

November 2009

TROUBLED ASSET RELIEF PROGRAM

Continued
Stewardship Needed
as Treasury Develops
Strategies for
Monitoring and
Divesting Financial
Interests in Chrysler
and GM



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Highlights of [GAO-10-151](#), a report to congressional committees

Why GAO Did This Study

The Department of the Treasury (Treasury) provided \$81.1 billion in Troubled Asset Relief Program (TARP) aid to the U.S. auto industry, including \$62 billion in restructuring loans to Chrysler Group LLC (Chrysler) and General Motors Company (GM). In return, Treasury received 9.85 percent equity in Chrysler, 60.8 percent equity and \$2.1 billion in preferred stock in GM, and \$13.8 billion in debt obligations between the two companies.

As part of GAO's statutory responsibilities for providing oversight of TARP, this report addresses (1) steps Chrysler and GM have taken since December 2008 to reorganize, (2) Treasury's oversight of its financial interest in the companies, and (3) considerations for Treasury in monitoring and selling its equity in the companies. GAO reviewed documents on the auto companies' restructuring and spoke with officials at Treasury, Chrysler, and GM, and individuals with expertise in finance and the auto industry.

What GAO Recommends

GAO recommends that the Secretary of the Treasury ensure the expertise needed to monitor Treasury's investment in Chrysler and GM remains in place, report to Congress on its general approach for monitoring the companies' performance, and have a plan for evaluating the optimal method and timing for divesting Treasury's equity. Treasury generally agreed with GAO's findings, conclusions, and recommendations.

View [GAO-10-151](#) or [key components](#). For more information, contact Katherine A. Siggerud (sigguerk@gao.gov) or A. Nicole Clowers (clowersa@gao.gov) at 202-512-2834.

TROUBLED ASSET RELIEF PROGRAM

Continued Stewardship Needed as Treasury Develops Strategies for Monitoring and Divesting Financial Interests in Chrysler and GM

What GAO Found

Chrysler and GM have made changes since December 2008 to address key challenges to achieving viability, but the ultimate effect of these changes remains to be seen. The companies have eliminated a substantial amount of their long-term debt, reduced the number of brands and models of vehicles they sell, rationalized their dealership networks, and lowered production costs and capacities by reducing the number of factories and employees. It is difficult to fully assess the impact of these changes because of the short amount of time that has passed since reorganization and the low level of new vehicle sales. Moreover, Chrysler and GM are revaluing their assets and liabilities based on their reorganizations in 2009 and expect to prepare financial statements based on this effort in the coming months.

Treasury does not plan to be involved in the day-to-day management of Chrysler and GM, but it plans to monitor the companies' performance. Treasury developed several principles to guide its role as a shareholder, including the commitment that although Treasury reserves the right to set up-front conditions to protect taxpayers and promote financial stability, Treasury will oversee its financial interests in a hands-off, commercial manner. The conditions that Treasury set for the companies include requiring that a portion of their vehicles be manufactured in the United States and that they report to Treasury on the use of the TARP funding provided. Treasury officials told us that they are also requiring that Chrysler and GM submit financial information on a regular basis and that they plan to meet with the companies' top management on a regular basis to discuss the companies' financial condition.

Treasury should make certain that its current approach for monitoring and selling its equity in Chrysler and GM fully addresses all important considerations financial and industry experts identified. For example, Treasury initially hired or consulted with a number of individuals with experience in investment banking or equity analysis to help assess Chrysler's and GM's financial condition and develop financing packages for the companies. Many of these individuals have recently left as the restructuring phase of Treasury's work has been completed. Treasury will need to ensure these staff and any staff that depart in the future are replaced as needed with similarly qualified personnel. Also, Treasury does not currently contract with or employ outside firms with specialty expertise for its work with the auto industry but may need to do so in the future, to make sure sufficient expertise is available to oversee the government's significant financial interests in Chrysler and GM. In addition, although Treasury officials told us they are considering all options for divesting the government's ownership interests, including an initial public offering or private sale, they have focused primarily on a series of public offerings for GM and have not identified criteria for determining the optimal time and method to sell. Regardless of the option pursued, however, Treasury is unlikely to recover the entirety of its investment in Chrysler or GM, given that the companies' values would have to grow substantially above what they have been in the past.

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Abbreviations

AIFP	Automotive Industry Financing Program
COP	Congressional Oversight Panel
EESA	Emergency Economic Stabilization Act
GM	General Motors Company
NAS	National Academy of Sciences
OFS	Office of Financial Stability
SEC	Securities and Exchange Commission
TARP	Troubled Asset Relief Program
UAW	International Union, United Automobile, Aerospace and Agricultural Implement Workers of America

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United States Government Accountability Office
Washington, DC 20548

November 2, 2009

Congressional Committees

After authorizing more than \$80 billion in financial assistance to the ailing domestic automotive industry since December 2008, the Department of the Treasury (Treasury) is in the unprecedented position of having ownership stakes in two of the nation's three largest auto manufacturers—Chrysler Group LLC (Chrysler) and General Motors Company (GM).¹ Although most automakers experienced declining sales in the last couple of years as the economy slipped into a recession, the current economic conditions have particularly hurt the sales of Chrysler and GM, resulting in significant financial losses and necessitating the use of billions of dollars of borrowed money or cash reserves to keep operating. In December 2008, the chief executive officers of Chrysler and GM testified before Congress that without federal assistance, their companies would likely run out of the cash needed to keep operating.

Concerned that the collapse of one, or both, of these companies could pose a systemic risk to the nation's economy, the previous Administration established the Automotive Industry Financing Program (AIFP) under the Troubled Asset Relief Program (TARP) in December 2008.² Through AIFP, Treasury provided loans to help Chrysler and GM continue operating as the companies restructured. In exchange for the funding it provided,

¹Prior to bankruptcy reorganization, the companies' legal names were Chrysler LLC and General Motors Corporation. Chrysler Group LLC and General Motors Company are new legal entities that were created through the bankruptcy process to purchase the operating assets of the pre-reorganization companies. The new companies also received some of the debts of the pre-reorganization companies, including a portion of the loans Treasury provided to the companies prior to bankruptcy filing. Throughout this report, in cases where such a distinction is important, we refer to the pre-reorganization companies as "old Chrysler" and "old GM," and the post-reorganization companies as "new Chrysler" and "new GM." The third domestic automaker, Ford Motor Company, has not requested assistance from Treasury.

²The Emergency Economic Stabilization Act of 2008 (EESA), Pub. L. No. 110-343, 122 Stat. 3765 (2008), codified at 12 U.S.C. §§ 5201 et. seq., originally authorized Treasury to buy or guarantee up to \$700 billion in troubled assets. The Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22, Div. A, Title IV, § 402(f), 123 Stat. 1632, 1658 (2009), codified at 12 U.S.C. 5225(a)(3), amended the act and reduced the maximum allowable amount of outstanding troubled assets under the act by almost \$1.3 billion, from \$700 billion to \$698.741 billion.

Treasury received 9.85 percent equity in the new Chrysler,³ 60.8 percent equity and \$2.1 billion in preferred stock in the new GM, and about \$13.8 billion in debt obligations between the two companies.⁴ The companies still struggle to remain competitive with other automakers and to regain market share.

We have previously reported that in a market economy the federal role in aiding industrial sectors should generally be of limited duration and establish clear limits on the extent of government involvement. Regarding assistance to the auto industry, we have noted that Treasury should have a plan for ending its financial involvement with Chrysler and GM that indicates how it will both sell its equity and ensure adequate repayment for the financial assistance it provided.⁵ The current Administration has stated that it is a “reluctant shareholder” in Chrysler and GM, but that it would be irresponsible to “[give] away the equity stake to which taxpayers were rightly entitled.”⁶ As such, Treasury has said that in managing its equity it will seek to exit as soon as practicable, maximize return on investment, and foster strong companies that can be independently viable.

As part of our statutorily mandated responsibilities for providing timely oversight of TARP, we are continuing to monitor Treasury’s assistance to the auto industry, including how Treasury is managing its equity in

³Treasury’s share in the company will become 8 percent if Fiat, another of Chrysler’s shareholders, meets fuel efficiency-related performance targets and is granted additional equity.

⁴Other parties that received equity stakes in the reorganized companies include the Canadian government, which provided financial assistance to the companies, and the auto workers union’s health care trust, which agreed to accept equity in the company in exchange for future monetary contributions.

⁵GAO, *Troubled Relief Asset Program: June 2009 Status of Efforts to Address Transparency and Accountability*, GAO-09-658 (Washington, D.C.: June 17, 2009).

