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TROUBLED ASSET RELIEF PROGRAM

Continued Attention Needed to Ensure the Transparency and Accountability of Ongoing Programs

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Chairman Baucus, Ranking Member Grassley, and Members of the Committee:

I am pleased to be here today to discuss our work on the Troubled Asset Relief Program (TARP), which Congress established on October 3, 2008 in response to the financial crisis that threatened the stability of the U.S. financial system and the solvency of many financial institutions. Under the original TARP legislation, the Department of the Treasury (Treasury) had the authority to purchase or insure $700 billion in troubled assets held by financial institutions.[1] As we have seen, since TARP's inception Treasury has chosen to use those funds for a variety of activities, including injecting capital into key financial institutions, implementing programs to address problems in the securitization markets, providing assistance to the automobile industry and American International Group, Inc. (AIG), and working to help homeowners struggling to keep their homes. Today, some of these programs have been discontinued and others are winding down, but others—such as homeownership preservation programs—may continue for some time. Treasury has also seen some participating institutions repay their TARP funds as they recover their financial health. The prospect for repayment from some other institutions, both large and small, remains unclear.

The Emergency Economic Stabilization Act (the act) that authorized TARP required GAO to report at least every 60 days on findings from our oversight of actions taken under the programs.[2] We have been monitoring

[1]The Emergency Economic Stabilization Act of 2008 (the act), Pub. L. No. 110-343, 122 Stat. 3765 (2008), 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, 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. The Dodd-Frank Wall Street Reform and Consumer Protection Act, H.R. 4173, 111th Cong, passed by both the House and Senate and expected to be signed into law by the President this week, would (1) reduce Treasury's authority to purchase or insure troubled assets to $475 billion and (2) prohibit Treasury, under the act, from incurring any additional obligations for a program or initiative unless the program or initiative had already been initiated prior to June 25, 2010.

[2]The act requires the U.S. Comptroller General to report at least every 60 days, as appropriate, on findings resulting from oversight of TARP's performance in meeting the act's purposes; the financial condition and internal controls of TARP, its representatives, and agents; the characteristics of asset purchases and the disposition of acquired assets, including any related commitments entered into; TARP's efficiency in using the funds appropriated for its operations; its compliance with applicable laws and regulations; and its efforts to prevent, identify, and minimize conflicts of interest among those involved in its operations.

TARP programs since their inception and our reports have highlighted challenges facing many of these programs. To date, we have issued over 25 reports and testimonies related to TARP and made over 50 recommendations to improve the transparency and accountability of its operations.[3] My statement today draws primarily on 7 reports we have issued since October 2009.[4] Specifically, this statement focuses on (1) the nature and purpose of activities that have been initiated under TARP and ongoing challenges, (2) the process for making decisions related to unwinding TARP programs, and (3) indicators of credit conditions in markets targeted by TARP programs. To do our work, we reviewed our prior reports and other documents provided by Treasury's Office of Financial Stability (OFS) and conducted interviews with Treasury and OFS officials. In addition, we have updated the program's receipts and disbursements through June 30, 2010, and indicators of credit markets as of July 1, 2010. We conducted these performance audits between July 2009 and June 2010 and updated information in July 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Summary

Treasury has initiated a number of programs under TARP, some of which have ended or are being unwound. Others—especially those aimed at preserving homeownership and encouraging lending to small businesses—

[3]Appendix I lists our reports and selected testimonies since the program was enacted.

[4]See GAO, *Troubled Asset Relief* Program: *One Year Later, Actions Are Needed to Address Remaining Transparency and Accountability Challenges*, GAO-10-16 (Washington, D.C.: Oct. 8, 2009); *Troubled Asset Relief Program: Continued Stewardship Needed as Treasury Develops Strategies for Monitoring and Divesting Financial Interests in Chrysler and GM*, GAO-10-151 (Washington, D.C.: November 2, 2009); *Troubled Asset Relief Program: Treasury Needs to Strengthen Its Decision-making Process on the Term Asset Backed Securities Loan Facility*, GAO-10-25 (Washington, D.C.: Feb. 5, 2010); *Troubled Asset Relief Program: Automaker Pension Funding and Multiple Federal Roles Pose Challenges for the Future*, GAO-10-492 (Washington, D.C.: April 6, 2010); *Troubled Asset Relief Program: Update of Government Assistance to AIG*, GAO-10-475 (Washington, D.C.: Apr. 27, 2010); *Troubled Asset Relief Program: Further Actions Needed to Fully and Equitably Implement Foreclosure Mitigation Programs*, GAO-10-634 (Washington, D.C.: June 25, 2010); *Troubled Asset Relief Program: Treasury's Framework for Deciding to Extend TARP Was Sufficient, but Could be Strengthened for Future Decisions*, GAO-10-531, (Washington, D.C.: June 30, 2010).

