examination process and its results, do you believe that supervisory enforcement memoranda should be disclosed to the public, which is ultimately responsible for paying the costs of such failure? If you do not believe that such memoranda should be made public, please explain why not in light of the rationale I have cited.

Treasury agrees that the financial crisis revealed serious flaws in the supervisory process. Supervisors for several large financial institutions missed emerging weaknesses or failed to react forcefully when such weaknesses were known. Treasury has called for a fundamental reassessment of the supervision and regulation of financial institutions based on an analysis of the lessons learned in the years leading up to this crisis.

However, Treasury does not believe that memoranda of understanding that were confidential at the time of signing should be made public after the fact. Supervised entities rely on decisions taken by supervisors, including supervisor's decisions to keep information confidential. Supervisors need to maintain their ability to ensure confidentiality in order to effectively carry out their authori-

ties. In addition, the distinction between public and nonpublic enforcement actions is important to the conduct of supervision: the issuance of public enforcement actions represents a significant escalation in supervisory efforts to address weaknesses at financial institutions. It is important that supervisors retain the ability to address issues either confidentially or publicly, as warranted by specific circumstances.

Questions for the Record from Damon Silvers, Deputy Chair, Congressional Oversight Panel

1. Can you explain how it was in the public interest to allow Bank of America to repay TARP funds in such a manner that it had less Tier I capital than it did before the repayment? If you disagree with this characterization of the transaction, please explain why?

While it would not be appropriate for Treasury to comment on any individual institution, it is important to note that Treasury is required under the American Recovery and Reinvestment Act of 2009 to accept repayment of TARP funds "without regard to whether the financial institution has replaced such funds from any other source," subject to consultation with the appropriate federal banking agency. As a result, many of the elements of this question would be best directed to the regulatory bodies that oversee the safety and soundness of individual institutions.

We also note that one of our objectives has been to improve the quality of capital in the banking system. Although in some cases following the repayment of TARP, the total Tier 1 capital of an institution has been lower than that immediately preceding repayment, the quality of capital at institutions that have repaid TARP funds has generally improved. Tier 1 capital, the highest quality form of capital, has accounted for the vast preponderance of new capital raised by institutions since the Supervisory Capital Assessment Program (SCAP) stress test results were released. For example, the institutions subject to the stress test alone have raised more than $110 billion from common equity issuance since the May release of the stress test results.

Further, the level of capital immediately before and immediately after TARP repayment is not the only relevant comparison. Post-repayment capital levels and ratios should also be compared to pre-TARP capital levels and ratio and, more generally, to supervisory capital requirements. Tier 1 capital has increased substantially at individual institutions and in the banking sector as a whole since the inception of TARP, demonstrating that TARP has successfully served as a bridge to private capital.

Lastly, we believe that, consistent with the stability of the financial system, it is in the public interest for taxpayers to get their money back from TARP recipients, with interest, at the earliest date consistent with continued financial stability. Our judgment has been and continues to be that by replacing the Treasury investments with private capital, institutions will be in a better position to expand lending as the economy expands.

2. Can you explain further why it was not possible in your view to negotiate concessions from the largest AIG counterparties as part of the rescue of AIG, in light of their limited number and those enti-

ties' substantial stake in government intervention to support AIG and their relative financial and political vulnerability? Note I am not asking whether the Treasury and the Federal Reserve Bank of New York should have allowed AIG to go bankrupt or whether the Treasury and the New York Fed should have allowed a general default on all AIG derivaties-related obligations.

On January 27, 2010, the House Committee on Oversight and Government Reform held a hearing that addressed the government's role in negotiations with AIG's counterparties.[1] As part of that hearing, I, former Treasury Secretary Henry Paulson, Federal Reserve Bank of New York (FRBNY) General Counsel Thomas Baxter, and others provided extensive testimony on the subject. Although I provide an answer to your question below, I also refer you to the testimony from that hearing.

In the fall of 2008, a near-complete collapse of our financial system was a realistic possibility. Americans were starting to question the safety of their money in the nation's banks, and a growing sense of panic was producing the classic signs of a generalized run. Peoples' trust and confidence in the stability of major institutions, such as AIG, and the capacity of the government to contain the damage was vanishing. Lehman Brothers filed for bankruptcy just a few days after AIG alerted Federal authorities that its problems had become acute. In the wake of Lehman's failure major institutions such as Washington Mutual and Wachovia experienced debilitating deposit withdrawals, eventually collapsed, and were acquired by competitors. Money market funds also suffered a broad run, threatening what was considered one of the safest investments for Americans and severely disrupting the commercial paper market, a vital source of funding for many businesses.

In this chaotic environment, the Federal Reserve and Treasury concluded that AIG's failure could be catastrophic. At the time, the failure of a large, global, highly-rated financial institution that had written hundreds of billion dollars of insurance on a range of financial instruments could have tipped an already weak and fragile financial system and economy into the abyss. The company's failure would directly threaten the savings of millions of Americans to whom it had provided financial protection through investment contracts and products that protect participants in 401(k) retirement plans. AIG was one of the largest life and property-casualty insurance providers in the United States. The withdrawal of such a major underwriter at the time risked creating a void for millions of households and businesses for basic insurance protection. And doubts about the value of AIG life insurance products could have generated doubts about similar products provided by other life insurance companies, feeding the panic that was crippling the economy.