⁶Ron Bloom, Senior Advisor, U. S. Department of the Treasury, written testimony before the Congressional Oversight Panel, Regarding Treasury’s Automotive Industry Financing Program, July 27, 2009.

Chrysler and GM and how it plans to sell this equity.⁷ This report will explore the following issues related to Treasury's ownership of Chrysler and GM: (1) steps Chrysler and GM have taken since December 2008 to reorganize, (2) Treasury's oversight of its financial interests in Chrysler and GM, and (3) important considerations for Treasury in monitoring and selling its equity in the companies.

Scope and Methodology

To identify steps Chrysler and GM have taken since December 2008 to reorganize, we reviewed information on the companies' finances and operations, including financial statements, select documents from their bankruptcy proceedings, and company-provided data, and interviewed representatives of the companies.

To determine how Treasury will monitor its financial interests in Chrysler and GM, we reviewed transaction documents related to the restructuring of Chrysler and GM that Treasury was a party to, such as the secured credit agreements and shareholders' agreements, which set forth Treasury's rights with regard to the companies and certain requirements the companies must comply with. We also reviewed information on Treasury's plans for overseeing its ownership interests in the companies, including White House and Treasury press releases, and testimony statements. In addition, we interviewed officials from Treasury's Office of Financial Stability (OFS), which was established to administer TARP, about their plans to monitor the government's financial interests, including Treasury's enforcement of the reporting requirements that were established for Chrysler and GM. We did not, however, independently

⁷See our previous reports on TARP assistance to the auto industry: GAO, *Auto Industry: Summary of Government Efforts and Automakers' Restructuring to Date*, [GAO-09-553](#) (Washington, D.C.: Apr. 23, 2009); *Auto Industry: A Framework for Considering Federal Financial Assistance*, [GAO-09-247T](#) (Washington, D.C.: Dec. 5, 2008); *Auto Industry: A Framework for Considering Federal Financial Assistance*, [GAO-09-242T](#) (Washington, D.C.: Dec. 4, 2008); and [GAO-09-658](#). EESA requires GAO to report at least every 60 days on findings resulting from, among other things, oversight of TARP's performance in meeting the purposes of the act, the financial condition and internal controls of TARP, the characteristics of both asset purchases and the disposition of assets acquired, TARP's efficiency in using the funds appropriated for the program's operation, and TARP's compliance with applicable laws and regulations. This is the ninth report issued in compliance with that mandate.

verify the processes and procedures Treasury has established to monitor and enforce the reporting requirements.⁸

To identify important considerations for Treasury in monitoring and determining how and when to sell its equity in Chrysler and GM, we conducted a review of the academic literature on government ownership of private entities, including both domestic and international cases of private equity investments, privatization, and nationalization, and reviewed analyses of the potential future value of Chrysler and GM and Treasury's equity stake. We also interviewed individuals with expertise in the financial condition of domestic automakers, principles of corporate restructuring, and government ownership of private entities. The financial and business experts whose opinions are represented in this report were selected from a list of experts identified for us by the National Academy of Sciences (NAS) for our earlier report on challenges facing Chrysler and GM.⁹ Of the panel of experts we interviewed for that report, we contacted a subset whose expertise was particularly relevant to structuring an exit strategy. In addition to individuals identified by NAS, we spoke with individuals NAS experts themselves identified as being knowledgeable in this area. We also added two experts with investment experience specifically in the auto industry. We chose experts in government management of investments in private companies by identifying former federal government officials who were involved in well-known cases of government assistance to private entities, such as the federal assistance provided to Chrysler in 1979. We conducted individual semistructured interviews with these individuals, both in person and by telephone. Once this review was completed, we analyzed the content of the literature and the interviews for recurring themes and summarized these common results. A list of the individuals we spoke with is provided in appendix I.

We conducted this performance audit from August 2009 to November 2009 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our

⁸We are currently conducting a coordinated review with the Special Inspector General for TARP on U.S. government oversight of and interaction with companies in which the government has provided "exceptional assistance." As part of this review, we will examine the internal controls Treasury has established to manage its portfolio of investments and its interaction with the institutions, which include Chrysler and GM.

⁹[GAO-09-553](#).

findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

Treasury's decision to provide substantial amounts of funding to the auto industry—more than 12 percent of the TARP funds authorized to date—and to accept equity in the companies as a form of repayment for a portion of the assistance reflects Treasury's view of the importance of the industry to the financial health of the United States as a whole. The auto industry—including automakers, dealerships, and automotive parts suppliers—contributes substantially to the U.S. economy by, for example, directly employing about 1.7 million people, according to industry and government data.¹⁰ To help stabilize this industry and avoid economic disruptions, Treasury authorized \$81.1 billion through AIFP from December 2008 through June 2009 for the following purposes.

- **Funding to support automakers during restructuring.** Treasury has provided financial assistance to Chrysler and GM to support their restructuring as they attempt to return to profitability. This assistance was provided in loans and equity investments in the companies.
- **Auto Supplier Support Program.** Under this program, Chrysler and GM received funding for the purpose of ensuring payment to suppliers. The program was designed to ensure that automakers receive the parts and components they need to manufacture vehicles and that suppliers have access to liquidity on their receivables.
- **Warranty Commitment Program.** This program was designed to mitigate consumer uncertainty about purchasing vehicles from the restructuring automakers by providing funding to guarantee the warranties on new vehicles purchased from them. Funds were provided to Chrysler and GM under this program but have been repaid in full because both were able to continue to honor consumer warranties.
- **Funding to support automotive finance companies.** Treasury has provided funding to support Chrysler Financial and GMAC LLC, financial

¹⁰See National Automobile Dealers Association, "NADA Data 2009: Economic Impact of America's New-Car and New-Truck Dealers" (McLean, Va.: 2009) and United States Department of Labor, Bureau of Labor Statistics, Table B-12: Employees on Non-farm Payrolls by Detailed Industry, August 2009.

services companies whose businesses include providing consumer financing for vehicle purchases and dealer financing for inventory. Chrysler Financial is following Treasury's directive to liquidate its business and is planning to wind down its operations by the end of 2011. GMAC has agreed to provide Chrysler customers and dealers with financing for retail and wholesale purchases.

Table 1 provides information on the funding levels Treasury authorized under AIFP, the amounts Chrysler, GM, and the finance companies have repaid, and Treasury's plans to be repaid or otherwise compensated for the outstanding funds. Treasury officials have said the agency does not intend to provide more funding to Chrysler or GM.

Table 1: TARP Funding Provided to the Auto Industry, as of September 20, 2009

(Dollars in billions)

Company	Description of funding	Authorized amount	Repayments of principal	Interest and dividend payments	Amount and form of future repayments
Chrysler	Loans to Chrysler for general business purposes and restructuring	\$12.5	0	0.052	A total of up to \$7.1 billion will be repaid as a term loan, including \$5.1 billion to be repaid within 8 years and \$2 billion to be repaid within 2.5 years. Treasury also received a 9.85 percent equity share in the new Chrysler. Treasury also has \$5.4 billion of debt in the old Chrysler, but it is not clear at this time whether this amount will be repaid. ^a
	Supplier Support Program loan	1.0	0	0.002	Amounts provided are due to be repaid by April 2010.
	Warranty Commitment Program loan	0.28	0.28	0.003	All funds have been repaid.
	Total	\$13.8	0.28	0.06	
General Motors	Loans to GM for general business purposes and restructuring	49.5	0	0.168	A total of \$6.7 billion will be repaid as a term loan. Treasury also received \$2.1 billion in preferred stock, and 60.8 percent equity in the new GM. Treasury also has \$986 million debt in the old GM, which it does not expect to be repaid.
	Supplier Support Program loan	2.5	0	0.004	Amounts provided are due to be repaid by April 2010.
	Warranty Commitment Program loan	0.361	0.361	0	All funds have been repaid.

Company	Description of funding	Authorized amount	Repayments of principal	Interest and dividend payments	Amount and form of future repayments
	Loan to participate in GMAC rights offering	0.884	0	0.009	Treasury exchanged this loan for a portion of GM's equity in GMAC. As a result, Treasury holds a 35.4 percent common equity interest in GMAC. The GM loan was terminated but GM paid \$9 million in interest on the loan to participate in GMAC rights offering before the loan was terminated.
Total		\$53.24	0.36	0.18	
Chrysler Financial	Loan funded through Chrysler LB Receivables Trust	1.5	1.5	0.007	Loan repaid in full plus about \$7 million in interest. ^b
GMAC	Preferred stock and convertible preferred stock	12.5	Not applicable	0.43	Treasury may convert \$7.5 billion of its preferred shares to common shares upon specific events such as public offerings.
Total		\$81.1	\$2.1	\$0.68	

Source: GAO analysis of Treasury information.

