

August 2010

FINANCIAL ASSISTANCE

Ongoing Challenges and Guiding Principles Related to Government Assistance For Private Sector Companies



GAO

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Highlights of [GAO-10-719](#), a report to congressional committees

Why GAO Did This Study

The recent financial crisis resulted in a wide-ranging federal response that included providing extraordinary assistance to several major corporations. As a result of actions under the Troubled Asset Relief Program (TARP) and others, the government was a shareholder in the American International Group Inc. (AIG); Bank of America; Citigroup, Inc. (Citigroup); Chrysler Group LLC (Chrysler); General Motors Company (GM); Ally Financial/GMAC, Inc. (GMAC); and Fannie Mae and Freddie Mac (Enterprises). The government ownership interest in these companies resulted from financial assistance that was aimed at stabilizing the financial markets, housing finance, or specific market segments. This report (1) describes the government’s ownership interest and evaluates the extent of government involvement in these companies, (2) discusses the government’s management and monitoring of its investments and exit strategies, and (3) identifies lessons learned from the federal actions.

This work was done in part with the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) and involved reviewing relevant documentation related to these companies and the federal assistance provided. GAO interviewed officials at Treasury, Federal Reserve, Federal Housing Finance Agency (FHFA), and the banking regulators, as well as the senior executives and relevant officials at the companies that received exceptional assistance.

View [GAO-10-719](#) or [key components](#). For more information, contact Orice Williams Brown at (202) 512-8678 or williamso@gao.gov.

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What GAO Found

The extent of government equity interest in companies receiving exceptional assistance varied and ranged from owning preferred shares with no voting rights except in limited circumstances (Bank of America until it repurchased its shares in 2009) to owning common shares with voting rights (Chrysler, Citigroup, GM, and GMAC) to acting as a conservator (the Enterprises). In each case, the government required changes to the companies’ corporate governance structures and executive compensation. For example, of the 92 directors currently serving on boards of these companies, 73 were elected since November 2008 (see table 1). Many of these new directors were nominated by their respective boards, while others were designated by the government and other significant shareholders as a result of their common share ownership. The level of involvement in the companies varied depending on whether the government served as an investor, creditor, or conservator. For example, as an investor in Bank of America, Citigroup, and GMAC, the Department of the Treasury (Treasury) had minimal or no involvement in their activities. As both an investor in and a creditor of AIG, Chrysler, and GM—as a condition of receiving assistance—the government has required some combination of the restructuring of their companies, the submission of periodic financial reports, and greater interaction with company personnel. FHFA—using its broad authority as a conservator—has instituted a number of requirements and practices that involve them in the Enterprises.

Table 1: Changes in Boards of Directors since November 2008

Company	Current number of directors	New directors since November 2008	Government-designated directors
AIG	13	8	2
Bank of America	13	10	none
Citigroup	15	8	none
GM	13	13	10
Chrysler	9	9	3
GMAC	9	8	3
Fannie Mae	10	8	10
Freddie Mac	10	9	10
Total	92	73	38

Source: SIGTARP and GAO analysis of government’s agreements and company-provided data.

The government has taken a variety of steps to manage its investments and consider exit strategies. It developed guidance outlining its approach and hired asset managers to help manage some of its investments. Treasury’s staff manage the investments of Chrysler, GM, and GMAC, including others. Also, the Federal Reserve and Treasury collaborate in monitoring the government’s debt and preferred equity investments in AIG, while the AIG trustees appointed by the Federal Reserve are responsible for divesting the government’s beneficial interest. Conversely, although FHFA is responsible for monitoring the Enterprises and Treasury holds the preferred equity investment, congressional action will be needed to determine the long-term structures and exit strategies for the Enterprises.