will continue. Many participating institutions have repaid the funds they received, reducing the federal government's exposure under TARP. Since TARP was authorized, Treasury has disbursed $385 billion for loans and equity investments. As of June 30, 2010, Treasury had received almost $25 billion in dividend and interest payments and warrant repurchases, as well as more than $198 billion in repayments. Among the programs no longer making commitments are the Capital Purchase Program (CPP) and Targeted Investment Program (TIP), while the Home Affordable Modification Program (HAMP) and new small business lending initiatives are expected to continue for some time. Although Treasury has received significant repayments of the funding it provided to financial institutions, some investments and loans could still result in substantial losses to the government. We have been monitoring TARP programs since their inception, including the financial condition of those institutions that received significant assistance. In particular, Chrysler Group LLC and General Motors Company (GM) have shown some indications of progress toward returning to profitability, such as doing better than they and Treasury had initially projected in terms of revenues, operating earnings, and cash flow. However, the extent to which the federal government will fully recoup its investment in the auto industry is uncertain, and the companies face several challenges in the coming years, including returning to and sustaining strong growth and profitability. Since early 2009, we have also been monitoring the status of federal assistance to AIG and its financial condition using indicators we developed. In April 2010, we reported that our indicators showed that AIG's financial condition has remained relatively stable largely due to the federal assistance provided by the Federal Reserve and Treasury, but the extent to which the federal government will recoup its investment remains uncertain and will not only depend on the AIG's financial condition but also other market factors such as the performance of the insurance sectors and the credit derivatives markets that are beyond the control of AIG or the government.

Many of our reports have also highlighted the challenges facing TARP programs and made recommendations to enhance transparency and accountability of its programs. For example, we have noted several challenges facing HAMP and have reported that the program has made limited progress, has suffered from inconsistent program implementation, and continues to confront additional challenges. These include converting trial modifications to permanent status and ensuring program stability and effective program management. We reported that while Treasury had taken some steps to address these challenges it urgently needed to finalize and implement the various components of HAMP and ensure the transparency and accountability of these efforts. We will continue to monitor these programs and have ongoing work on several facets of TARP, including those initiatives that have a small business focus.

We have also reviewed Treasury's framework for deciding to extend TARP beyond December, 31, 2009, and found that the process was sufficient but could be strengthened for similar decisions that will need to be made in the future. Specifically, we found that the extent of coordination could be enhanced and formalized between Treasury and the Federal Deposit Insurance Corporation (FDIC) and recommended that Treasury formalize coordination with FDIC for future decisions. Although the authority for TARP is set to expire soon, Treasury will continue to face decisions in winding down programs, and many of these decisions will require interagency coordination. Because TARP will be unwinding concurrently with other important regulatory interventions, decisions about the sequencing of the exits from the programs will require regulators to work closely together. We also noted that Treasury could strengthen its analytical framework by identifying clear objectives for small business initiatives and explaining how relevant indicators motivated TARP program decisions.

We have noted in past reports that some of the anticipated effects of TARP on credit markets and the economy had materialized and that some securitization markets had experienced a tentative recovery. Indicators we have been monitoring suggest that credit markets have been able to sustain their recovery despite the winding down of key programs initiated by the Federal Reserve, Treasury, FDIC and others. For example, the cost of credit and perceptions of risk (as measured by premiums over Treasury securities) have fallen in interbank, mortgage, and corporate debt markets. Further, the volume of credit, as measured by new mortgage loans and asset-backed securities (ABS), has improved since the first TARP program, CPP. Unfortunately, by any measure foreclosure and delinquency statistics for residential housing remain well above their historical averages despite programs such as HAMP. However, a slow recovery does not necessarily mean that TARP is ineffective, because in absence of TARP it is possible that foreclosure and delinquency rates would be higher. Moreover, full recovery will likely take some time given the build up of imbalances in the real estate, fiscal and household sectors over several years. Finally, because any new TARP activity will be limited to home ownership preservation and small business lending programs, we will also continue to monitor indictors such as foreclosure and delinquencies as potential measures of the programs' success.

Some TARP Programs Are Winding Down, but Others Require Continued Attention

Since TARP was authorized, Treasury has implemented a range of programs aimed at stabilizing the financial system and preserving homeownership. As of June 30, 2010, it had disbursed $385 billion for TARP loans and equity investments, and Treasury has already recouped some of these disbursements (table 1). As of June 30, 2010, Treasury had received almost $25 billion in dividend and interest payments and warrant repurchases and more than $198 billion in repayments.

Table 1: TARP Program Disbursements, Repayments, and Additional Proceeds, as of June 30, 2010 (dollars in billions)

Program	Total Cash Disbursed	Repayments[1]	Additional Proceeds[1]
Capital Purchase Program (CPP)	$204.9	$146.9	$17.3
Targeted Investment Program	40.0	40.0	4.3
Automotive Industry Financing Program	79.7	11.2	2.4
American International Group Investments	47.5	0.0	0.0
Home Affordable Modification Program	0.3	N/A	N/A
SBA 7(a) Securities Purchase Program	0.1	<0.1	<0.1
Term Asset-Backed Securities Loan Facility	0.1	0.0	0.0
Public Private Investment Program	12.4	0.4	0.1
Asset Guarantee Program (AGP)[2]	0.0	0.0	0.6
Totals	**$385.0**	**$198.5**	**$24.7**

Source: Department of the Treasury

[1]This table shows the TARP activity from inception through June 30, 2010. Additional Proceeds includes dividends from equity securities, interest income from loans and securities, proceeds from repurchases of warrants and warrant preferred stock, and proceeds from warrant auctions. Treasury has sold 2.6 billion shares of Citigroup common stock for $10.5 billion, of which $8.5 billion is included in “Repayments,” and $2.0 billion, which represents gains on the sales, is included in “Additional Proceeds.” As of June 30, 2010, Treasury still owned 5.1 billion shares of Citigroup common stock.