Note: Numbers are affected by rounding.

^aThe \$5.4 billion is composed of the original remaining loan and additional amounts provided as bankruptcy financing. Payment of this amount is contingent on receipt of distributions from Chrysler Financial in an amount equal to the greater of \$1.375 billion or 40 percent of distributions.

^bIn lieu of warrants, Treasury received an additional note from Chrysler Financial. The initial aggregate principal amount of the note was \$15 million, which Chrysler Financial has repaid.

As a condition of the initial federal financial assistance provided in December 2008 and January 2009, the Bush Administration required that Chrysler and GM develop restructuring plans that would, among other things, identify how the companies plan to achieve and sustain long-term financial viability. President Obama rejected the restructuring plans that Chrysler and GM submitted in February 2009, and required the companies to develop more aggressive plans. After reviewing the revised plans, the President announced in April 2009 and June 2009 that the government would provide additional financial assistance to support Chrysler's and GM's restructuring efforts, respectively. To effectuate the restructuring plans, both companies filed voluntary petitions for reorganization under Chapter 11 of the U.S. Bankruptcy Code. Through the bankruptcy process, the newly organized Chrysler and GM purchased substantially all of the operating assets of the old companies. In June 2009 and July 2009, respectively, the new Chrysler and new GM emerged from the bankruptcy process with substantially less debt and with streamlined operations. The old companies, which retained very few assets but most of the liabilities, remain in bankruptcy, where their remaining liabilities are being dealt with. These liabilities include a portion of the loans Treasury provided to the companies prior to bankruptcy in the amounts of \$5.4 billion for

Chrysler and \$986 million for GM. As noted, Treasury has stated that it has no plans to provide additional assistance to Chrysler and GM. Figure 1 describes other key events in the funding and restructuring of the auto companies.

Figure 1: Key Events in Treasury’s Assistance to the Auto Industry and Chrysler’s and GM’s Restructuring

	Date	Chrysler actions	GM actions
2008	2008		
	December	Chrysler and GM chief executive officers testify before Congress that without federal assistance, their companies will not have the cash necessary to continue operations.	
NOV	December 19	Treasury announces it will use TARP funds to establish the Auto Industry Financing Program to stabilize the U.S. automotive industry and avoid disruptions that would pose systemic risk to the nation’s economy.	
DEC	December 31		☛ Treasury agrees to provide \$13.4 billion in AIFP funding to GM.
	2009		
	January 2	☛ Treasury lends \$4.0 billion in AIFP funding to Chrysler.	
	February 17	Chrysler and GM submit restructuring plans to Treasury as required by their loan agreements.	
2009	March 19	Treasury announces the Auto Supplier Support Program.	
JAN	March 30	White House announces that Chrysler and GM’s restructuring plans do not establish a credible path to viability and do not merit additional government investment. The companies are given additional time to show greater progress. White House announces the Warranty Commitment Program.	
FEB	April 3		☛ GM and Treasury execute a credit agreement to lend up to \$3.5 billion to GM for the Auto Supplier Support Program. ^a
	April 7	☛ Chrysler and Treasury execute a credit agreement to lend up to \$1.5 billion to Chrysler for the Auto Supplier Support Program. ^b	
	April 22		☛ Treasury lends \$2 billion in additional funding to GM.
MAR	April 29	☛ Treasury lends \$280 million to Chrysler under the Warranty Commitment Program.	
	April 30	Chrysler files voluntary petitions under Chapter 11 of the U.S. Bankruptcy Code. ☛ White House announces it will provide \$8.5 billion through loans and equity investments in the company to support Chrysler’s restructuring.	
	May 20		☛ Treasury lends \$4 billion in additional funding to GM.
MAY	May 27		☛ Treasury lends \$361 million to GM under the Warranty Commitment Program.
	June 1	Bankruptcy judge approves Chrysler’s restructuring proposal.	GM files voluntary petitions under Chapter 11 of the U.S. Bankruptcy Code. ☛ Treasury announces it will provide up to \$30.1 billion to GM through loans and equity investments to support a bankruptcy proceeding and to transition GM through restructuring.
JUN	June 10	New Chrysler purchases substantially all of old Chrysler’s assets. ☛ Treasury executes a \$7.1 billion credit agreement with new Chrysler.	
JUL	July 5		Bankruptcy judge approves GM’s restructuring proposal.
AUG	July 10		New GM acquires substantially all of old GM’s assets.

Source: GAO analysis of Treasury information.

^aThis amount was subsequently reduced to \$2.5 billion.

^bThis amount was subsequently reduced to \$1 billion.

Chrysler and GM Have Addressed Some Challenges Important to Achieving Viability, but the Effect of These Actions Remains to Be Seen

Since the condition of the domestic auto industry first came to the forefront of national attention in December 2008, Chrysler and GM have made changes to address key challenges to achieving viability, but the effect that these actions will have on the companies remains to be seen. As we previously reported, a number of operational and financial challenges stand in the way of Chrysler's and GM's return to profitability.¹¹ Some of these challenges are beyond the companies' control, such as current economic conditions and limited credit availability. However, other factors the companies can exert more control over include the companies' debt levels, dealership networks, and production costs and capacity. Aided by substantial government assistance and bankruptcy reorganization, they have begun to address a number of these challenges. Although the companies' restructuring efforts started before receiving government assistance under TARP, our analysis focuses on the period between first receiving TARP assistance (around the end of 2008) and after bankruptcy reorganization (June 2009 and July 2009 for Chrysler and GM, respectively). The following are some key challenges that Chrysler and GM have begun to address.

- **Reducing debt.** Through the bankruptcy process, Chrysler and GM eliminated a substantial amount of their long-term financial liabilities, including debt owed to bank lenders and bondholders. In our previous work, we discussed the importance of reducing debt for companies to achieve long-term viability. By reducing the amount the companies pay in interest expense, cash flow is improved, freeing up more money for research and development and other activities that can help the businesses prosper. The precise amount of the companies' total debt reduction is not known because the value of some debts will not be determined until the companies' post-reorganization accounting is complete. However, some reduced or eliminated debts whose values are known include \$6.9 billion of secured bank debt owed by old Chrysler, of which \$2 billion was repaid and none carried forward to new Chrysler; \$5.9 billion of secured bank debt owed by old GM, substantially all of which was repaid by old GM, leaving new GM with none of this debt; substantial reductions of the companies' monetary obligations to the trusts established to provide health care benefits to retirees of the International Union, United Automobile, Aerospace and Agricultural Implement Workers of America (UAW); and about \$27 billion in unsecured GM bondholder debt and \$2 billion in unsecured Chrysler obligations, which stayed as a liability of the

¹¹[GAO-09-553](#).

old GM and old Chrysler, leaving new GM and new Chrysler with none of this debt.

- **Reducing the number of brands and models.** GM is reducing its North American brands from eight to four.¹² In November 2007, Chrysler announced it would eliminate four models within its three primary brands—Chrysler, Dodge, and Jeep—and in October 2009 it announced that it would create a fourth brand by splitting the Ram brand out of the Dodge brand. As we have previously reported, advantages of reducing brands and models include eliminating costs such as factory tooling and product development, reducing intracompany competition for sales of similar models, and allowing more focus and resources on the remaining models' quality, image, and performance.
- **Rationalizing dealership networks to align with sales volumes.** Both Chrysler and GM have made cuts to their dealership networks since year-end 2008. As we reported in April, the companies' dealer networks were too large to be supported by recent sales levels. As of April 2009, Chrysler, Ford, and GM dealerships—most of which are independently owned and operated—were more numerous and, in general, sold half or fewer vehicles per dealership than dealerships selling vehicles from foreign automakers. Higher sales per store allow for a greater return on the dealer's fixed costs of running the business, allowing for more investment in facilities and advertising—which ultimately benefits the automaker by improving the price for which its cars are sold. As of June 30, 2009, shortly after the new Chrysler emerged from bankruptcy, Chrysler had reduced its U.S. dealerships to 2,382, a reduction of about 28 percent from the year-end 2008 level of 3,298.¹³ As of July 2009, when the new GM emerged from bankruptcy, its number of dealers had declined to 6,039 through normal attrition, down from 6,375 at year-end 2008. GM is executing "wind-down" agreements with another approximately 1,300 dealerships and expects another 600 Saturn, Saab, or Hummer dealerships to be transferred to another manufacturer or be phased out. With additional normal attrition, GM expects to have between 3,600 and 3,800 dealerships by the end of 2010, which will represent a 44 percent reduction from 2008 year-end numbers.

¹²Most recently, in October 2009, GM reached an agreement to sell its Hummer brand to a Chinese company, which is slated to take over operations in 2012.