While the debate about whether the government should intervene in private markets to avert a systemic crisis continues, only the future will reveal whether the government is again faced with the prospect of having to intervene in private markets to avert a systemic crisis. As with other past crises, experience from the most recent crisis offers additional insights to guide government action, should it ever be warranted. —

Specifically, the government could protect the taxpayer’s interest in any crisis by not only continuing to follow the principles previously identified by GAO (i.e., identifying and defining the problem, determining a national interest and setting clear goals, and protecting the government’s and taxpayer’s interests) but also by adhering to five additional principles based on the federal government’s experience with the current crisis. First, it is essential to develop a strategic and coordinated approach when comprehensive and global governmental action is required. Second, taking actions to ensure the government has a strategy for managing any investments resulting from its intervention is necessary to help mitigate perceived or potential conflicts and manage external influences. Third, the federal government’s intervention in private markets requires that those efforts be transparent and effectively communicated. Fourth, establishing an adequate oversight structure to help ensure accountability is essential. And finally, taking steps to mitigate moral hazard will be necessary to not only ensure that regulatory and market-based structures limit risk taking before a crisis occurs, but to also create strong disincentives to seeking federal assistance through utilization of stringent requirements.

Table 2: GAO Framework for the Federal Government When Providing Financial Assistance to Private Market Participants

Principles	Description
<i>Established guiding principles</i>	
Identify and define the problem	Separating out those issues that require an immediate response from the structural challenges that will take longer to resolve.
Determine national interests and set clear goals and objectives	Choosing whether a legislative solution or other government intervention best serves the national interest.
Protect government’s Interests	Ensure not only that financial markets continue to function effectively, but also that any investment provides the highest possible return. For example, requiring concessions from all parties, placing controls over management, obtaining collateral when feasible, and being compensated for risk.
<i>New guiding principles</i>	
Coordinate actions on a global and comprehensive basis	Financial crises that are international in scope require comprehensive, global actions, and government interventions must be closely coordinated by the parties providing assistance—including U.S. and foreign governments—to help ensure that limited resources are used effectively.
Mitigate perceived or potential conflicts	Any action that results in the government having an ownership interest in private sector companies requires that the government’s strategy for managing its investments include plans to mitigate perceived or potential conflicts that may arise from its newly acquired role as shareholder or creditor and its existing role as regulator, supervisor, or policymaker.
Ensure adequate transparency by establishing an effective communication strategy	Federal intervention into the private markets requires a strategy to help ensure open and effective communication with Congress and taxpayers. An effective communication strategy is important during changing market events and could help the public understand the policy goals that the government is trying to achieve and its rationale for spending public funds.
Establish a strong system for accountability	A system of accountability helps ensure that the interest of the government and taxpayers are adequately protected and the programs’ objectives are achieved efficiently and effectively. Monitoring and other internal controls can help prevent and detect fraud.
Take steps to mitigate moral hazard	Federal government’s financial assistance may create moral hazard or encourage market participants to expect similar emergency actions—the too big to fail perception. The government should ensure that financial assistance to private market participants include terms that make it a last resort and specify when the assistance will end.

Source: GAO.

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Abbreviations

AGP	Asset Guarantee Program
AIFP	Automotive Industry Financing Program
AIG	American International Group, LLC
CAP	Capital Assistance Program
CEO	Chief Executive Officer
CFO	Chief Financial Officer
Citigroup	Citigroup, Inc.

Chrysler	Chrysler Group, LLC
CPP	Capital Purchase Program
EESA	Emergency Economic Stabilization Act of 2008
Enterprises	Fannie Mae and Freddie Mac
FDIC	Federal Deposit Insurance Corporation
Federal Reserve	Board of Governors of the Federal Reserve System
FHFA	Federal Housing Finance Agency
FRBNY	Federal Reserve Bank of New York
GM	General Motors Company
GMAC	Ally Financial, Inc.
HAMP	Home Affordable Modification Program
HERA	Housing and Economic Recovery Act of 2008
OCC	Office of the Comptroller of the Currency
OFS	Office of Financial Stability
Recovery Act	American Recovery and Reinvestment Act of 2009
SCAP	Supervisory Capital Assistance Program
SEC	Securities Exchange Commission
SIGTARP	Special Inspector General for the Troubled Asset Relief Program
SSFI	Systemically Significant Failing Institutions Program
TARP	Troubled Asset Relief Program
TIP	Targeted Investment Program
Treasury	Department of the Treasury