Convinced that the failure of AIG could be catastrophic for a financial system already in free fall, the Federal Reserve and Treasury determined that it was in the best interests of the United States to support AIG in order to slow the panic and prevent further damage to our economy. From the beginning, it was clear that

[1] House Committee on Oversight and government, Hearing, "The Federal Bailout of AIG," Jan. 27, 2010, transcripts and webcast of hearing available at http://oversight.house.gov/index.php?option=com_content&task=view&id=4756&Itemid=2.

AIG needed a durable restructuring of its balance sheet and operations. Although the government faced escalating and unprecedented challenges on many fronts of the financial storm in September and October, it continued to work to address this need. Falling asset prices generated both substantial losses on the company's balance sheet and increases in required payments to AIG's counterparties under the terms of its credit production contracts. This, along with other factors, undermined market confidence in AIG and put its investment-grade credit rating again at risk. Understanding the counterparty negotiations addressed by your question requires an understanding of the role of the rating agencies in AIG's businesses. Avoiding further downgrades of AIG's credit rating was absolutely essential to sustaining the firm's viability and protecting the taxpayers' investment. Under credit protection contracts that AIG had written and the terms of various funding arrangements, AIG was required to make additional payments to its counterparties if its credit rating was downgraded. A downgrade (to below a certain level) also constituted an event of default or termination under many contracts. In addition, rating downgrades of the AIG parent holding company would have significantly undermined confidence in its insurance subsidiaries. People do not buy insurance products from firms they do not believe have the financial capacity to make good on those commitments over the long term—firms that they do not believe will pay out a life insurance policy or compensate a business if a factory burns down. Credit ratings are central to how people judge that viability.

The counterparty negotiations were conducted in connection with the formation and funding of Maiden Lane III LLC (ML III), a company formed to purchase troubled assets that AIG had insured and to help insulate the company from further liquidity drains, thereby preventing it from being downgraded and failing. Before the Federal Reserve became involved with AIG, the company had entered into credit default swap (CDS) contracts with various third parties to protect the value of certain risky securities, called multi-sector CDOs, in exchange for periodic premium payment. The value of these securities was tied to pools of other assets, mostly subprime mortgages. The contracts required AIG to provide its counterparties collateral as the market value of the underlying CDOs, the credit rating of the assets behind the CDO, or AIG's credit rating declined. As the financial crisis intensified, each of these events occurred. As of November 5, 2008, AIG had already posted approximately $37 billion in collateral against these exposures in accordance with the terms of the contracts, and these collateral calls contributed significantly to the $25 billion in losses that AIG reported for the third quarter of 2008. The box below provides a simplified example to help understand these contracts and negotiations with counterparties to them.

AIG's CREDIT DEFAULT SWAP EXPOSURE—SIMPLIFIED EXAMPLE

While the financial contracts involved were complex, AIG had basically agreed to insure the value of certain risky securities called multi-sector CDOs. The value of these securities was tied to pools of other assets, mostly subprime mortgages. As the financial crisis intensified, the value of the securities fell sharply. AIG incurred losses on these contracts and had to post collateral or make payments on the insurance.

To help understand this kind of contract, imagine AIG had provided insurance on the value of a tangible asset, such as a house, to the homeowner. If the price of the house fell, AIG would be required to post collateral, or essentially make a payment to the owner, equal to the decline in the value of the house. So, if the house was originally worth $200,000 and fell to $125,000, AIG had to give $75,000 to the homeowner as collateral and would incur a loss of the same amount. In addition, AIG would have to post more collateral if the credit rating of the house fell, because it would signal that the home's value was in jeopardy. Finally, if AIG's credit rating fell, it would have to post even more collateral because the homeowner would be concerned about whether AIG could ultimately pay on the insurance.

The problem was AIG had written billions of dollars of such insurance without sufficient capital. AIG was fine as long as the prices of the assets they were insuring—housing prices, in the example—didn't fall, the credit rating of the assets didn't fall, and AIG's own credit rating didn't fall. But if any of those events happened, it would be in trouble. In the fall of 2008, each of these events occurred. The value of the assets, their credit rating, and AIG's own credit rating all fell, bringing AIG to the brink of bankruptcy.

The counterparty/homeowner was fully protected and had all the leverage. If AIG failed to pay on the insurance, the counterparty could keep the collateral and the asset (house) and sue AIG for damages. Further, if AIG had failed to pay or threatened not to pay, it would have been downgraded and collapsed—threatening the economy. If the government had guaranteed the insurance, as some have suggested, and asset prices fell, the counterparty could demand more collateral and keep the asset (house). Therefore, the government funded ML III to buy the asset (house) at fair market value ($125,000). The counterparty kept the collateral ($75,00) in exchange for tearing up the insurance. As a result, the counterparty received par ($200,000), but the taxpayer gained the opportunity to benefit from recovery in asset prices—as has occurred. The transaction supported AIG's viability and credit rating, removing a substantial threat to the economy at the crisis's peak.