¹³Chrysler began downsizing its operations prior to filing for bankruptcy. For instance, at year-end 2006, it had 3,749 dealerships.

- Reducing production costs and capacity.** Both companies have made reductions in their production costs and capacity since year-end 2008, according to company-provided information. In our April report, we noted such reductions are important because the companies' pre-reorganization cost structures were not sustainable given the decline in their sales and market shares in recent years.¹⁴ Table 2 shows the reductions the companies made between year-end 2008 and the dates they emerged from bankruptcy. In addition to the reductions made during these time periods, the companies implemented restructuring efforts prior to 2008 and plan additional reductions in the future. For instance, Chrysler closed two factories, reduced a number of shifts, and cut nearly 29,000 hourly, salaried, and supplemental employees between year-end 2006 and year-end 2008. GM announced in September 2009 that it will add a third shift at three U.S. assembly plants as part of a plan to close other plants to increase the efficiency of its manufacturing operations. Chrysler and GM have also reached agreements with the UAW, in accordance with the terms of the companies' prebankruptcy loans from Treasury, which will result in further reductions in production costs. Under these terms, the companies were required to use their best efforts to reduce total compensation paid to U.S. employees, including wages and benefits, to be comparable with the total compensation Honda, Nissan, or Toyota pays to employees at their U.S. facilities. The companies were also required to use their best efforts to make changes to work rules to be comparable with the work rules of Honda's, Nissan's, or Toyota's U.S. facilities. Changes the UAW agreed to as part of restructuring included cancellation of cost-of-living adjustments for current workers and restructuring of skilled trade classifications, among other things.

Table 2: Changes to Chrysler's and GM's U.S. Production Costs and Capacity

Production capacity ^a	Chrysler			GM		
	Year-end 2008	After reorganization	Percent reduction	Year-end 2008	After reorganization	Percent reduction
Factories	21	20 ^b	4.8%	47	34	27.7%
Hourly employees	24,135	21,082	12.6%	61,999	54,391	12.3%
Salaried employees	10,691	10,307	3.6%	29,655	27,091	8.6%

Source: GAO presentation of Chrysler and GM data.

^aAccording to Treasury, these numbers will likely continue to change in the future, since the companies' restructuring efforts are not complete.

^bFour additional factories that remain with old Chrysler are planned for future closure.

¹⁴[GAO-09-553](#).

Whether and to what extent these changes will improve Chrysler's and GM's profitability and long-term viability remains to be seen. Many elements of a company's financial statements are also used in measures of financial health, but neither Chrysler nor GM has finalized new financial statements based on their reorganization. Chrysler and GM have agreed to provide certain financial information, as outlined in agreements between Chrysler and its shareholders, including Treasury, and between GM and the Securities and Exchange Commission (SEC). Consistent with the agreements, Chrysler and GM plan to complete the process of determining the fair value of the assets and liabilities transferred to the new companies for their audited 2009 year-end financial statements, which they expect to complete by April 2010 and March 2010, respectively.¹⁵ Chrysler will provide its 2009 audited annual financial statement to Treasury and its other shareholders, and GM will provide its 2009 audited annual financial statement to SEC, where it will also be available to the public. Chrysler will begin filing quarterly and annual financial reports with SEC beginning with its 2010 audited annual financial statements, which will be publicly available through SEC. Before audited annual financial statements are filed with SEC, Chrysler and GM will make other select information publicly available.

Moreover, whether enough time has passed for the impact of the structural changes to be seen is unlikely, especially given that the automakers have not completed restructuring, the economy is still recovering, and new vehicle purchases remain at low levels. For instance, although the federal Car Allowance Rebate System program resulted in a sales spike in August,¹⁶ September sales returned to historically low levels. These and other challenges are likely to delay the companies' recovery beyond what it would be under more favorable economic circumstances.

¹⁵Under an agreement between new GM and the Securities and Exchange Commission (SEC), new GM will file by March 31, 2010, a quarterly financial report for the third quarter of 2009 and an annual financial report for 2009. According to SEC, because GM is a newly formed entity with only five shareholders, it is not required to file periodic or current reports. Also, according to SEC, it does not have any written or oral agreements with Chrysler, which was not a public company prior to its reorganization and is not currently a public company, on future filing requirements.

¹⁶The Car Allowance Rebate System is more commonly referred to as Cash for Clunkers.

Treasury Does Not Plan to Be Involved in Chrysler's or GM's Day-to-Day Operations or Management, but It Plans to Closely Monitor the Companies' Performance

Treasury, which has a sizable financial stake in Chrysler and GM, does not plan to be involved in the day-to-day management of the companies, but it has established certain requirements that will be in effect as long as it holds debt or equity in the companies.¹⁷ Treasury has distinct rights as both a creditor and an equity owner. Its rights as a creditor are documented in the secured credit agreements, which set forth the terms and provisions of the loans Treasury provided to new Chrysler and new GM. Its rights as an equity owner are documented in a number of transactional documents related to the formation of the new Chrysler and the new GM, including shareholders' agreements, equity registration rights agreements, and organizational documents. Treasury's role as an equity owner focuses on monitoring the financial health of the companies in order to protect the value of Treasury's equity stake.¹⁸ Treasury developed several principles to guide its role as an equity owner, including the commitment that, although Treasury reserves the right to set up-front conditions to protect taxpayers and promote financial stability, Treasury plans to oversee its financial interests in a commercial manner, in which it will focus primarily on maximizing its return and take a hands-off approach to day-to-day management. Treasury plans to reserve its involvement for major transactions such as the sale of a controlling share of the companies. Treasury's role as a creditor is not as clearly delineated, but much like in its role as equity owner, Treasury has said it will focus on monitoring the companies' financial health.

Conditions set by Treasury in the credit agreements include requiring that the companies comply with provisions applicable to companies receiving TARP assistance, in accordance with the Emergency Economic Stabilization Act (EESA), as well as other requirements that are specific to

¹⁷Our discussion focuses on the financial assistance Treasury provided to fund the companies' operations and restructuring because it represents the most substantial portion of the assistance the companies received. It does not address the conditions of the smaller amounts provided under the Supplier Support Program and the Warranty Commitment Program.

¹⁸The Congressional Oversight Panel was created as part of TARP to review the current state of financial markets and the regulatory system. The panel is empowered to hold hearings, review official data, and write reports on actions taken by Treasury and financial institutions and their effect on the economy. The Congressional Oversight Panel issued a report on federal assistance provided to the auto industry in September 2009. See Congressional Oversight Panel, *September Oversight Report: The Use of TARP Funds in the Support and Reorganization of the Domestic Automotive Industry* (Washington, D.C.: Sept. 9, 2009).

Chrysler and GM.¹⁹ According to the agreements, Chrysler and GM must do the following:

- **Produce a portion of their vehicles in the United States.** Chrysler must either manufacture 40 percent of its U.S. sales volume in the United States or its U.S. production volume must be at least 90 percent of its 2008 U.S. production volume. GM agrees to use its commercially reasonable best efforts to ensure that the volume of manufacturing conducted in the United States is consistent with at least 90 percent of the level envisioned in GM's business plan.
- **Comply with the executive compensation requirements of EESA.**²⁰ These requirements state that bonuses or incentive compensation paid to any of the senior executive officers or the next 20 most highly compensated employees based on materially inaccurate earnings must be repaid, no golden parachute payments may be made to a senior executive officer or any of the next five most highly compensated employees, compensation in excess of \$500,000 per executive may not be deducted for tax purposes, and the companies must establish a compensation committee of independent directors to review employee compensation plans and the risks posed by these plans.
- **Have an expense policy that is in compliance with TARP standards for compensation and corporate governance.** The policy must govern hosting and sponsoring for conferences and events, travel accommodations and expenditures, office or facility renovations and relocations, and entertainment and holiday parties, among other things.
- **Report to Treasury on the use of government funds.** The companies are to provide Treasury with a report each quarter setting forth in reasonable detail the actual use of the TARP funding they received upon exiting from bankruptcy.

¹⁹As noted, GAO and the Special Inspector General for the Troubled Asset Relief Program are conducting coordinated work on Treasury's oversight of Chrysler's and GM's compliance with these requirements.

²⁰Section 111 of EESA, as amended by the American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, Div. B, Title VII, 123 Stat. 115, 516-520 (2009), codified at 12 U.S.C § 5221, prescribes certain standards for executive compensation and corporate governance for recipients of financial assistance under TARP. Treasury published an interim final rule setting forth the applicable compensation and corporate governance standards (74 Fed. Reg. 28,394, June 15, 2009, codified at 31 C.F.R. Part 30).