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United States Government Accountability Office
Washington, DC 20548

August 3, 2010

Congressional Committees

The federal government historically has intervened in financial markets during times of economic crisis from the Great Depression to the Savings and Loan crisis of the 1980s. During the most recent financial crisis, the federal government has shown a willingness to intervene in private markets after determining that national interests were at stake. From the fall of 2008 to June 2010, eight large financial institutions and companies have received more than \$447 billion in exceptional amounts of financial assistance, which resulted in the government having an ownership interest in these companies.¹ Specifically, the government is currently a significant shareholder in five companies and acts as conservator of two housing government-sponsored enterprises—Fannie Mae and Freddie Mac (Enterprises).² In addition, the government has provided financial assistance to these companies to support the credit, insurance, and the secondary mortgage markets through the purchase of debt and mortgage-backed securities, asset guarantees, and the extension of lines of credit. These situations have raised questions about the appropriate role of the federal government as a shareholder, its management of its assets, the implications of government ownership for private markets, and the government's plans for divesting its investments in the companies and finding a sustainable solution to the current problems of the Enterprises.³

This report, done in part with the Special Inspector General for the Troubled Asset Relief Program (SIGTARP), looks at the extent of the government's involvement in companies that have received exceptional assistance from the federal government, including American International Group Inc. (AIG); Bank of America Corporation (Bank of America); Chrysler Group LLC (Chrysler); Citigroup, Inc. (Citigroup); General

¹See appendix II for the calculation of the total assistance amount and the assistance amounts by specific company.

²On December 9, 2009, Bank of America repurchased \$45 billion of preferred shares, and on March 5, 2010, Treasury auctioned its Bank of America warrants for \$1.54 billion which ended its participation in the Troubled Assets Relief Program.

³While there are several other government-sponsored enterprises, for purposes of this report the capitalized term "Enterprises" refers to Fannie Mae and Freddie Mac.

Motors Company (GM); and Ally Financial Inc. (GMAC),⁴ as well as the government's involvement in the Enterprises.⁵ Under the Emergency Economic Stabilization Act of 2008 (EESA), GAO is required 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 operations, and TARP's compliance with applicable laws and regulations.⁶ The report objectives are to (1) describe how and why the government obtained an ownership interest in the companies, (2) evaluate the extent of government involvement in companies receiving exceptional assistance, (3) describe the government's monitoring of the companies' financial viability and exit strategies, and (4) discuss the challenges associated with the government's ongoing involvement in the companies and the Enterprises.

To address the first objective, we reviewed relevant documents from the Board of Governors of the Federal Reserve System (Federal Reserve), Department of the Treasury's (Treasury) Office of Financial Stability (OFS), Federal Housing Finance Agency (FHFA), the Enterprises' regulator, and the Federal Reserve Bank of New York (FRBNY); contractual agreements between the government and the companies; Troubled Asset Relief Program (TARP) transaction reports; and Securities and Exchange Commission (SEC) filings. We also interviewed officials from Treasury, the Federal Reserve Board, and FRBNY. In addition, as

⁴On May 10, 2010, GMAC changed its name to Ally Financial, Inc.

⁵Treasury considers each of these companies, with the exception of Fannie Mae and Freddie Mac, as "exceptional assistance" companies. A company is considered receiving exceptional assistance when it has been provided more assistance than allowed under a widely available standard program, such as a capital access program.

⁶Pub. L. No. 110-343, Div. A, § 116, 122 Stat. 3765, 3783 (2008) (codified at 12 U.S.C. § 5226).

appropriate, we used information from previous reports by GAO and SIGTARP.⁷

To determine the extent of government involvement in those companies receiving exceptional assistance, we reviewed the contractual agreements between Treasury and these companies to determine how Treasury intended to use its voting rights and to identify the requirements Treasury imposed on the companies. We also interviewed officials from Treasury, OFS, FHFA, and federal banking regulators—the Federal Reserve, FRBNY, Federal Reserve Bank of Chicago (FRB-Chicago), Federal Reserve Bank of Richmond (FRB-Richmond), Federal Deposit Insurance Corporation (FDIC), and Office of the Comptroller of the Currency (OCC). We also interviewed the AIG trustees appointed by FRBNY and the senior management of the companies that received exceptional amounts of assistance and the Enterprises. Further, to understand the extent of any external influence that Congress and the federal agencies might be placing on the companies, we reviewed correspondences, including both letters and e-mail messages, that Chrysler and GM officials received from members of Congress and other government officials and interviewed the government relations staff at AIG, Bank of America, Chrysler, Citigroup, GM, and GMAC.