[2]The “Additional Proceeds” for AGP include dividends relating to Citigroup preferred securities received in consideration for an asset guarantee, and a $276 million fee received from Bank of America relating to the termination of a potential loss-sharing agreement. On December 23, 2009, the Citigroup asset guarantee was terminated. Accordingly, as of June 30, 2010, TARP has no asset guarantee outstanding. Pursuant to the Citigroup asset guarantee termination, Treasury retained $2.2 billion in Citigroup trust preferred securities, and subject to certain conditions, the FDIC may transfer $800 million of additional Citigroup trust preferred securities to Treasury at the close of Citigroup’s participation in the FDIC’s Temporary Liquidity Guarantee Program.

Some programs have been terminated, such as the bank capital programs, while others are ongoing and could continue for some time. Furthermore, Treasury’s investments in some financial institutions could still result in losses to the government.

Bank capital programs. Bank capital programs authorized under TARP, such as CPP, TIP, and the Capital Assistance Program (CAP), were established to help stabilize the financial system and ensure the flow of credit to businesses and consumers. Treasury is no longer disbursing funds through these programs because according to Treasury, they have largely achieved their goals of both stabilizing the financial system and individual institutions.

- CPP was intended to restore confidence in the banking system by increasing the amount of capital in the system. Treasury provided capital to qualifying financial institutions by purchasing preferred shares and warrants or subordinated debentures. Under the CPP, Treasury disbursed about $205 billion to 707 financial institutions nationwide from October 2008 through December 2009. Treasury has received about $147 billion in repayments and about $17 billion in dividend and interest payments and warrant income as of June 30, 2010. In our past reports, we have made numerous recommendations to strengthen transparency and accountability of this key TARP program. For instance, we recommended that Treasury report whether financial institutions' activities are generally consistent with the purposes of program. We also recommended that Treasury consider making the warrant valuation process transparent to the public by disclosing details regarding the warrant repurchase process. In both of these areas, Treasury has addressed these recommendations by releasing bank survey information on lending and detailed reports on warrant repurchases. However, as institutions leave the program, which includes the largest banks, they are no longer required to report information on lending to Treasury.

- TIP was designed to foster market stability and thereby strengthen the economy by investing in institutions that Treasury deemed critical to the functioning of the financial system on a case-by-case basis. Only two institutions—Bank of America Corporation and Citigroup Inc.—participated in this program and each received $20 billion in capital investment. Both institutions repaid Treasury for these investments in December 2009.

- CAP was designed to further improve confidence in the banking system by helping ensure that the nation's largest 19 U.S. bank holding companies had sufficient capital to cushion themselves against larger than expected future losses, as determined by the Supervisory Capital Assessment Program (SCAP)—or "stress test"—conducted by the federal banking regulators. CAP made TARP funds available to any institution not able to raise private capital to meet SCAP requirements. In the end, 9 of the 10 institutions that needed additional capital as a result of SCAP raised over

$70 billion from private sources, and GMAC received additional capital from Treasury under the Automotive Industry Financing Program (AIFP).[5] No CAP investments were made and the program closed on November 9, 2009.

Although these programs are no longer making new investments, the lessons learned from them will be useful in future efforts to stabilize the financial markets and improve ongoing bank supervision. We are currently reviewing the characteristics of firms that received CPP investments and assessing Treasury's procedures for selecting institutions to participate and Treasury's role when institutions elect to repay their CPP investments. We are also evaluating the process that the regulators used to design and implement SCAP, as well as the financial performance of the participating institutions compared to SCAP estimates. As part of this work, we will also assess how regulators and the banks are applying lessons learned from SCAP. We plan to issue reports on CPP and SCAP in the coming months.

Auto Industry Financing Program (AIFP). From December 2008 through June 2009, Treasury committed $81.1 billion to help stabilize the auto industry, including about $62 billion to fund GM and Chrysler while they restructured. In return for the assistance provided to Chrysler and GM, Treasury received 9.85 percent equity in the reorganized Chrysler, 60.8 percent equity and $2.1 billion in preferred stock in the reorganized GM, and $13.8 billion in debt obligations between the two companies. As of June 30, 2010, approximately $11.2 billion of the $79.7 billion disbursed has been repaid to the Treasury.[6] Treasury has stated that it plans to sell its equity in these companies as soon as practicable.

The federal government's ability to recoup its investments will depend on the profitability of GM and Chrysler. Since we last reported on the financial condition of the auto industry in November 2009, Chrysler and GM have shown some indications of progress towards returning to profitability.[7] For example:

[5]On May 10, 2010, GMAC Inc. changed its name to Ally Financial Inc.

[6]This amount includes $413 million repaid under the auto supplier support program and a $1.9 billion repayment from Chrysler Holding (CGI Holding) in settlement of one of the loans that Treasury extended to finance Chrysler LLC, the "Old Chrysler." The CGI Holding payment did not affect the amount of debt owed by the reorganized Chrysler.