To remove the persistent threat that these contracts posed to AIG's continuing viability, ML III purchased the underlying CDOs from the counterparties at their then fair market value. The counterparties received $27 billion in payment from ML III, retained approximately $35 billion in collateral previously provided by AIG, transferred the CDOs to ML III, and terminated the CDS contracts. Thus, the counterparties essentially received the "par" value of $62 billion, consistent with the terms of their insurance contracts with AIG. ML III's purchase was funded by a $24 billion loan from the FRBNY and $5 billion equity contribution by AIG.

In designing and implementing this transaction the FRBNY's objective was, as it always is, to protect the taxpayer. The FRBNY made judgments about these transactions carefully with the advice of outside counsel and financial experts. As they had done when establishing the lending facility in September, the FRBNY and its advisors reviewed a range of materials, including details regarding AIG's exposure to each counterparty under the CDS contracts. However, the FRBNY faced significant constraints. The CDS con-

tracts entitled the counterparties to full or par value. The FRBNY could not credibly threaten not to pay without being willing to follow through on that threat and put AIG into bankruptcy. At the time, the government was working desperately to rebuild confidence in the financial system. Any suggestion that it might let AIG fail would have worked against that vital aim. The FRBNY could not risk a protracted negotiation. AIG's financial position was deteriorating rapidly, and the prospect of a further ratings downgrade was imminent. AIG was scheduled to report a $25 billion loss for the third quarter on November 10, and the ratings agencies had informed AIG that, absent a parallel announcement of solutions to its liquidity and capital problems, they would downgrade the company yet again. Such a downgrade would have led to AIG's failure and triggered the same catastrophic consequences the government had been trying to avoid since September 2008. Moreover, a bankruptcy would have entitled the counterparties to terminate the CDS contracts and keep the collateral that AIG had previously posted, as well as the underlying CDOs that AIG had insured.

The Special Inspector General for the Troubled Asset Relief Program (SIGTARP) has suggested that the FRBNY should have used its regulatory authority, or some other means, to coerce AIG's counterparties to accept concessions.[2] This was not a viable option for several reasons. First, if the FRBNY had tried to force counterparties to accept less than they were legally entitled to, market participants would have lost confidence in AIG leading to the company's failure. Once a company refuses to meet its full obligations to a customer, other customers will quickly find other places to do business. Second, the counterparties could have said refused to grant such concessions, kept the collateral they had already received, kept the CDO securities that AIG had insured, and sued AIG for breach of contract. This would have increased the taxpayer's potential exposure and precluded them from benefiting from any recovery in the value of the CDOs, which has in fact happened.

Third, if the FRBNY had attempted to use its regulatory authority to coerce or extract concessions from AIG's counterparties, that attempt would likely have led to a further downgrade of AIG's ratings, precisely the result that all of the government's actions were intended to avoid. An "investment grade" credit rating is the rating agencies' judgment that creditors will likely be repaid in accordance with the terms of their contracts, not according to a hypothetical government-coerced discount. If the FRBNY had attempted to force counterparties to accept less than they were legally entitled to, then AIG would not have met the ratings agencies' standards for "investment grade" status, and it would likely have lost its "investment grade" rating. Such a downgrade could have led to the company's collapse, threatened government efforts to rebuild confidence in the financial system, and meant a deeper recession, more financial turmoil, and a much higher cost for American taxpayers. In addition, the SIGTARP has stated that Treasury and the Federal Reserve "were fully prepared to use their leverage as regu-

[2] Factors Affecting Efforts to Limit Payments to AIG Counterparties, Nov. 17, 2009, available at http://www.sigtarp.gov/reports/audit/2009/Factors__Affecting__Efforts__to__Limit__Payments__to__AIG__Counterparties.pdf.

lators to compel the nine largest financial institutions (including some of AIG's counterparties) to accept TARP funding." The SIGTARP suggests that the government should have similarly compelled concessions from AIG's counterparties. First, I disagree with the SIGTARP's characterization of the government's discussions with the initial recipients of TARP funds. Second, the circumstances and authority in that situation were fundamentally different from what existed in the ML III transaction. Congress granted the Federal Reserve and, through EESA, Treasury with the responsibility to ensure the safety and soundness of the financial system. In the Federal Reserve's case, that authority was limited to providing liquidity and regulating bank holding companies. In Treasury's case, it was limited to purchasing or guaranteeing assets. Consistent with that responsibility and authority, in the midst of the financial crisis the government encouraged nine banks to accept additional capital. They were not forced to forfeit contractual rights for the benefit of another financial institution. The latter would have been an abuse of the authority granted by Congress, violated private parties' contractual rights, and undermined confidence in the government's strategy to stabilize the U.S. financial system.