To describe the management and monitoring of the government's investment and the development of exit strategies for the investments, we reviewed financial information prepared by the asset managers, as well as the Bank of America and Citigroup proposals submitted to the Federal Reserve requesting that the institutions be allowed to repurchase their preferred shares and the financial reports that Chrysler and GM submitted to the team within OFS overseeing Treasury's investment in the auto industry (Auto Team). We also interviewed officials from the Federal Reserve, FHFA, FRBNY, FRB-Chicago, FRB-Richmond, and OFS teams

⁷*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.: Nov. 2, 2009); *Troubled Asset Relief Program: Status of Government Assistance Provided to AIG*, GAO-09-975 (Washington, D.C.: Sept. 21, 2009); GAO, *Fannie Mae and Freddie Mac: Analysis of Options for Revising the Housing Enterprises' Long-term Structures*, GAO-09-782 (Washington, D.C.: Sept. 10, 2009); and SIGTARP, *Factors Affecting Efforts to Limit Payments to AIG Counterparties*, SIGTARP-10-003 (Washington, D.C., Nov. 17, 2009) and *Emergency Capital Injections Provided to Support the Viability of Bank of America, Other Major Banks, and the U.S. Financial System*, SIGTARP-10-001 (Washington, D.C., Oct. 5, 2009).

that monitor government investments, including the AIG investment team, the Auto Team, and financial firms serving as asset managers for Treasury.

We conducted this performance audit from August 2009 to August 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 provided a reasonable basis for our findings and conclusions based on our audit objectives.

Background

The federal government intervention and involvement in the financial markets was created through a number of existing and recently enacted laws. This legal framework provided the financial resources for assistance, the federal government's authorities, and the restrictions companies were required to comply with in exchange for the financial assistance. In assisting the public to understand its involvement in the companies, in May 2009 the administration published a set of core principles that are to guide the government's management of ownership interests in private firms. Most of the institutions that the government had or has an ownership interest in are regulated by one of several financial regulators, which have a role in overseeing the financial condition and operations of its regulated entities.

The federal government's efforts in late 2008 to stabilize the financial markets are not its first intervention in private markets during economic downturns. The government has previously undertaken large-scale financial assistance efforts, including to private companies. For example, in the 1970s and early 1980s Congress created separate financial assistance programs totaling more than \$12 billion to stabilize Conrail, Lockheed-Martin, and Chrysler, with most of the funds being distributed in the form of loans or loan guarantees.⁸ Most recently, in response to the most severe financial crisis since the Great Depression, Congress provided Treasury additional authority to stabilize the financial system. In particular:

- In July 2008, Congress passed the Housing and Economic Recovery Act of 2008 (HERA), which established FHFA—the agency responsible for the monitoring of safety and soundness and the housing missions of the

⁸The amount was not adjusted for inflation.

Enterprises and the other housing government-sponsored enterprises, namely, the Federal Home Loan Banks—and among other things, provided for expanded authority to place the Enterprises in conservatorship or receivership and provides Treasury with certain authorities to provide financial support to the Enterprises.⁹ In accordance with HERA, on September 6, 2008, FHFA placed the Enterprises into conservatorship because of concern that their deteriorating financial condition (\$5.4 trillion in outstanding obligations) would destabilize the financial system.¹⁰ The goals of the conservatorships are to preserve and conserve the assets and property of the Enterprises and enhance their ability to fulfill their missions. FHFA has the authority to manage the Enterprises and maintains the powers of the board of directors, officers, and shareholders. Treasury agreed to provide substantial financial support so that Enterprises could continue as going concerns to support mortgage financing, subsequently, the Federal Reserve Board committed to a variety of activities, including purchasing substantial amounts of their debt and securities to support housing finance, housing markets, and the financial markets more generally.