[7]GAO-10-151.

- In April and May 2010, both the new GM and new Chrysler released financial statements for 2009 and the first quarter of 2010. Thus far, according to Treasury officials, both companies are doing better than they and Treasury had initially projected in terms of revenues, operating earnings, and cash flow. We are in the process of reviewing the financial statements in more detail for a subsequent report.

- Also in April 2010, GM repaid Treasury the remaining $4.7 billion on the $6.7 billion in debt it owed to Treasury using TARP funds from an escrow account established for the company when it reorganized through the bankruptcy process. According to Treasury officials, GM was legally permitted to keep the remaining $6.6 billion left in the escrow account after this repayment.

- Treasury recently stated that it plans to participate in a GM initial public offering (IPO), in which Treasury, other GM shareholders, and GM will sell a portion of their shares in the company. Treasury stated that it expects the IPO to occur sometime after the third quarter of this year. Treasury has hired the Lazard investment firm to help manage its equity and prepare for the IPO. The proceeds from the sale of Treasury's shares will be used towards repaying the government's initial investment in GM.

While these steps indicate progress in the companies' journey towards profitability, the extent to which the federal government will recoup its investment in the auto industry is uncertain, and the companies' face several challenges in the coming years. For instance:

- In April 2010, we reported on the impact of restructuring on GM's and Chrysler's pension plans.[8] We found that although the new companies had assumed sponsorship of the pension plans, the future of the plans remained uncertain, in part because the companies are legally required to make large contributions to the plans that they will be able to make only if they became profitable again. If the companies are not able to return to viability and their plans are terminated, the Pension Benefit Guarantee Corporation would face the significant financial and administrative costs of taking over these plans.

- While Chrysler and GM sales, and industry sales as a whole, were up substantially in spring 2010 from spring 2009 (up 12 percent for GM and 35 percent for Chrysler), more recent trends are not as positive. For example,

[8] GAO-10-492.

compared with May 2010 levels, June 2010 sales decreased more than usual (13 percent for GM and 12 percent for Chrysler).[9] Industry analysts largely attributed this decline to consumers' wariness about the state of the economy. Improved economic conditions, and in turn, improved vehicle sales, are critical to the future profitability of the companies and the timing and success of an IPO.

To help address these challenges, we made several recommendations in our November 2009 report. For example, we recommended that Treasury ensure that it had adequate staffing to monitor the government's investment in the auto companies and that it communicate to Congress its plans to monitor the companies' performance. In response to our recommendation, Treasury has hired additional staff to monitor the federal government's investment in the auto companies. However, as of July 2010 Treasury had not committed to additional communication with Congress on its future monitoring plans. In addition, we are continuing to monitor the financial condition of the industry and in ongoing work are reviewing the current financial condition and outlook of GM and Chrysler. As part of that ongoing work, we are also reviewing the status of the federal government's efforts to assist workers and communities that have relied on the auto industry for their economic base.

American International Group, Inc (AIG) Investments. One of TARP's earliest programs was designed to provide exceptional assistance aimed at preventing broad disruptions to the financial markets by stabilizing institutions that were considered systemically significant. In particular, in November 2008 Treasury joined the Federal Reserve's effort to provide assistance to AIG, which first began in September 2008 and was restructured in November 2008 and again in March 2009. Since early 2009, we have been monitoring the status of federal assistance to AIG and the company's financial condition using GAO-developed indicators and we have issued two reports that include information on them.[10] In the April 2010 report, our indicators showed that AIG's financial condition had remained relatively stable largely due to the federal assistance from the Federal Reserve and Treasury. AIG is repaying its debt to the federal government, but much of the progress reflects numerous exchanges of

[9]According to Edmunds.com, auto sales typically decrease by approximately 3 percent from May to June each year.

[10]GAO, *Troubled Asset Relief Program: Status of Government Assistance to AIG*, GAO-09-975 (Washington, D.C.: Sept. 21, 2009) and GAO-10-475.

debt that AIG owed the Federal Reserve Bank of New York Revolving Credit Facility for various issues of preferred equity. With this shift from debt to equity, the federal government's exposure to AIG is increasingly tied to the future health of AIG, its restructuring efforts, and its ongoing performance. Similarly, the government's ability to fully recoup the federal assistance is uncertain and will be determined by the long-term health of AIG, the company's success in selling businesses as it restructures, and other market factors such as the performance of the insurance sectors and the credit derivatives markets that are beyond the control of AIG or the government. We will continue to monitor these issues and plan to issue our next report in October 2010.[11]

Home Affordable Modification Program (HAMP). HAMP is Treasury's cornerstone effort under TARP to meet the act's purposes of preserving homeownership and protecting home values and is designed to address the dramatic increase in foreclosures. Treasury announced the framework for HAMP in 2009 and said it would use up to $50 billion of TARP funds to help at-risk homeowners avoid potential foreclosure, primarily by reducing their monthly mortgage payment. Unlike other TARP programs, HAMP expenditures are not investments that will be partially or fully repaid, but rather, expenditures that once made will not be recouped. According to Treasury, $250 million has been disbursed under the HAMP program as of June 30, 2010. In our March 2010 testimony before the House of Representatives' Committee on Oversight and Government Reform, we noted that Treasury continued to face implementation challenges with HAMP.[12] We stated that the program had made limited progress, suffered from inconsistent program implementation, and faced additional challenges going forward. Specifically:

- While the program was anticipated to help 3 to 4 million homeowners, Treasury reported as of the end of May 2010, only 1.2 million homeowners had started trial modifications and 347,000 homeowners had received

[11]In a current study requested by the House Committee on Oversight and Government Reform and the House Committee on Financial Services, we are examining the decision-making process and actions taken by the Federal Reserve in providing aid to the company, as well as considering lessons learned in the federal government's financial rescue of the firm.