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- **Have internal controls to ensure compliance with the requirements.** The companies are to promptly establish internal controls to provide reasonable assurance of compliance in all material respects with each of the credit agreement's requirements for executive privileges and compensation, aircraft, expenses, and the Employ American Workers Act.²¹ The companies must also have documentation of these controls and the companies' compliance with them.
 - **Report on events related to pension plans.** The companies must report to Treasury if actions occur that could result in the companies failing to meet the minimum funding requirements for their pension plans, or if the companies plan to terminate any of their plans.²²

To protect the value of its equity share and the likelihood of loan repayment, Treasury has also established requirements under which the companies must report financial information, and it intends to use this information to closely monitor the financial condition of Chrysler and GM. The financial reporting requirements are set forth in Treasury's credit agreements with the companies and other agreements that specify the rights of the companies and their shareholders, which include Treasury and other parties.²³ GM is also subject to additional reporting requirements related to the reserve portion of its loan from Treasury that is being held in escrow.²⁴ Treasury has agreed with the companies on additional financial, managerial, and operating information, which the companies will provide in monthly reporting packages, along with items specified in the agreements. Tables 3 and 4 provide details on Chrysler's and GM's reporting requirements.

²¹The Employ American Workers Act was included in the American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, Div. A, Title XVI, § 1611, 123 Stat. 115, 305 (2009).

²²GAO has ongoing work reviewing the state of the automakers' pension plans and the potential liabilities to the federal government should the plans be terminated. We plan to issue this report in early 2010.

²³In the case of Chrysler, the corresponding document is the Amended and Restated Limited Liability Company Operating Agreement of Chrysler Group LLC, and in the case of GM, the corresponding document is the Shareholders Agreement by and among General Motors Company, United States Department of the Treasury, 7176384 Canada Inc., and UAW Retiree Medical Benefits Trust. Chrysler's and GM's reporting requirements are not identical because each agreement was negotiated separately and, in the case of the operating and shareholders' agreements, with the input of the shareholders.

²⁴Of the \$30.1 billion that Treasury provided to GM at its bankruptcy filing, \$16.4 billion was held in escrow to be accessed by GM on an as-needed basis with the consent of Treasury. As of October 5, 2009, GM had requested and received \$3 billion from the escrow account.

Table 3: Chrysler's Financial Reporting Requirements

Requirements Treasury established as creditor

Until repayment of the loan, Chrysler must provide to Treasury

- its consolidated balance sheet and the related consolidated statements of income and cash flow, on a quarterly and annual basis, and
- updates to its schedules of real property, mortgaged property, pledged equity and notes, subsidiaries, and mortgage filing offices (beginning in 2010).

Requirements Treasury established as equity owner

As long as Treasury holds its initial membership shares in Chrysler, Chrysler must provide

- public reports containing quarterly and annual financial information, and
- quarterly and annual financial reports to the Securities and Exchange Commission (beginning with its 2010 audited annual financial statements).

As long as Treasury holds more than 5 percent equity, Chrysler must provide to Treasury

- monthly, quarterly, and annual management financial reports summarizing results of the company for the period and comparing these results with the annual budget, and
- unaudited quarterly and audited annual balance sheets and related statements of income and cash flow.

Source: GAO presentation of Treasury information.

Table 4: GM's Financial Reporting Requirements

Requirements Treasury established as creditor

Until repayment of the loan, GM must provide to Treasury

- its consolidated balance sheet and the related consolidated statements of income and cash flow, on an annual (audited) and quarterly basis (unaudited),
- copies of any financial statements or reports GM is required to file with the Securities and Exchange Commission, and
- other information that Treasury might periodically request.

Until the balance of GM's escrow account reaches zero or the escrow account's expiration on June 30, 2010, GM must provide to Treasury

- biweekly 13-week forecasts,
- monthly liquidity status reports, and
- monthly budgets covering a 5-year period.

Requirements Treasury established as equity owner

As long as Treasury owns at least 10 percent of GM's common stock, GM must provide to Treasury

- all financial statements, budgets, reports, liquidity statements, materials, data, and other information pursuant to Section 5 of the credit agreement, and
- a monthly report, the format and content of which Treasury has the right to specify.

Source: GAO presentation of Treasury information.

According to Treasury officials, they plan to review and analyze the reports they receive under creditor and equity owner requirements to identify areas of concern, such as actual market share lagging behind the projected market share, an excess of inventory, or other signs that business is foundering. Treasury does not have authority to direct the companies to take specific actions to address such findings, but Treasury said it plans to notify the companies' management and the Secretary of the Treasury if it sees any cause for concern in the financial reports. In addition to reviewing financial information, Treasury's team of staff responsible for overseeing AIFP (subsequently referred to as the auto team) plans to meet monthly via teleconference and quarterly in person with the companies' top management to discuss the companies' progress against their restructuring plans. Important findings that result from the review of financial reports or management meetings will also be conveyed to key staff in OFS and other Treasury offices with responsibilities for managing TARP investments. Treasury also intends to use financial reports as a basis for decisions on how and when to sell its equity in the companies, as discussed below.

While Treasury has stated that it plans to manage its investments in Chrysler and GM in a hands-off manner and will not interfere in day-to-day operations of the companies, Chrysler and GM will be subject to requirements regarding compensation, expenses, and reporting that other auto companies are not. For example, as discussed above, each company is subject to certain requirements about the vehicles it is to produce, such as the requirement to produce a portion of its vehicles in the United States. In addition, Chrysler's shareholders, including Treasury, have agreed that Fiat's equity stake in Chrysler will increase if Chrysler meets certain benchmarks, such as producing a vehicle that achieves a fuel economy of 40 miles per gallon or producing a new engine in the United States.²⁵ Treasury officials stated that they established such up-front conditions not

²⁵As part of its reorganization, Chrysler arranged an alliance with the Italian automaker Fiat, whereby Fiat is contributing intellectual property and "know-how" to Chrysler in exchange for a 20 percent equity share in the reorganized company. Fiat will have the right to earn up to 15 percent in additional equity in three tranches of 5 percent each in exchange for meeting performance metrics, including introducing a vehicle produced at a Chrysler factory in the United States that performs at 40 miles per gallon; providing Chrysler with a distribution network in numerous foreign jurisdictions; and manufacturing state-of-the-art, next-generation engines at a U.S. Chrysler facility. Fiat will also hold an option to acquire up to an additional 16 percent fully diluted equity interest in the restructured Chrysler. Fiat may exercise this option and exceed 50 percent ownership in Chrysler once Treasury's loan has been repaid in full.

solely to protect Treasury's financial interests as a creditor and equity owner but also to reflect the Administration's views on responsibly utilizing taxpayer resources for these companies. While Treasury has stated it does not plan to manage its stake in Chrysler or GM to achieve social policy goals, these requirements and covenants to which the companies are subject indicate the challenges Treasury has faced and likely will face in balancing its roles.

Treasury's Approach for Monitoring and Selling Its Ownership Interest in Chrysler and GM Does Not Fully Address All Important Considerations Experts Identified

Treasury's general goals of exiting as soon as practicable, maximizing return on investment, and improving the strength and viability of Chrysler and GM are reasonable but possibly competing, according to the group of financial and industry experts we spoke with. For example, if Treasury sells its stake as soon as practicable, it may not maximize its return because too little time may have elapsed to demonstrate to investors the companies' potential for future profitability. Similarly, maximizing return on investment might require actions that do not contribute to making the companies strong and viable—for example, if Chrysler or GM does not return to profitability, Treasury may need to act to liquidate the companies, with the proceeds divided among its shareholders and creditors, to maximize its return on investment. Treasury will ultimately have to address these inherent trade-offs, decide which goal is most important, and then manage its interest in a way that prioritizes that goal over others. Treasury officials told us that they have considered these trade-offs and scenarios, including the worst-case scenario of Chrysler and GM not attaining long-term viability, and that they intend to balance these competing goals when deciding when and how to exit.

Treasury's current approach for monitoring its equity in Chrysler and GM does not fully address the considerations that our group of experts identified as important. In particular:

- **Retain necessary expertise.** Experts stressed that it is critical for Treasury to employ or contract with individuals with experience managing and selling equity in private companies. Individuals with investment, equity, and capital market backgrounds should be available to provide advice and expertise on the oversight and sale of Treasury's equity. This is crucial because prior to TARP, Treasury did not typically buy and sell stakes in private companies, so it has needed to employ appropriate personnel and to retain consultants, such as investment bankers and private equity analysts and firms, who are knowledgeable about such investment decisions. One expert we interviewed noted that housing such individuals in a program office created specifically and solely to oversee

the government's investment in the companies could be beneficial. Program staff would be devoted solely to this purpose, and staff turnover would be low so that institutional knowledge would be preserved over the life of the program. The literature also stressed the importance of designating staff to oversee equity sales.