- In October 2008, Congress passed EESA, which authorized the creation of TARP to, among other things, buy up to \$700 billion in troubled assets, such as mortgage-backed securities and any other financial instrument that the Secretary of the Treasury, in consultation with the Chairman of the Federal Reserve Board, determined that it needed to purchase to help stabilize the financial system.¹¹ EESA created OFS within Treasury to administer TARP, which comprises a number of programs that were designed to address various aspects of the unfolding financial crisis. Early in the program, Treasury determined that providing capital infusions would be the fastest and most effective way to address the crisis. In return

⁹Pub. L. No. 110-289, 122 Stat. 2654. (July 30, 2008).

¹⁰Conservatorship is “the legal process in which a person or entity is appointed to establish control and oversight of a Company to put it in a sound and solvent condition.” See Federal Housing Finance Agency, “Fact Sheet: Questions and Answers on Conservatorship” (press release, Sept. 7, 2008) p. 1.
http://www.treas.gov/press/releases/report/fhfa_consrv_faq_090708hp112.pdf.

¹¹Pub. L. No. 110-343, 122 Stat. 3765 (2008), (codified, as amended, at 12 U.S.C. §§ 5201 *et seq.*). EESA originally authorized Treasury to purchase 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. 123 Stat. 1632 (2009), amended EESA to reduce the maximum allowable amount of outstanding troubled assets under the act by almost \$1.3 billion, from \$700 billion to \$698.7 billion. Section 1302 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, 2133 (2010), reduced the maximum amount of authorized TARP funding to \$475 billion.

for these capital infusions, Treasury received equity in the hundreds of companies that have participated in the program. In return for receiving these capital infusions, TARP-recipients were subject to certain requirements and restrictions, such as dividend requirements and limits on executive compensation.

The American Recovery and Reinvestment Act of 2009 (Recovery Act) amended and expanded EESA's executive compensation provisions and directed Treasury to require appropriate standards for executive compensation and corporate governance of TARP recipients.¹² On June 10, 2009, Treasury adopted an interim final rule to implement the law for executive compensation and corporate governance, including limits on compensation, providing guidance on the executive compensation and corporate governance provisions of EESA, and setting forth certain additional standards pursuant to authority under EESA. The requirements for executive compensation generally include: (1) limits on compensation that exclude incentives for senior executive officers to take unnecessary and excessive risks that threaten the value of TARP recipients; (2) provision for the recovery of any bonus, retention award, or incentive compensation paid to certain executives based on materially inaccurate statements of earnings, revenues, gains, or other criteria; (3) prohibition on "golden parachute"¹³ payments accrued to certain executives; (4) prohibition on payment or accrual of bonuses, retention awards, or incentive compensation to certain executives; and (5) prohibition on employee compensation plans that would encourage manipulation of earnings reported by TARP recipients to enhance employees' compensation. The regulation required the establishment of Office of the Special Master for TARP Executive Compensation (Special Master) to review the compensation payments and structures of TARP recipients of "exceptional financial assistance," which includes all of the companies in our study with the exception of the government-sponsored Enterprises. The Senior Preferred Stock Agreements between Treasury and the Enterprises negotiated prior to EESA and the Recovery Act included a requirement that FHFA consult with Treasury relating to executive compensation.

¹²Pub. L. No. 111-5, Div B, Title VII, 123 Stat. 115, 516-521.

¹³A golden parachute is defined as any payment for the departure from a TARP recipient for any reason or any payment due to a change in control of the TARP recipient.

Several TARP Programs Have Resulted in the Government's Ownership Interest

A number of programs under TARP—designed to help stabilize institutions and financial markets—have resulted in Treasury having an ownership interest in such institutions.