[12]GAO, *Troubled Asset Relief Program: Home Affordable Modification Program Continues to Face Implementation Challenges*, GAO-10-556T (Washington, D.C.: Mar. 25, 2010).

permanent modifications. Servicers told us that the continued changes to the program posed significant implementation challenges for them.

- Although HAMP's goal was to create clear, consistent, and uniform guidance for loan modifications across the industry, we reported that there was wide variation in servicers' practices with respect to communicating with borrowers about HAMP, evaluating borrowers who were current or not yet 60 days delinquent on mortgage payments for whether they were in danger of "imminent default," and tracking HAMP complaints.

- Finally, we identified additional challenges that HAMP faced going forward, including converting trial modifications to permanent status, addressing the growing issue of negative equity, limiting redefaults among borrowers who receive modifications, and ensuring program stability and effective program management.

In June 2010, we issued a report that expanded on our March testimony and discussed Treasury's actions to address the challenges that we had outlined in the March hearing.[13] We reported that while Treasury had taken some steps to address these challenges it urgently needed to finalize and implement the various components of HAMP and ensure the transparency and accountability of these efforts. For example, Treasury announced several potentially substantial new HAMP-funded efforts in March 2010, but did not say how many borrowers these programs were intended to reach. In particular, Treasury announced a principal reduction program that could help borrowers with substantial negative equity, but made the program voluntary for servicers. We noted that Treasury needed to ensure that future public reporting on this program provided program transparency and address the potential question of whether borrowers were being treated fairly. In addition, we reported that as Treasury continues with its first-lien mortgage loan modification program and implements other HAMP-funded programs, including the second-lien modification and foreclosure alternatives, it will need to adhere to standards for effective program management and establish sufficient program planning and implementation capacity.

Our June 2010 report contained eight recommendations to Treasury, including that it expeditiously establish specific criteria for imminent

[13]GAO-10-634.

default, specify which HAMP complaints servicers should track, finalize and issue remedies for servicer noncompliance with HAMP requirements, and implement a prudent design for remaining HAMP-funded programs. However, Treasury has yet to fully implement several of the recommendations we made in July 2009 to improve HAMP's effectiveness, transparency, and accountability.[14] For example, we recommended that Treasury consider methods of monitoring borrowers who receive HAMP mortgage loan modifications and continue to have high total household debt (more than 55 percent of their income) to determine whether they obtain the required HUD-approved housing counseling. While Treasury has told us that monitoring borrower compliance with the counseling requirement would be too burdensome, we continue to believe that it is important that Treasury determine whether borrowers are actually receiving counseling and whether the counseling requirement is having its intended effect of limiting redefaults. In addition, we recommended that Treasury place a high priority on fully staffing the Homeownership Preservation Office—the office within Treasury responsible for overseeing HAMP implementation—and noted that having enough staff with appropriate skills was essential to governing HAMP effectively. However, Treasury has since reduced the number of staff in this office without formally assessing staffing needs. We believe that having sufficient staff is critical to Treasury's ability to design and implement HAMP-funded programs quickly and effectively. We will continue to monitor Treasury's implementation and management of HAMP-funded programs as part of our ongoing oversight of TARP to ensure that these programs are appropriately designed and operating as intended.

Small Business Initiatives. TARP also includes programs that have a small business emphasis or component. Treasury has announced two new initiatives aimed at small business lending. The Community Development Capital Initiative (CDCI) will provide capital to Community Development Financial Institutions (CDFIs). CDCI is open to CDFI-certified banks, thrifts, and credit unions which have been certified by Treasury's CDFI Fund as targeting more than 60 percent of their small business lending and other economic development activities to underserved communities. The second initiative, the Small Business and Community Lending Initiative, refers to Treasury's SBA 7(a) securities purchase program, which makes

[14]See GAO, *Troubled Asset Relief Program: Treasury Actions Needed to Make the Home Affordable Modification Program More Transparent and Accountable*, GAO-09-837(Washington, D.C.: July 23, 2009).

direct purchases of securitized loan pools guaranteed under SBA's 7(a) small business loan guarantee program.[15] Finally, the Term Asset-Backed Securities Loan Facility (TALF), which is winding down, accepted asset-backed securities (ABS) as collateral for loans to restore liquidity in securitization markets, including securities consisting of SBA-guaranteed loan pools. We are currently reviewing these efforts and our objectives are to assess the data that are available on small business lending and to assess the status of Treasury's actions in meeting its goals for these programs.