In assessing Chrysler's and GM's financial condition and future prospects and putting together financing packages for the companies, Treasury hired or consulted with a number of individuals with experience in investment banking, equity analysis, and the auto industry, but it has not established a program office to oversee its investment in the auto companies. As with the rest of the TARP programs, OFS oversees the investment in the auto companies. Some OFS employees work exclusively on the automotive companies, while others divide their time among multiple TARP programs. While the auto team has experienced a significant decline in its number of staff, and presently has limited engagements with outside firms with specialty expertise such as investment banking or equity analysis to assist in its management of its investment in the auto companies, Treasury officials stated that the rest of OFS is available to "backfill" as necessary and acts as a program office for Treasury's investment in the auto industry. However, OFS is not a dedicated program office for overseeing Treasury's investment in Chrysler and GM, in that it has responsibilities for Treasury's investments in other companies. Treasury officials also stated that the reduction in the number of staff on the auto team has been a reflection of the team's reduced workload now that the intensive process of restructuring the companies is over and that the size of the team required for monitoring the government's investment is smaller than for a restructuring process.

Because of the particular needs of the auto companies and the unprecedented nature of providing such assistance, Treasury hired or contracted with a number of individuals with expertise in the auto industry, equity investment, and relevant areas of law throughout the first half of calendar year 2009 as Treasury assessed Chrysler's and GM's financial condition, assembled financing packages for the companies, and helped with restructuring efforts. When Treasury was heavily involved in the restructuring of the companies, Treasury's auto team consisted of 12 professional staff and 4 administrative staff, and it used the services of investment banking, consulting, and law firms. Since those agreements have been finalized and the workload has declined, two-thirds of the original professional staff has left, leaving Treasury with 4 of the original professional staff dedicated to auto issues, other OFS staff who have also helped monitor these investments, and limited use of investment or

industry consultants. The leader of the auto team, who also serves as a senior adviser to the President on the auto industry, was recently appointed Senior Counselor for Manufacturing Policy, requiring him to split his time between the auto team and his new role. Moreover, Treasury officials told us that there will likely be additional staff reductions in the future because they plan to disband the auto team over time as other OFS staff assume the role of monitoring the financial condition of the companies. In commenting on a draft of this report, Treasury officials stated that in light of recent and expected staff turnover, they are prepared to hire personnel from within Treasury or externally to fill Treasury's monitoring function. Nonetheless, given the wind-down of the auto team—and the associated loss of dedicated staff with industry- and company-specific knowledge and expertise—we are concerned that Treasury may not have sufficient expertise to actively oversee and protect the government's ownership interests, including determining when and how to divest these interests.

In general, Treasury has faced challenges hiring the full complement of staff necessary to administer the TARP programs, in part because qualified candidates can often find a more competitive salary with a financial regulator, which has the authority to establish its own compensation programs without regard to certain requirements applicable to executive branch agencies. We have reported on the importance of Treasury documenting the skills and competencies it needs to administer the program and continuing to expeditiously hire personnel.²⁶ The quality of human capital policies and practices including, but not limited to, hiring affects the control environment. A strong control environment will depend, in part, on the managerial and other staff hired.²⁷ Treasury has made progress in hiring staff to administer TARP duties, but Treasury officials have not formally evaluated whether the staffing level to oversee AIFP is appropriate for their current and projected needs. Officials said that they had considered future needs and determined that Treasury's monitoring role could be achieved with fewer staff. In response to a request for documentation of their evaluation of staffing needs, Treasury provided us with a document showing the current and projected number of staff working on AIFP, but this document did not show how Treasury

²⁶GAO, *Troubled Asset Relief Program: Status of Efforts to Address Transparency and Accountability Issues*, [GAO-09-296](#) (Washington, D.C.: Jan. 30, 2009).

²⁷GAO, *Standards for Internal Control in the Federal Government*, [GAO/AIMD-00-21.3.1](#) (Washington, D.C.: November 1999).

determined the appropriate number of staff or areas of expertise that would be needed for future workloads. In commenting on a draft of this report, Treasury officials stated that they had not had difficulty hiring qualified professionals to work on the auto team and did not anticipate having difficulties finding qualified staff in the future should the need arise for additional hiring.

- **Monitor and communicate company, industry, and economic indicators.** All of the experts we spoke with emphasized the importance of monitoring company indicators such as financial and operating performance, automotive industry-wide indicators such as vehicle sales, and broader economic indicators such as interest rates and consumer spending. Monitoring these indicators allows investors, including Treasury, to determine how well the companies, and in turn the investment, are performing in relation to the rest of the industry. It also allows an investor to determine how receptive the market would be to an equity sale, something that contributes to the price at which the investor can sell. Some experts also noted that Treasury should assign an individual with expertise in investment banking or private equity to be in charge of monitoring these metrics, which Treasury officials told us they had done. In addition to monitoring the investment, communicating a clearly articulated vision for TARP programs is important, as we have previously reported. Understanding the different TARP programs and the distinct rationale for each can be difficult for Congress, the markets, and the public, because many of the programs address specific developments and have similar guidelines and terms. Specifically for AIFP, what Treasury's goals are for its investment in Chrysler and GM, and in turn, which indicators and metrics are necessary to determine progress in achieving these goals, is important information for Congress and the public to have. Although Treasury provides public information on activities in the TARP programs, including AIFP, through its legally mandated monthly reports to Congress, transaction reports, and others, these reports do not provide information on the indicators Treasury plans to use in assessing its goals for its auto investments. Identifying these indicators for Congress, and sharing as much of this information as possible, while still respecting the need for certain business sensitive information not to be released, could help Congress and the public better understand whether the investment in the auto companies has been successful.

Treasury's auto team plans to closely monitor the performance of Chrysler and GM by way of financial reports from the companies such as balance sheets and liquidity statements, which, in general, measure the financial health of a company at the time of the statement. It also plans to monitor

industry and broader economic indicators. The auto team plans to use this information to alert Chrysler and GM management to any problematic areas in the companies, and to help determine the best time and strategy for divesting the government's interest. Finally, Treasury officials have not informed Congress which components of the reporting package will be shared or how they plan to use the information contained in these packages to assess and monitor the companies' performance. In commenting on a draft of this report, Treasury noted that it will not make the components of these reports public because the release of certain information could put Chrysler and GM at a competitive disadvantage, thereby harming the potential recovery of taxpayer funds. Treasury further noted that the companies will publicly report on certain financial information—similar to what publicly traded companies report—in the future.

- **To the extent possible, determine the optimal time and method to divest.** One of the key components of an exit strategy is determining how and when to sell the investment. Given the many different ways to dispose of equity—through public sales, private negotiated sales, all at once, or in batches—experts noted that the seller's needs should inform decisions on which approach is most appropriate. For example, if an investor is interested in selling quickly but the company has not demonstrated the level of performance necessary for a successful initial public offering (IPO), in which the company first sells stock to the public, the investor should consider other sale options, such as a private sale. According to experts, a successful IPO requires that the companies show signs of earnings growth and future profitability, something that will take a considerable amount of time for Chrysler and GM, as they only recently emerged from bankruptcy. Attracting investors to the market is essential because lack of sufficient investor interest may result in depressed value of shares. Experts noted that a convergence of factors related both to financial markets and to the company itself create an ideal window for an IPO; this window can quickly open and close and cannot easily be predicted. This requires constant monitoring of up-to-date company, industry, and economic indicators when an investor is considering when and how to sell. As Treasury evaluates these indicators, considering all possible sale strategies is important.

Members of the auto team said that they plan to consider indicators such as profitability and prospects, cash flow, market share, and market conditions to determine the optimal time and method of sale. The ultimate decision on when and how to sell will be made by the Secretary of the Treasury, but auto team staff will be in charge of monitoring these

indicators and recommending a strategy to the Secretary and Assistant Secretary for Financial Stability. Although Treasury officials said they plan to consider all options for selling the government's ownership stakes in Chrysler and GM, they noted that they believe the most likely scenario for GM is to dispose of Treasury's equity in the company through a series of public offerings. Treasury has publicly discussed the possibility of selling part of its equity in the company through an IPO that would occur sometime in 2010. However, by publicly discussing a method and a time for a sale of GM shares now, the extent to which Treasury is using the indicators to inform method and timing decisions is unclear. Moreover, two of the experts we spoke with said GM might not be ready for a successful IPO by 2010, because it may be too early for the company to have demonstrated sufficient progress to attract investor interest, and two other experts noted that 2010 would be the earliest possible time for an IPO. For Chrysler, Treasury officials noted that the department is more likely to consider a private sale because its equity stake is smaller, and several of the experts we interviewed noted that non-IPO options could be possible for Chrysler, given the relatively smaller stake Treasury has in the company (9.85 percent, versus its 60.8 percent stake in GM) and the relative affordability of the company. In commenting on a draft of this report, Treasury officials stated that they were aware of the diversity of opinions on divesting the government's interest in the auto companies and would make an appropriate determination to maximize the taxpayers' return. To achieve the maximum return for taxpayers, Treasury also said it plans not to disclose more information about its strategy to divest its ownership interests than is necessary.