- The Capital Purchase Program (CPP) is the largest TARP program and at its peak had more than 700 participants, including Bank of America and Citigroup. Created in October 2008, it aimed to stabilize the financial system by providing capital to viable banks through the purchase of preferred shares and subordinated debentures.¹⁴ These transactions generally provide that the banks pay fixed dividends on the preferred shares, that the debentures accrue interest, and that the banks issue a warrant to purchase common stock, preferred shares, or additional senior debt instruments.¹⁵
- The Targeted Investment Program (TIP), established in December 2008, was designed to prevent a loss of confidence in financial institutions that could (1) result in significant market disruptions, (2) threaten the financial strength of similarly situated financial institutions, (3) impair broader financial markets, and (4) undermine the overall economy. Treasury determined the forms, terms, and conditions of any investments made under this program and considered the institutions for approval on a case-by-case basis. Treasury required participating institutions to provide warrants or alternative considerations, as necessary, to minimize the long-term costs and maximize the benefits to the taxpayers, in accordance with EESA. Only two institutions participated in TIP, Bank of America and Citigroup, and both repurchased their preferred shares and trust preferred shares, respectively, from Treasury in December 2009. Treasury has terminated the program.
- The Asset Guarantee Program (AGP), was created in November 2008 to provide a federal government guarantee for assets held by financial institutions that had been deemed critical to the functioning of the U.S. financial system. The goal of AGP was to encourage investors to keep funds in the institutions. According to Treasury, placing guarantee assurances against distressed or illiquid assets was viewed as another way to help stabilize the financial system. In implementing AGP, Treasury

¹⁴Preferred shares are a class of ownership in a corporation that generally has a higher claim on the assets and earnings than common stock.

¹⁵Section 113(d) of EESA, codified at 12 U.S.C § 5223(d), provides that the Secretary of the Treasury may not purchase any asset, including equity interests, from financial institutions unless Treasury also receives a warrant to purchase stock or debt instrument from the financial institution.

collected a premium on the risk assumed by the government that was paid in preferred shares that were exchanged later for trust preferred shares. Citigroup terminated its participation on December 23, 2009. Treasury has since terminated AGP.¹⁶ While the asset guarantee was in place, no losses were claimed by Citigroup and no federal funds were paid out.

- The AIG Investment Program—originally called the Systemically Significant Failing Institutions Program (SSFI)—was created in November 2008 to help avoid disruptions to financial markets from an institutional failure that Treasury determined would have broad ramifications for other institutions and market activities. AIG has been the only participant in this program and was provided the assistance because of its systemic importance to the financial system. The assistance provided under this program is reflected in the securities purchase agreements, which required Treasury to purchase preferred shares from AIG and entitles Treasury to dividends declared by AIG on these preferred shares and provide warrants to purchase common stock.
- The Automotive Industry Financing Program (AIFP) was created in December 2008 to prevent a significant disruption to the U.S. automotive industry. Treasury determined that such a disruption would pose a systemic risk to financial market stability and have a negative effect on the U.S. economy. The program was authorized to provide funding to support automakers during restructuring, to ensure that auto suppliers to Chrysler and GM received compensation for their services and products, and to support automotive finance companies. AIFP provided sizeable loans to Chrysler and GM (including a loan to GM that was convertible into shares of GMAC that were purchased with the proceeds). Treasury loaned up to \$1.5 billion to Chrysler Financial, which was fully repaid on July 14, 2009. Ultimately the government obtained an equity stake through the restructurings and loan conversion.

¹⁶In January 2009, Treasury, FRB NY, FDIC, and Citigroup entered into an arrangement under the AGP. Under the AGP termination agreement, Citigroup, FDIC, and Treasury agreed that FDIC and Treasury retain approximately \$5.3 billion of trust preferred securities of Citigroup, as well as the warrants, and agreed that FRB NY would receive a \$50 million termination fee. In connection with the early termination of the guarantee, Treasury agreed to cancel \$1.8 billion of the trust preferred securities. Also, in January 2009, Bank of America entered into a term sheet with the Treasury, FDIC, and the FRB NY in which agencies agreed in principle to guarantee losses arising on a \$118 billion portfolio of Bank of America assets. In May 2009, Bank of America announced its intentions of terminating negotiations on the agreement, and in September 2009, Treasury, FRB NY, the FDIC, and Bank of America entered into a termination agreement with Bank of America under which Bank of America agreed to pay a termination fee of \$425 million.