Term Asset-Backed Securities Loan Facility (TALF). TARP was also intended to address problems in the securitization markets. TALF was designed to restore the securitization markets and improve access to credit for consumers and businesses.[16] It is administered by the Board of Governors of the Federal Reserve System (Federal Reserve) and the Federal Reserve Bank of New York (FRBNY) and Treasury committed $20 billion of TARP funds for credit protection for TALF assets. The program stopped accepting ABS and legacy commercial mortgage-backed securities (CMBS) as collateral for new loans in March 2010 and new-issue CMBS in June 2010. FRBNY issued about $71 billion in TALF loans, with most of them secured by credit card ABS, legacy CMBS, and auto loan ABS. Our analysis in our February 2010 report suggested that the securitization markets improved for the more frequently traded TALF-eligible sectors after the program's first activity in March 2009.[17] However, we did not find clear evidence that consumer credit rates changed significantly after TALF started. FRBNY officials said that it is possible that without TALF, interest rates on loans to consumers and small businesses could have been much higher.

We reported in February 2010 that TALF contained a number of features to help reduce the risk of loss to TARP funds. Analyses by Treasury and FRBNY project minimal, if any, use of TARP funds for TALF-related losses, and Treasury currently anticipates a profit. We found that CMBS could

[15]Treasury also had plans to purchase securities consisting of SBA 504 loan guarantees but has not made such purchases.

[16]The program provided nonrecourse loans to investors to purchase AAA-rated asset-backed securities (ABS) and commercial mortgage-backed securities (CMBS), which are in turn pledged as collateral for the loans.

[17]GAO-10-25. Given GAO's limitation on reviewing the Federal Reserve's monetary policy activities, we focused on Treasury's role in TALF.

pose a higher risk of loss than ABS, given the ongoing uncertainty in the commercial real estate market.[18] For this reason, we recommended that Treasury give greater attention to risks in commercial real estate and CMBS markets. In response, Treasury developed internal tracking reports to assess these trends.

We also found that at the outset of TALF, Treasury had not fully documented the rationale for final decisions that were made on managing risks associated with TALF—including decisions involving the Federal Reserve. We found that Treasury's analysis of TALF-related risks sometimes differed from FRBNY's and that Treasury lacked clear documentation on how it resolved discrepancies or made final decisions with the Federal Reserve and FRBNY. Documenting such rationales increases transparency and strengthens internal controls for decision making. Since the report, Treasury has created a process document that details how it assesses changes to TALF program terms proposed by the Federal Reserve, including specifying levels of management review and approval. In addition, Treasury has a formal process for assessing outside analyses it may request for assessing risks to TARP.

Finally, while Treasury bears the first-loss risk from assets that TALF borrowers might surrender in conjunction with unpaid loans, it has not developed measures to analyze and publicly report on the potential purchase, management, and sale of such assets. Without such a plan, Treasury may not fully and publicly disclose how such surrendered assets are managed and financed, undermining Treasury's efforts to be fully transparent about TARP activities. We recommended that Treasury review the data it might collect and publicly report on the event that any collateral is surrendered to TALF LLC and Treasury lends to it. To date, Treasury has not provided evidence that it has conducted such a review or established such a plan, though officials stated that they would hire an asset manager to assist in managing surrendered assets in order to protect taxpayer interests and noted that Treasury was committed to transparency regarding such assets.[19]

[18]Commercial real estate values have dropped by about 40 percent since their peak in 2007 and CMBS volumes by number have decreased by about 90 percent since their 2006 year-end peak.

[19]As of July 16, 2010 no TALF assets have been surrendered to TALF LLC.

Treasury's Framework for Deciding to Extend TARP Was Sufficient, but Could be Strengthened For Future Decisions

In anticipation of the upcoming decisions on the future of TARP, the need to unwind the extraordinary federal support across the board, and the fragile state of the economy, we made recommendations to Treasury in October 2009. Specifically, we suggested that any decision to extend TARP be made in coordination with relevant agencies and that Treasury use quantitative analysis whenever possible to support its reasons for doing so. We noted that without a robust analytic framework, Treasury could face challenges in effectively carrying out the next stages of its programs. Subsequently, on December 9, 2009, the Secretary of the Treasury notified Congress that he was extending the authority for TARP provided under the act until October 3, 2010.[20] The extension involved winding down some programs while extending others, transforming the program to one focused primarily on preserving homeownership and improving financial conditions for small banks and businesses. As such, according to Treasury, new commitments through October 3, 2010 will be limited to programs, under the Making Home Affordable Program (MHA), including HAMP, and small business lending programs. The Dodd-Frank Wall Street Reform and Consumer Protection Act, passed by both the House and Senate and expected to be signed by the President this week, would (1) reduce Treasury's authority to purchase or insure troubled assets to $475 billion and (2) prohibit Treasury, under the act, from incurring any additional obligations for a program or initiative unless the program or initiative had already been initiated prior to June 25, 2010.

In reviewing the analytical process underpinning this decision to extend TARP, we reported that Treasury used a deliberative process that included sufficient interagency coordination and consultation and considered a number of qualitative and quantitative factors.[21] However, we noted that the extent of coordination could be enhanced and formalized, specifically with the FDIC, for any upcoming decisions that would benefit from interagency collaboration. Although the economy is still fragile, a key priority will be to develop, coordinate, and communicate exit strategies to unwind the remaining programs and investments resulting from the extraordinary crisis-driven interventions. Because TARP will be unwinding concurrently with other important interventions by federal regulators,

[20]Treasury's authority under EESA to purchase, commit to purchase, or commit to guarantee troubled assets was set to expire on December 31, 2009, unless the Secretary submitted a written certification to Congress extending these authorities. EESA § 120, 122 Stat. at 3788 (codified at 12 U.S.C. § 5230).