Operating with these constraints, the FRBNY and AIG initiated discussions with the major counterparties about whether they would be prepared to accept concessions on the prices of the securities. The FRBNY knew that the likelihood of success of such a negotiation was modest, especially given the imminent deadline and the bargaining constraints under which it was operating. Not unexpectedly, the FRBNY discovered that most firms would not, under any condition, provide such a concession. One counterparty (UBS) said that it was willing, but only if every other counterparty would agree to equal concessions on their prices. In the end, the prices paid for the securities were their fair market value, and because the counterparties retained the collateral they had previously received from AIG, they all received an aggregate amount equal to par value of their securities. In return, the insurance contracts were terminated, and ML III kept the securities.

I strongly believe that the strategy that the Federal Reserve pursued in establishing ML III will generate a better outcome than any alternative. In particular, attempting to coerce concessions risked making the U.S. taxpayer significantly worse off.

Since ML III purchased the CDOs, they have generated significant cash flows that have been used to pay down the FRBNY's loan by more than 25 percent. The Federal Reserve and Treasury expect ML III to pay the FRBNY back in full and to generate substantial returns for U.S. taxpayers. The FRBNY is not only the senior creditor to ML III. It also has a right to two-thirds of any profits from the portfolio, once its loan has been repaid. Moreover, because ML III can hold the CDOs to maturity, it is largely immune from the trading prices and liquidity needs, and is therefore in a better position to maximize the value of the portfolio.

However, the government's return on ML III should be considered in the context of the overall return on its support for AIG. On the one hand, the Federal Reserve will likely generate returns on its financial support of AIG, including the FRBNY Credit Facility,

its loans to Maiden Lane II and Maiden Lane III, and its preferred interests in AIA Aurora LLC and ALICO Holdings LLC. On the other hand, it is unlikely that Treasury will fully recover the direct costs of its capital investments in AIG. In June 2009, the Congressional Budget Office estimated that Treasury would lose $35 billion of its $70 billion total commitment to AIG, including undrawn funds in the equity facility.[3] And the 2011 Budget reflected an expected loss of $48 billion on that commitment.

Today, on the basis of a range of measures, Treasury believes that losses on its investments in AIG are likely to be lower. If market conditions continue to improve and AIG's businesses perform well, the actual recovery on Treasury's preferred stock could be significantly higher. The Congressional Budget Office recently estimated that losses on all Treasury investments in AIG would be $9 billion.[4]

The President has put forward a concrete plan to recover every penny that Treasury committed to stabilize our financial system, including Treasury investments in AIG. The President's proposed Financial Crisis Responsibility Fee would be imposed on large financial institutions to recoup all losses from TARP investments.

Questions for the Record from Paul Atkins, Panel Member, Congressional Oversight Panel

1. With respect to Treasury's position that its authorization under EESA to extend $700 billion for the acquisition of troubled assets operates in the nature of a revolving line of credit, how does that treatment of repayments as restoring the ability to make further payments out of TARP up to the overall statutory limit not render nugatory the provisions of EESA that the public debt be reduced through repayments?

Section 106(d) of the Emergency Economic Stabilization Act of 2008 (EESA) requires that revenues and the proceeds from the sale of troubled assets purchased under that law must be paid into the general fund of the Treasury for reduction of the public debt. However, other applicable provisions under EESA govern the use of TARP funds. Section 115(a) authorizes Treasury to purchase troubled assets having aggregate purchases up to $700 billion "outstanding at any one time," and section 106(e) authorizes Treasury to continue to purchase troubled assets under commitments entered into by Treasury prior to EESA's sunset date. Finally, section 118 makes new funding available for new purchases of troubled assets.

Taken together, these provisions operate as follows: When a purchased troubled asset is sold or when a TARP investment is repaid, the proceeds are deposited into the Treasury general fund for reduction of the public debt. Upon such a sale or repayment, the total amount of troubled assets that are held by the Treasury and count against the $700 billion cap is reduced. This reduction in the total

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[3] Congressional Budget Office, The Troubled Asset Relief Program; Report on Transactions Through June 17, 2009, Jun. 2009, 2, available at http://www.cbo.gov/ftpdocs/100xx/doc10056/06-29-TARP.pdf.

[4] Congressional Budget Office, The Budget and Economic Outlook: Fiscal Years 2010–2020, Jan. 2010, at 13, available at http://www.cbo.gov/ftpdocs/108xx/doc10871/01-26-Outlook.pdf.

amount of assets "outstanding" frees up headroom under the cap. To be clear, the funds used to pay for any new purchases under the freed-up headroom under the cap are not the same as the funds received from the sale or repayment of troubled assets. Instead, new funding is made available under section 118 for any new purchases and is recorded as a new, current-year cost.

That the words "outstanding at any one time" mean that the statutory cap is a "revolving" cap on purchasing authority is without question. These words are always used by Congress to confer revolving budget authority (whether revolving borrowing authority, revolving lending authority or, as in this case, revolving purchase authority) as opposed to "once-used-gone" authority.

EESA provides the U.S. government with a powerful tool for stabilizing the financial system. The Congress wisely provided Treasury with the flexibility to apply EESA's purchasing power over the lifetime of the statute.

2. How are the equity and other securities that Treasury has acquired under the CPP and other programs "troubled assets" under EESA, particularly since Treasury and the various institutions participating in those programs over the course of the past approximately 14 months have averred that the institutions into which Treasury's capital injections have been made were "healthy"?