Treasury officials said that on the basis of their analysis of the companies' future profitability, they believe that Chrysler and GM will be able to attract sufficient investor interest for Treasury to sell its equity. With regard to the possibility that there may not be sufficient investor interest, Treasury officials said they would monitor the financial markets and the companies' operations in order to identify any issues that could affect profitability, and work with the companies' boards of directors and management to address them. In the event that the companies do not return to profitability in the time frame Treasury has projected, Treasury officials said that they will consider all commercial options for disposing of Treasury's equity, including liquidation.

- **Manage investments in a commercial manner.** Experts emphasized the importance of Treasury resisting external pressures to focus on public policy goals over focusing on its role as a commercial investor. For example, some experts said that Treasury should not let public policy goals such as job

retention interfere with its goals of maximizing its return on investment and making Chrysler and GM strong and viable companies. They said that this is especially important because making the companies financially strong and competitive may require reducing the number of employees. Nevertheless, one expert suggested that Treasury should consider public policy goals and include the value of jobs saved and other economic benefits from its investment when calculating its return, since these goals, though not important to a private investor, are critical to the economy.

As long as Treasury maintains ownership interests in Chrysler and GM, it will likely be pressured to influence the companies' business decisions. Treasury has said that it plans to manage its investment in Chrysler and GM in a commercial way. Yet Treasury faces external pressures, such as to prioritize jobs over maximizing its return. For example, Congress is currently considering a number of bills to restore automotive dealers' contracts terminated in restructuring, and Treasury officials noted that they receive frequent calls from Members of Congress expressing concern about dealership closings. To protect Treasury's investment from these external pressures, a recent Congressional Oversight Panel report recommended that Treasury hold its equity interests in the auto companies in a trust managed by an independent trustee.²⁸ Treasury officials told us they cannot currently establish a trust managed by independent trustees because of a requirement in EESA that states that troubled assets are subject to the supervision of the Secretary of the Treasury.²⁹ The officials stated that if Treasury created a trust with the assets managed by independent trustees, the Secretary would not be able to exercise his authority over the assets as required by law. Congress is considering legislation that would authorize and require the Secretary to transfer to a limited liability company all equity in TARP recipients in which the government has a certain equity interest as a result of TARP assistance. The bills further provide that the equity is to be managed in trust for the benefit of taxpayers.³⁰ Treasury officials told us they

²⁸Congressional Oversight Panel, *September Oversight Report: The Use of TARP Funds in the Support and Reorganization of the Domestic Automotive Industry* (Washington, D.C.: Sept. 9, 2009).

²⁹"In order to provide the Secretary with flexibility to manage troubled assets in a manner designed to minimize cost to taxpayers, the Secretary is authorized to establish vehicles, subject to supervision by the Secretary, to purchase, hold, and sell troubled assets and issue obligations." Pub. L. No. 110-343, Sec. 101(c)(4), codified at 12 U.S.C. § 5211(c)(4).

³⁰In order for a trust to be established, the government would have to have at least a 15 percent ownership in the company as a result of TARP assistance in the House bill and at least a 20 percent ownership interest as a result of TARP assistance in the Senate bill. See H.R. 3594, 111th Cong. (2009) and S. 1280, 111th Cong. (2009).

believe their planned approach for managing Treasury's equity in Chrysler and GM is sufficient for now.

Regardless of the sales strategies used, the companies will have to grow substantially in order to reach values at which Treasury would recover the entirety of its equity investment upon sale of its equity, which Treasury and others consider to be unlikely. On the basis of our analysis, shown in table 5, we estimate that Chrysler and GM would need to have a market capitalization of \$54.8 billion and \$66.9 billion, respectively, for Treasury to earn enough on the sale of its equity to break even.³¹ A recent Congressional Oversight Panel report reached similar conclusions on what the companies would have to be worth.³² As a point of reference for these values, in 1997, the last year Chrysler was a publicly traded company, its market capitalization value ranged between \$23.1 billion and \$31.7 billion, and in 1998, when it merged with Daimler, it was valued at an estimated \$37 billion. GM, at its peak in 2000, had a market capitalization of \$57 billion.³³ In commenting on a draft of this report, Treasury officials noted that the companies' past equity values are not comparable to today's equity values because the companies have substantially restructured their balance sheets through bankruptcy. Although we recognize the changes the companies have experienced in recent years, we believe this information provides a sense of the magnitude of growth that will be required of the companies.

³¹Our analysis included all funds Treasury has provided to the auto companies that will be repaid through a combination of debt and equity. We assume that new Chrysler and new GM will repay all debts, and that the debts of old Chrysler and old GM will not be repaid, including \$5.4 billion to old Chrysler and \$986 million to old GM. As a result, Treasury's equity will have to be worth its total investments minus projected repayments of principal and preferred stock. This analysis excludes funds provided for the Supplier Support Program and the Warranty Commitment Program, since these funds were issued as loans and will be paid back as such. In addition, this analysis does not take into account the cost or opportunity cost to Treasury of lending, any interest Treasury should or could charge to the automakers on the portion of its investment that has been converted into equity, the present value of the investment, or the value of any social costs or benefits resulting from the investment. If Fiat achieves its operating goals and earns an additional 15 percent equity, Treasury's equity stake will decline to 8 percent, meaning that Chrysler's total equity value would need to reach \$57 billion for Treasury to recoup its investment.

³²Congressional Oversight Panel, *September Oversight Report: The Use of TARP Funds in the Support and Reorganization of the Domestic Automotive Industry*.

³³Evercore Group, LLC, the financial services company that estimated GM's future value for the bankruptcy court, concluded that new GM would be worth between \$59 billion and \$77 billion in 2012.

Treasury’s own analysis suggests that the circumstances necessary for the companies to reach market capitalizations high enough for Treasury to fully recover its equity investment are unlikely. Treasury officials also noted that considering the companies’ enterprise values—a measure of a business’s total value, including the value of equity and debt—in addition to equity value is important, because enterprise value takes into account the likelihood of repayment of loans and other obligations extended to the companies as well as the value of equity stakes.³⁴

Table 5: Value of Chrysler and GM Equity Required for Treasury to Recoup Its Investment

(Dollars in billions)

Description of funding	Treasury investment	Amount in term loans and preferred stock	Equity stake (percent)	Amount equity stake must be worth to recoup equity investment (<i>investment—loans and preferred stock</i>)	Equity value of company necessary to recoup investment (<i>amount equity must be worth/60.8 percent for GM and 9.85 percent for Chrysler</i>)
Total loans to Chrysler	\$12.5	\$7.1	9.85	\$5.4^a	\$54.8
Loans to Chrysler prior to bankruptcy	4.0				
Loans to Chrysler after bankruptcy	8.5				
Total loans to GM	49.5	8.8	60.8	40.7	66.9
Loans GM prior to bankruptcy	19.4				
Loans to GM after bankruptcy	30.1				

Source: GAO analysis of Treasury information.

^aThis value does not take into account any repayments Treasury will receive from the payment-in-kind interest that will accumulate over the life of the \$7.1 billion loan, (\$17 million per quarter), the additional \$288 million note, or the value of Treasury’s interest in Chrysler Financial’s equity (the greater of \$1.375 billion or 40 percent of the equity). These figures together would be worth \$833 million, thereby reducing the amount Treasury’s equity stake would have to be worth from \$5.4 billion to \$4.6 billion, and reducing the equity value Chrysler would have to attain from \$54.8 billion to \$46.7 billion.

However, these estimates do not take into account other benefits and costs that are more difficult to measure, such as the impact of Treasury’s investment on jobs and local and national economies and the opportunity

³⁴In June, the Congressional Budget Office (CBO) estimated that the federal government would recoup only 27 percent of its initial investment in the auto industry. CBO’s analysis relies on data from the auto companies prior to bankruptcy to estimate the likelihood of repayment in the future. Chrysler and GM had poor credit ratings and significant debts prior to bankruptcy, so the average projected repayment is only 27 cents on the dollar.

costs Treasury incurred in providing financial assistance. The impact on the economy is difficult to measure because, according to the Council of Economic Advisors, it involves predicting what employment and economic performance would have been without government investment. Nevertheless, a more comprehensive analysis that takes these effects into account would yield a richer picture of the value of Treasury's net investment and net return, especially given that the government's goal upon first providing assistance to the auto industry was to prevent economic disruption.