[21]GAO-10-531.

decisions about the sequencing of the exits from various federal programs will require bringing a larger body of regulators to the table to plan and sequence the continued unwinding of federal support. We also noted that Treasury could strengthen its analytical framework by identifying clear objectives for small business programs and explaining how relevant indicators motivated TARP program decisions. Finally, we recommended (1) formalizing coordination with FDIC for future TARP decisions and (2) improving the transparency and analytical basis for TARP program decisions. Though TARP will soon expire, Treasury will still need to work with other agencies to effectively conduct a coordinated exit from TARP and other government financial assistance.

Indicators Suggest a Recovery in Credit Markets, but Isolating the Impact of TARP's Foreclosure Mitigation and Small Business Lending Efforts Will Be Difficult

Many market observers have said that, taken together, the concerted actions by Treasury and others helped avert a more severe financial crisis, although some critics believe that the markets would have recovered without government support. Particular programs have been reported to have had the desired effects, especially if stabilizing the financial system and restoring confidence was considered to be the principal goal of the intervention. In our October 2009 and February 2010 reports we noted that some of the anticipated effects of TARP on credit markets and the economy had materialized and that some securitization markets had experienced a tentative recovery. During our review of the decision to extend TARP, Treasury noted that some programs that it believed had accomplished their goals would be terminated. For example, as noted earlier, Treasury ended CPP and CAP largely because of banks' renewed ability to access capital markets. It also noted improvements in securitization markets and stabilization of certain legacy asset prices as motivating the closing of TALF and the Public Private Investment Program (PPIP).[22] Indicators we have been monitoring suggest credit markets have been able to sustain their recovery despite the winding down of key programs initiated by the Federal Reserve, Treasury, FDIC and others. As shown in table 2 interbank, mortgage, corporate debt, and securitization markets continue to perform better than their pre-TARP lows. The cost of credit and perceptions of risk (as measured by premiums over Treasury securities) have fallen in interbank, mortgage, and corporate debt markets,

[22]"Closed" means no new agreements to undertake transactions will occur through the program, but does not necessarily imply no activity is occurring. Many of the programs have resulted in equity investments, loans, and commitments that remain outstanding.

and the volume of credit, as measured by new mortgage loans and asset-backed securities, has increased since the first TARP program, CPP.

Table 2. Select Credit Market Indicators as of July 6, 2010

Credit market rates and spreads

Indicator	Description	Basis point change since October 13, 2008
LIBOR	3-month London interbank offered rate (an average of interest rates offered on dollar-denominated loans)	Down 422
TED Spread	Spread between 3-month LIBOR and 3-month Treasury yield	Down 414
Aaa bond rate	Rate on highest quality corporate bonds	Down 179
Aaa bond spread	Spread between Aaa bond rate and 10-year Treasury yield	Down 85
Baa bond rate	Rate on corporate bonds subject to moderate credit risk	Down 275
Baa bond spread	Spread between Baa bond rate and 10-year Treasury yield	Down 181
Mortgage rate	30-year conforming loan rate	Down 189
Mortgage spread	Spread between 30-year conforming loan rate and 10-year Treasury yield	Down 89

Quarterly mortgage and ABS volumes, and mortgage defaults

Indicator	Description	Change from 4Q 2008 to 1Q 2010
Mortgage originations	New mortgage loans	Up $60 billion to $320 billion
Asset-backed security issuance	New securities backed by auto loans, credit cards, student loans, and commercial mortgages	Up $19 billion to $21 billion
Foreclosure rate	Percentage of homes in foreclosure	Up 133 basis points to 4.63 percent

Source: GAO analysis of data from Global Insight, the Federal Reserve, Thomson Reuters, and Inside Mortgage Finance.

Note: Rates and yields are daily except mortgage rates, which are weekly. Higher spreads (measured as premiums over Treasury securities of comparable maturity) represent higher perceived risk in lending to certain borrowers. Higher rates represent increases in the cost of borrowing for relevant borrowers. As a result, "Down" suggests improvement in market conditions for credit market rates and spreads. Foreclosure, asset-backed security issuance and mortgage origination data are quarterly. See previous TARP reports for a more detailed discussion (GAO-09-161 and GAO-09-296).

Unfortunately, rising foreclosures continue to highlight the challenges facing the U.S. economy. By any measure foreclosure and delinquency statistics for residential housing remain well above their historical averages despite programs such as HAMP. However, a slow recovery does not necessarily mean that TARP is ineffective, because in absence of TARP it is possible that foreclosure and delinquency rates would be higher. Moreover, full recovery will likely take some time given the build up of imbalances in the real estate, fiscal and household sectors over several years.