EESA defines "troubled asset" to mean "(A) residential or commercial mortgages and any securities, obligations, or other instruments that are based on or related to such mortgages, that in each case was originated or issued on or before March 14, 2008, the purchase of which the Secretary determines promotes financial market stability; and (B) any other financial instrument that the Secretary, after consultation with the Chairman of the Board of Governors of the Federal Reserve System, determines the purchase of which is necessary to promote financial market stability, but only upon transmittal of such determination, in writing, to the appropriate committees of Congress." Each purchase of a troubled asset has been made in accordance with this language. Since the enactment of EESA, I have made such determinations, in consultation with the Chairman of the Board of Governors of the Federal Reserve System, which have been transmitted to the appropriate committees of Congress. In the case of the Capital Purchase Program, participation was reserved for viable institutions that were recommended by their federal banking regulator to receive a TARP investment. The Secretary of the Treasury under the prior Administration determined that injecting capital into viable institutions by purchasing preferred shares in those institutions was an effective way of increasing the capital base and strength of those institutions, thereby promoting financial market stability.

3. At our hearing on 10 December, you discussed Treasury's plans to extend more TARP funds to smaller banks, ostensibly to increase their lending. If Treasury acquires equity or other securities from these banks, does that mean that these instruments are perforce "troubled assets" under EESA? Or, if Treasury acquires the underlying loans, are they perforce "troubled assets," even if the loan is performing? By extension, does that mean that any such bank receiving such a capital injection is a troubled bank?

Under the terms of the Small Business Lending Fund that the President announced earlier this month, capital investments would be made under new legislative authority, not through EESA. We are currently in the process of developing legislation with Congress that would define the exact parameters for purchases under that program, although—as Treasury has announced—our proposal would provide for capital investments in banks with less than $10 billion in assets that receive approval from their primary federal regulator.

4. Do you believe that the acquisition of stock and warrants under the CPP has been more—or less—effective than the original intent of TARP, which was to purchase "residential or commercial mortgages and any securities, obligations, or other instruments that are based on or related to such mortgages, that in each case was originated or issued on or before March 14, 2008"?

Capital injections and purchases of illiquid assets serve somewhat different functions. The purchase of illiquid assets is a targeted response to problems involving specific assets. Capital injections have the advantage of providing insurance against the full range of challenges facing financial institutions. As the financial crisis intensified following the failure of Lehman Brothers, the broadening panic moved beyond mortgage-backed, and related, securities. In addition, the deteriorating economic outlook posed new challenges for banks. In this context, capital injections through the CPP were a more effective means of containing the financial panic than purchases of illiquid mortgage-related assets.

5. Would you describe the current process in which Treasury determines which institutions should receive TARP assistance, how much, and under what terms? How was this determination made with respect to GMAC?

Each institution receiving Troubled Asset Relief Program (TARP) assistance followed a different determination process depending on the individual program within TARP through which the institution applied for funding.

Treasury's assistance to GMAC was provided under the Automotive Industry Financing Program (AIFP) consistent with the goals of that program. Treasury's determination to make additional investments in GMAC in 2009 was driven by the need to maintain automotive financing for dealers and consumers during the critical restructuring periods for GM and Chrysler and Treasury's commitment under the Supervisory Capital Assessment Program (SCAP).

Treasury's investments in GMAC have helped to provide a reliable source of financing to both auto dealers and customers seeking to buy cars following the severe contraction of credit in the auto finance markets starting in 2008. Alongside Treasury's efforts through the TALF program, a recapitalized GMAC has offered strong credit opportunities, helped stabilize our auto financing market, and contributed to the overall economic recovery.

As to the SCAP, U.S. federal banking supervisors believe it to be important for the largest U.S. bank holding companies (BHCs) to have a capital buffer sufficient to withstand losses and sustain lending even in a significantly more adverse economic environment than is currently anticipated. In keeping with this aim, the Federal Reserve and other federal bank supervisors engaged in the SCAP,

or the stress tests, with each of the 19 largest U.S. BHCs, including GMAC. As part of the SCAP, Treasury committed to contribute capital to these institutions in the event that any of them could not meet their SCAP buffer requirement via third party sources.

In line with its commitment to support the SCAP institutions, Treasury made a $7.5 billion investment in GMAC in the form of mandatorily convertible preferred stock (MCP) in May 2009. This investment was the result of two distinct capital needs: (i) $3.5 billion of the investment was an initial contribution towards the $9.1 billion SCAP buffer requirement, and (ii) $4.0 billion of the investment was to support the origination of Chrysler dealer and retail loans which had been previously funded by Chrysler Financial.

Treasury did not fund the additional $5.6 billion for the SCAP buffer requirement at that time. Waiting for certain events underlying the assumptions that formed the basis for the SCAP buffer to play out, resulted in a smaller Treasury funding requirement for the second installment. Due to a variety of factors, including that the establishment of the new General Motors and new Chrysler was accomplished with less disruption to GMAC than banking supervisors initially projected, the amount of funding to meet the SCAP was determined by the Federal Reserve to be $3.8 billion ($1.8 billion less than the $5.6 billion previously announced).