Conclusions

Treasury's substantial investment and other assistance, including loans from the Canadian government and concessions from the UAW, have contributed to the current stability of Chrysler and GM. However, because of the challenges continuing to face the auto industry—including the still recovering economy and weak demand for new vehicles—the ultimate impact that the assistance will have on the companies' profitability and long-term viability is uncertain. Although the immediate crisis of helping Chrysler and GM maintain solvency has passed for now and Treasury has no plans for further financial assistance to the companies, the significant sums of taxpayer dollars that are invested in these companies warrant continued oversight. It is critical that Treasury remain focused on protecting the government's interest in the coming months as Chrysler and GM work to become profitable. However, most of the original staff on Treasury's auto team either have left Treasury or may do so in the future. Treasury officials told us that OFS personnel will continue to provide oversight. Given the substantial decline in the number of staff and lack of dedicated staff for this oversight moving forward, however, we are concerned whether Treasury will continue to have the needed expertise to provide oversight of the use of government funds, assess the financial condition of the auto companies, and develop strategies to divest the government's interests. Monitoring industry conditions and determining when to divest will require a certain expertise, including a robust monitoring function through which detailed financial data from Chrysler and GM are reviewed on a regular basis. Transparency as to how the companies are being monitored also will be important to ensuring accountability and providing assurances that the taxpayers' investment—including both the loans to and equity in the companies—is being appropriately safeguarded. While we recognize that not all information that the companies report to Treasury should be made public because of concerns about disclosing proprietary information in a competitive market, Treasury's approach for evaluating the success of the AIFP should be as transparent as possible, given the large taxpayer investment.

While Treasury has stated that it plans to review all possible options for divesting itself of its ownership interest in Chrysler and GM, Treasury officials have focused primarily on an IPO for GM, both in our discussions with them and in their public statements. However, given the complexity of the economy and the financial markets, considering all of the options in the context of the companies' financial progress and current financial conditions will be important for Treasury. The past year has indicated the extent to which a company's financial situation can change within a period as short as a few months. Given the fluidity of conditions and the number of factors that will need to be considered when determining how and when to divest, it is important that Treasury identify the criteria it will use to evaluate the optimal method and timing for selling the government's ownership stake. Determining when and how to divest the government's ownership stake will be one of the most important decisions Treasury will have to make regarding the federal assistance provided to the domestic automakers, as this decision will affect the overall return on investment that taxpayers will realize from aiding these companies. Currently, the value of the companies would have to grow tremendously for Treasury to approach breaking even on its investment, requiring that Treasury temper any desire to exit as quickly as possible with the need to maintain its ownership interest long enough for the companies to demonstrate sufficient financial progress. Therefore, it is important that Treasury be able to explain why and how it decided to divest when the time arrives, and clearly established criteria will help Treasury communicate this decision to Congress and the public at the appropriate time to prevent this disclosure from negatively affecting the full recovery for taxpayers.

Recommendations for Executive Action

To improve the stewardship of the federal government's substantial financial investment in the auto industry, we recommend that the Secretary of the Treasury take the following three actions:

- Ensure that the department has the expertise needed to adequately monitor and divest the government's investment in Chrysler and GM, and obtain needed expertise in areas where gaps are identified. In addressing any existing or future expertise gaps, Treasury should consider both in-house and external expertise.
- Report to Congress on how it plans to assess and monitor the companies' performance to help ensure the companies are on track to repay their loans and to return to profitability. In reporting to Congress, Treasury should balance the need for transparency with the need to protect certain proprietary information that would put the companies at a competitive

disadvantage or negatively affect Treasury's ability to recover the taxpayers' investments.

- Develop criteria for evaluating the optimal method and timing for divesting the government's ownership stake in Chrysler and GM. In applying these criteria, Treasury should evaluate the full range of available options, such as IPOs or private sales.

Agency Comments and Our Evaluation

We provided a draft of this report to the Department of the Treasury for review and comment. Treasury generally agreed with the report's findings, conclusions, and recommendations, and provided written comments, which are reprinted in appendix II. Treasury also provided technical comments and clarifications via e-mail, which we incorporated as appropriate. In their technical comments, Treasury officials emphasized that they believe they have individuals within OFS who can provide the needed oversight of the government's investments in Chrysler and GM. We added Treasury's views on its current staffing and expertise levels to the final report. While we recognize that OFS employs a number of qualified individuals who have worked on the government's efforts to stabilize the auto industry, we nevertheless remain concerned about the loss of industry- and company-specific knowledge and expertise that Treasury has experienced and will continue to experience with the wind-down of the auto team. Such knowledge and expertise will be critical as Treasury monitors the financial health of Chrysler and GM and develops plans to divest its ownership interests in these companies. We are pleased that Treasury—in both its written and technical comments—commits to continue to take steps to assess and maintain the expertise required to monitor and manage Treasury's investments in these companies.

In their written and technical comments, Treasury officials also stressed the need to strike a balance between the goal of transparency and the need to avoid compromising the competitive positions of Chrysler and GM or the government's ability to recover its investments. We recognize the need to strike this balance and added language to the final report, including one of our recommendations, to acknowledge this difficult trade-off. We believe our revised recommendation that Treasury report to Congress on its plans to monitor the performance of the companies provides Treasury with sufficient flexibility to strike the appropriate balance.

We also provided relevant portions of a draft of this report to SEC, Chrysler, and GM for their review and comment. SEC, Chrysler, and GM

provided technical comments and clarifications that we incorporated as appropriate.

We are sending copies of this report to other interested congressional committees and members, the Department of the Treasury, and others. The report also is available at no charge on the GAO Web site at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact Katherine Siggerud at (202) 512-2834 or siggerudk@gao.gov or A. Nicole Clowers at (202) 512-2843 or clowersa@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix III.



Gene L. Dodaro
Acting Comptroller General
of the United States

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Committee on Ways and Means
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Appendix I: Financial and Industry Experts GAO Interviewed

Name	Affiliation
John Casesa	Casesa Shapiro Group
Justin Mirro	Moelis & Company
Thomas Maloney	Deutsche Bank
Warren Estey	Deutsche Bank
Rod Lache	Deutsche Bank
Henry Miller	Miller Buckfire
Durc Savini	Miller Buckfire
Eric Selle	J.P.Morgan
Himanshu Patel	J.P.Morgan
Charles Bowsher	Former Comptroller General of the United States
William Isaac	Former Chairman of the Federal Deposit Insurance Corporation

Source: GAO.

Appendix II: Comments from the Department of the Treasury



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

October 23, 2009

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

Dear Mr. McCool:

The Treasury Department (Treasury) appreciates the opportunity to review the GAO's latest report on Treasury's Troubled Asset Relief Program (TARP), entitled *Auto Industry: Continued Stewardship Needed as Treasury Develops Strategies for Monitoring and Divesting Financial Interests in Chrysler and GM*. Treasury welcomes the recognition by the GAO that Treasury through TARP investments has "contributed to the stability of Chrysler and GM." There is important work ahead and the GAO's recommendations are constructive as Treasury continues to implement its Auto Industry Financing Program.

Treasury continues to assess and take steps to maintain the expertise required to adequately monitor and manage Treasury's interests in Chrysler and GM. In addition, Treasury will continue to monitor and evaluate the performance of Chrysler and GM with a view toward determining the appropriate method and timing for divesting Treasury's interests in the auto companies. Treasury also intends to develop an approach for reporting on its investments in the auto industry that strikes an appropriate balance between our goal of transparency and the need to avoid compromising either the competitive positions of these companies or Treasury's ability to recover funds for taxpayers.

Once again, Treasury appreciates the opportunity to review this report and the GAO's thoughtful recommendations. Treasury also appreciates the GAO's close oversight of TARP as Treasury develops and implements its policies to stabilize the financial system. We look forward to continuing this constructive dialogue.

Sincerely,

A handwritten signature in black ink, appearing to read "Duane Morse".

Duane Morse
Chief Risk and Compliance Officer
Office of Financial Stability

Appendix III: GAO Contacts and Staff Acknowledgments

GAO Contacts

Katherine A. Siggerud, (202) 512-2834 or siggerudk@gao.gov

A. Nicole Clowers, (202) 512-2834 or clowersa@gao.gov

Staff Acknowledgments

In addition to the contacts named above, Raymond Sendejas, Assistant Director; Orice Williams Brown; Sarah Farkas; Timothy Guinane; Heather Halliwell; Terence Lam; Matthew McDonald; Susan Michal-Smith; Joshua Ormond; and Susan Sawtelle made important contributions to this report.

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