Experience with past financial crises, coupled with analyses of the specifics of the current situation, has led the Congressional Budget Office to predict a modest recovery that will not be robust enough to appreciably improve weak labor markets through 2011. Weaknesses in labor markets will likely weigh on residential housing markets. Given that any new TARP activity will be limited to home ownership preservation and small business lending programs, we will continue to monitor indictors such as foreclosure and delinquencies as potential measures of the efficacy of these programs. Isolating the impact of TARP from general market forces and other foreclosure initiatives will be a challenge. This challenge will be compounded in the area of small business lending because Treasury has yet to set explicit objectives for its small business lending programs and because a lack of comprehensive data on new lending makes assessing credit conditions for small business particularly difficult. In recommending that Treasury improve the transparency and analytical basis for TARP program decisions, we specifically noted the need to set quantitative program objectives for its small business lending programs and identify any additional data needed to make program decisions.

Mr. Chairman and Members of the Committee, I appreciate the opportunity to discuss these critically important issues and would be happy to answer any questions that you may have. Thank you.

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Appendix I: Related GAO Products

Troubled Asset Relief Program: Treasury's Framework for Deciding to Extend TARP Was Sufficient, but Could be Strengthened for Future Decisions. GAO-10-531. Washington, D.C.: June 30, 2010.

Troubled Asset Relief Program: Further Actions Needed to Fully and Equitably Implement Foreclosure Mitigation Program. GAO-10-634. Washington, D.C.: June 24, 2010.

Troubled Asset Relief Program: Update of Government Assistance Provided to AIG. GAO-10-475. Washington, D.C.: April 27, 2010.

Troubled Asset Relief Program: Automaker Pension Funding and Multiple Federal Roles Pose Challenges for the Future. GAO-10-492. Washington, D.C.: April 6, 2010.

Troubled Asset Relief Program: Home Affordable Modification Program Continues to Face Implementation Challenges. GAO-10-556T. Washington, D.C.: March 25, 2010.

Troubled Asset Relief Program: Treasury Needs to Strengthen Its Decision-Making Process on the Term Asset-Backed Securities Loan Facility. GAO-10-25. Washington, D.C.: February 5, 2010.

Troubled Asset Relief Program: The U.S. Government Role as Shareholder in AIG, Citigroup, Chrysler, and General Motors and Preliminary Views on its Investment Management Activities. GAO-10-325T. Washington, D.C.: December 16, 2009.

Financial Audit: Office of Financial Stability (Troubled Asset Relief Program) Fiscal Year 2009 Financial Statements. GAO-10-301. Washington, D.C.: December 9, 2009.

Troubled Asset Relief Program: Continued Stewardship Needed as Treasury Develops Strategies for Monitoring and Divesting Financial Interests in Chrysler and GM. GAO-10-151. Washington, D.C.: November 2, 2009.

Troubled Asset Relief Program: One Year Later, Actions Are Needed to Address Remaining Transparency and Accountability Challenges. GAO-10-16. Washington, D.C.: October 8, 2009.

Troubled Asset Relief Program: Status of Efforts to Address Transparency and Accountability Issues. GAO-09-1048T. Washington, D.C.: September 24, 2009.

Troubled Asset Relief Program: Status of Government Assistance Provided to AIG. GAO-09-975. Washington, D.C.: September 21, 2009.

Troubled Asset Relief Program: Treasury Actions Needed to Make the Home Affordable Modification Program More Transparent and Accountable. GAO-09-837. Washington, D.C.: July 23, 2009.

Troubled Asset Relief Program: Status of Efforts to Address Transparency and Accountability Issues. GAO-09-920T. Washington, D.C.: July 22, 2009.

Troubled Asset Relief Program: Status of Participants' Dividend Payments and Repurchases of Preferred Stock and Warrants. GAO-09-889T. Washington, D.C.: July 9, 2009.

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

Auto Industry: Summary of Government Efforts and Automakers' Restructuring to Date. GAO-09-553. Washington, D.C.: April 23, 2009.

Troubled Asset Relief Program: March 2009 Status of Efforts to Address Transparency and Accountability Issues. GAO-09-504. Washington, D.C.: March 31, 2009.

Federal Financial Assistance: Preliminary Observations on Assistance Provided to AIG. GAO-09-490T. Washington, D.C.: March 18, 2009.

Troubled Asset Relief Program: Status of Efforts to Address Transparency and Accountability Issues. GAO-09-417T. Washington, D.C.: February 24, 2009.

Troubled Asset Relief Program: Status of Efforts to Address Transparency and Accountability Issues. GAO-09-359T. Washington, D.C.: February 5, 2009.

Troubled Asset Relief Program: Status of Efforts to Address Transparency and Accountability Issues. GAO-09-296. Washington, D.C.: January 30, 2009.

Troubled Asset Relief Program: Additional Actions Needed to Better Ensure Integrity, Accountability, and Transparency. GAO-09-266T. Washington, D.C.: December 10, 2008.

Auto Industry: A Framework for Considering Federal Financial Assistance. GAO-09-242T . Washington, D.C.: December 4, 2008.

Troubled Asset Relief Program: Status of Efforts to Address Defaults and Foreclosures on Home Mortgages. GAO-09-231T. Washington, D.C.: December 4, 2008.

Troubled Asset Relief Program: Additional Actions Needed to Better Ensure Integrity, Accountability, and Transparency. GAO-09-161. Washington, D.C.: December 2, 2008.

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