On December 30, 2009, Treasury funded the second installment of an additional $3.8 billion in GMAC. In structuring the investment, Treasury ensured that its capital contribution was in a form the Federal Reserve deemed satisfactory to establish the SCAP buffer and was made on terms most beneficial to the U.S. taxpayer. As such, $2.54 billion of the investment was made in the form of trust preferred stock, which are senior to all other capital securities of GMAC.

6. Does a potential failure of GMAC itself pose a systemic risk to our financial system?

The investment in GMAC was consistent with the purposes of EESA, which is to restore liquidity and stability to the U.S. financial system. The Secretary of the Treasury was given broad discretion under EESA to establish programs to purchase "troubled assets." One such program was the Automotive Industry Financing Program (AIFP), which was established by my predecessor, in the Bush Administration, to prevent a significant disruption of the American automotive industry. It was determined that such a disruption would pose a systemic risk to financial market stability and have a negative effect on the economy.

Treasury's investments in GMAC were made pursuant to the AIFP and a "troubled asset" determination made by Secretary Paulson in December 2008. These investments have helped to provide a reliable source of financing to both auto dealers and customers seeking to buy cars. A recapitalized GMAC has enabled GMAC to restore liquidity to its finance business and helped to restore stability to the U.S. domestic automobile industry. This has in turn contributed to the overall economic recovery and to financial stability.

As noted above, the current investment in GMAC also represents the completion of funding provided to GMAC as part of the SCAP process. Ensuring SCAP compliance enables GMAC to maintain

adequate capital under stressed conditions and continue to fulfill its role as a leading provider of financing within the U.S. automotive industry. Completing the SCAP exercise should help assuage investor concerns and assist GMAC in its private capital raising efforts. Capital market access will provide GMAC with necessary liquidity and should allow Treasury ultimately to exit its investment in a manner that protects taxpayers.

7. Has Treasury performed a legal analysis of its authority under EESA with respect to foreclosure mitigation, including section 109 of EESA? Has Treasury performed such a legal basis for HAMP, HARP, etc.? Please provide any such legal memoranda or opinions to the Panel.

Treasury has separately provided Mr. Paul Atkins with a response to the request for a legal analysis of Treasury's authority under EESA with respect to foreclosure mitigation, including section 109 of EESA, and Treasury's legal basis for its Home Affordable Modification Program (HAMP). Delivery of that response did not waive the attorney-client privilege and its subject to the Panel's confidentiality protocol entered into on May 21, 2009 and updated on December 11, 2009.

The Home Affordable Refinancing Program (HARP) is a refinancing program developed by Fannie Mae and Freddie Mac (Government-sponsored enterprises, or GSEs) under the supervision of the federal regulator of the GSEs (the Federal Housing Finance Agency), and is available for eligible GSE-owned or GSE-guaranteed mortgages. Treasury does not administer the HARP, and the HARP is not based on Treasury legal authorities.

8. According to Treasury's guidelines with respect to the Home Affordable Modification Program (HAMP), "new borrowers will be accepted until December 31, 2012" and "program payments will be made for up to five years after the date of entry into a Home Affordable Modification." How does Treasury intend to make HAMP payments using TARP funds beyond EESA's expiration date of October 3, 2010? Please cite the specific legal authority that allows Treasury to do this.

EESA section 106(e) specifically authorizes Treasury to continue to fund the purchase of assets after the EESA purchase-authority sunset date (now October 3, 2010) under purchase commitments entered into before that purchase-authority sunset date. All HAMP payments made to servicers after October 3, 2010, will be funded under purchase commitments with servicers that will have been entered into before October 3, 2010.

9. Has Treasury performed an analysis or developed a metric to determine how effective TARP has been in encouraging various categories of lending, including interbank, commercial, residential mortgage, consumer revolving credit, etc.? Can banks and similar institutions in the current economic environment increase their lending, while simultaneously increasing their capital and writing off non-performing assets?

The U.S. banking system entered this crisis with insufficient capital. As credit losses mounted, first because of the deterioration in the U.S. housing market and subsequently because of the sharp contraction in the economy, banks have had to adjust. That adjustment has come through raising additional capital, reductions in

total assets held by banks, and changes in the composition of those assets. The fact that bank lending continues to contract is an indication that the adjustment in the U.S. banking sector is ongoing.

But the recession has also reduced the demand for credit as both consumers and businesses have pulled back. In addition it has undermined the creditworthiness of many borrowers. The reduction in lending by banks reflects all three of the factors: the need for banks to adjust their balance sheets; reduced demand for credit; and the decline in the creditworthiness of many borrowers.

The primary objective of TARP was to first contain the financial panic that followed the failure of Lehman Brothers and then to ensure the stability of the financial system by encouraging private capital raising by major financial firms. TARP has made an important contribution to achieving those objectives. Without TARP the contraction in lending would no doubt have been much more severe. But developing a specific estimate of TARP's impact on lending is problematic because it requires making a judgment about what would have happened had TARP not been put in place.

Questions for the Record from Richard Neiman, Panel Member, Congressional Oversight Panel

1. Foreclosure Prevention: As we discussed at our December hearing, January 1st is expected to be a critical day for the roughly 375,000 homeowners whose trial modification period expires. Most of these homeowners have made at least 3 months of timely payments as required by the HAMP program. However, less than half of these homeowners have submitted all required documentation, and by some estimates half of these borrowers that have submitted their documentation have yet to have their documentation validated by the servicer. Thus, it looks as if possibly over 75% of homeowners who have demonstrated a willingness and ability to make timely payments on their trial modifications may be eliminated from the program and once again facing foreclosure.

(a) Do you see the documentation problem as one of homeowners failing to get their materials in, servicers failing to validate, or perhaps a problem inherent in the documentation requirement itself?

Converting trial modifications to permanent modifications is the shared responsibility of borrowers and servicers. Treasury has taken a number of steps to simplify the process for both borrowers and servicers. On October 8, Treasury published streamlined and simplified documentation requirements for HAMP. In November, Treasury launched a conversion campaign, including posting the HAMP application documents and a number of new tools for borrowers on our consumer website, *www.makinghomeaffordable.gov*. As part of the conversion campaign, Treasury and Fannie Mae (as our agent) are requiring servicers to report conversion progress on a daily basis.

As of the end of January, over 1 million Americans had begun trial modifications, saving an average of $500 per month. However, only about 31,000 of those trials had become permanent modifications. Although both borrowers and servicers share responsibility for increasing the number of per-

manent modifications, it is clear that servicers need to do a better job of increasing capacity, reaching out to borrowers and processing documents quickly. The current number of permanent modifications suggests a lack of mobilization by major servicers to convert borrowers to permanent modifications.

For this reason, on December 23, Treasury released Supplemental Directive 09–10 (SD 09–10), enclosed here and posted at *www.hmpadmin.com.* Per SD–10, effective on December 23 and lasting through January 31, 2010, Treasury implemented a temporary review period for all active HAMP trial modifications scheduled to expire on or before January 31, 2010, with the exception of modifications failing property eligibility requirements, such as those that are investor owned.

During this review period, servicers were required to confirm the status of borrowers in active HAMP trial modifications scheduled to expire on or before January 31, 2010 as either current or not current. Servicers also must have confirmed which, if any, documents are due from borrowers. Servicers must send written notification to borrowers to inform them that they are at risk of losing eligibility for a permanent HAMP modification because the borrower has (i) failed to make all required trial period payments, (ii) failed to submit all required documentation, or (iii) failed both to make all required trial period payments and to submit all required documentation. The notice must have provided the borrower with the opportunity to correct any error in the servicer's records or submit any missing documents or payments within 30 days of the notice or through January 31, 2010, whichever was later. If a borrower provided evidence of the servicer's error or corrects the deficiency within the timeframe provided, the servicer must have considered the new information and determine if the borrower is eligible to continue in the HAMP modification process.

On January 28, 2010, Treasury took an additional step to streamline the documentation process, releasing Supplemental Directive 10–01 which introduces a requirement for full verification of borrower eligibility prior to offering a trial period plan. Effective for all HAMP trial period plans with effective dates on or after June 1, 2010, a servicer may only offer a borrower a trial period plan based on verified income documentation in accordance with program guidelines. This Supplemental Directive also provides guidance to assist servicers in making HAMP eligibility determinations for borrowers currently in active trial period plans, including those borrowers subject to the temporary review period required by Supplemental Directive 09–10.

(b) What documentation flexibility, if any, could perhaps be provided that would not impact program integrity but would help people meet their documentation requirements and stay in their homes? For example, could alternative documents such as bank statements be accepted in lieu of a profit and loss statement? What particular documents does your office find to be consistently missing or deemed inadequate?

Treasury has taken a number of steps to simplify documentation requirements. On October 8, Treasury published streamlined documentation requirements for borrowers, simplifying the documentation required for borrowers to get permanent modifications. As outlined above, on December 23, Treasury published new guidance for servicers requiring trial modifications to be placed in a temporary review period while servicers review document receipt and processing to ensure that all borrowers are being treated fairly and in accordance with program guidelines.

Treasury has also launched a conversion campaign, requiring servicers to provide detailed data describing the status of all borrowers in trial modifications and cataloguing which documents are missing. As part of the conversion campaign, Treasury and Fannie Mae have sent staff to servicer locations to better understand alternative documentation processes that could facilitate conversions while maintaining program standards. These specific documentation issues are being discussed and resolved by Treasury and Fannie Mae on a daily basis, with new FAQs posted on the administrative website, *www.hmpadmin.com*, to explain program flexibilities on a regular basis. We will continue to examine ways to further streamline documentation and to make program adjustments to improve execution.

The program guidelines released on January 28, 2010 also included a number of additional steps to streamline specific documentation requirements, so as to increase the number of permanent modifications.

(c) Do you expect that upcoming program improvements such as document standardization and the implementation of a web portal for online document tracking will alleviate the problem? Can any of these program improvements be implemented before the current March start date, so they can help people now at risk of losing their trial modifications?

Steamlined documentation requirements announced on October 8 have had a significant positive impact in simplifying the HAMP modification process for servicers and borrowers. The streamlined documentation requirements were effective as of October 8, 2009. The temporary review period will also help require servicers to re-evaluate the status of trial modifications and document handling procedures. In addition, the temporary review period will require servicers to let borrowers know where they stand—by providing a letter outlining any missing documents, and an opportunity to correct errors or complete the application. The temporary review period process was effective as of December 23. The new additional streamlined processes for conversions of modifications announced on January 28, 2010 also became effective upon announcement—and we are seeing the impact of these changes in improved pull-through rates. As of the end of January there were over 116,000 permanent modifications and over 67,000 permanent modifications pending final approval. This group of approximately 180,000 permanent and pending permanent modifications represents about a third of the population of trial modi-

fications who have completed the trial modification and are at a point in the process where they are able to convert to permanent. We recognize that there is much additional work to be done in converting borrowers to permanent modifications but view the changes outlined above as significant progress.

We expect that the web portal will further enhance the ability of borrowers to submit documents and servicers to receive and process HAMP applications. We are working to implement the web portal as quickly as possible.

(d) What is the process for notifying borrowers if their trial modification fails to convert to a permanent modification? Will the reasons be provided, and what process is in place for borrowers to appeal?

As described in Supplemental Directive 09–08 (SD–09–08), enclosed here and posted at *www.hmpadmin.com,* every borrower that is not approved for a trial modification must be sent a written explanation for the denial, indicating one of the specific denial reasons outlined in SD 09–08. In the letter required by SD 09–08, the borrower must also be provided with information about other foreclosure alternatives, contact information for the servicer, contact information for the HOPE Now hotline, and instructions on how to contact MHA Help.

In addition, on December 23, Treasury released Supplemental Directive 09–10 as outlined above, requiring most trial modifications to be placed into a temporary review period. During this review period, servicers must have provided borrowers with a notice indicating application deficiencies. The notice must have provided the borrower with the opportunity to correct any error in the servicer's records or submit any missing documents or payments within 30 days of the notice or through January 31, 2010, whichever was later. If a borrower provides evidence of the servicer's error or corrects the deficiency within the timeframe provided, the servicer must consider the new information and determine if the borrower is eligible to continue in the HAMP modification process.

2. Small Business Lending: What additional clarity can you provide regarding Treasury's capital assistance program for small banks announced in October? As you stated, banks my be reluctant to participate due to potential stigma. What steps are you taking to address these concerns and to implement the program? What is the date for release of additional program details? Assistant Secretary Allison responded to questioning at our October hearing that he expected between $10 and $50 billion allocated to the program; is this still the estimated amount?

On Tuesday, February 2, the President announced details of his new proposal to create a Small Business Lending Fund. Under this proposal, $30 billion in TARP funds would be transferred, through legislation, to a new program outside of TARP to support small business lending. The program would be separate and distinct from TARP. Participation would be limited to community and other smaller banks with less than $10 billion in assets. A core function of the new fund would be to offer banks capital with built-in incentives to increase small business lending—as banks increase lending, the dividend rate on the new capital they had received would

fall. The administration will work closely with the Congress to design this program and discuss other ways that the Small Business Lending Fund could be fully deployed.

As referenced, concerns about TARP stigma have been a significant concern throughout the policy process. These concerns in large part motivated the decision to call for TARP funds to be formally transferred through legislation to a new, separate entity. We believe that creating a distinct fund will encourage broader participation.

3. Limitations on Banks' Risky Activity: Large financial institutions are a large part of our free market system, but they are also supported by a Federal safety net. Their deposits are insured by the FDIC, they have access to funding through the Federal Reserve, and of course have recently received significant taxpayer assistance through TARP. Are there certain activities that bank holding companies currently engage in that might be too risky given their access to government and taxpayer support?

Under the legislation proposed by the Administration and passed by the House in December, the largest financial firms operating in the U.S. would be subject to higher capital, liquidity, and supervisory standards. For instance, the largest, most interconnected institutions will be subject to additional concentration limits and regulators may establish short-term debt limits as well. These new limits will help ensure that our largest, most interconnected financial firms have sufficient capital, liquidity, and other buffers to bear the risks they take. The Administration recognizes that the engagement by one or more of the largest, most interconnected firms in high volumes of certain high-risk activities could increase risk to the financial system. Accordingly, the Administration supports provisions in the House bill that give regulators the authority to force institutions to limit or terminate any activity that could threaten financial stability.

While many of the largest, most interconnected firms are currently organized as bank holding companies (BHCs), these are not the only firms that will be subject to activity limitations and higher prudential standards. The Administration's proposed legislation would also require any firm that owns an insured depository institution to become a bank holding company and, therefore, to be subject to the activity limits and higher safety and soundness standards of the Bank Holding Company Act. In addition, the Administration's proposal would identify other firms that are so large and interconnected that their failure could threaten financial stability and bring those firms under BHC Act activity limits and tough, consolidated supervision at the holding company—subject to the higher capital, liquidity, and supervisory standards mentioned above.

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