-
- The Capital Assistance Program (CAP), established in February 2009, was designed to help ensure that qualified financial institutions have sufficient capital to withstand severe economic challenges. These institutions were required to meet eligibility requirements substantially similar to those used for CPP. A key component of CAP was the Supervisory Capital Assessment Program (SCAP), under which federal bank regulators, led by the Federal Reserve, conducted capital assessments, or “stress tests,” of large financial institutions. Participation in SCAP was mandatory for the 19 largest U.S. bank holding companies (those with risk-weighted assets of \$100 billion or more as of December 31, 2008).¹⁷ The tests were designed to determine whether these companies had enough capital to absorb losses and continue lending even if economic and market conditions were worse than expected between December 2008 and December 2010.¹⁸ Institutions deemed not to have sufficient capital were given 6 months to raise private capital. In conjunction with the test, Treasury announced that it would provide capital through CAP to banks that needed additional capital but were unable to raise it through private sources. GMAC was the only institution determined to need additional capital assistance from Treasury. GMAC received the additional capital assistance through AIFP on December 30, 2009. Treasury announced the closure of CAP, on November 9, 2009.

In addition to loans and guarantees, Treasury purchased or received various types of equity investments, ranging from common stock to subordinated debentures and warrants.

¹⁷Risk-weighted assets are the total assets and off-balance sheet items held by an institution weighted for risk according to Federal Reserve regulations.

¹⁸Federal bank regulators that conducted the stress test included the Federal Reserve and Federal Reserve Banks, FDIC, and OCC. GAO is currently conducting a review of the Supervisory Capital Assessment Program that it plans to issue later this year.

Table 1: Definitions of Equity Investments

Type of investment	Definition
Common stock	Unit of ownership in a company that generally entitles the owner to a pro rata share of company assets and right to vote.
Preferred stock	Preferred stock is a form of ownership in a company that entitles its holders to some preference or priority over the owners of common stock, usually with respect to dividends or asset distributions in liquidation.
Mandatory convertible preferred stock	A type of preferred share that must be converted to common stock at the issuer's request, if specific criteria are met by a certain date.
Trust preferred stock	Cumulative preferred stock instruments that are considered hybrid securities because they contain features of both debt and equity.
Subordinated debenture	Subordinated debentures are bonds whose claim on income and assets of the issuer in the event of default or if the issuer files for bankruptcy is ranked below the claims of senior bondholders, but above all classes of equity.
Warrants	An option to buy shares of common stock or preferred stock at a predetermined price on or before a specified date.

Source: GAO and SIGTARP.

Four Core Principles Guide Treasury's Management of Its Equity Interest

Recognizing the challenges associated with the federal government having an ownership interest in the private market, the administration developed several guiding principles for managing its TARP investments. According to the principles issued in March 2009, the government will:

- *Act as a reluctant shareholder.* The government has no desire to own equity stakes in companies any longer than necessary and will seek to dispose of its ownership interests as soon as practical. The goal is to promote strong and viable companies that can quickly be profitable and contribute to economic growth and jobs without government involvement.
- *Reserve the right to set up-front conditions.* The government has the right to set up-front conditions to protect taxpayers, promote financial stability, and encourage growth. These conditions may include restructurings as well as changes to ensure a strong board of directors that selects management with a sound long-term vision to restore their companies to profitability and to end the need for government support as quickly as is practically feasible.
- *Not interfere in the day-to-day management decisions of a company in which it is an investor.* The government will not interfere with or exert control over day-to-day company operations. No government employees will serve on the boards or be employed by these companies.

-
- *Exercise limited voting rights.* As a common shareholder, the government will vote on only core governance issues, including the selection of a company’s board of directors and major corporate events or transactions. While protecting taxpayer resources, the government has said that it intends to be extremely disciplined as to how it uses even these limited rights.

Regulators Play Key Role in Overseeing Regulated Institutions That Received Assistance

Federal financial regulators—Federal Reserve, FHFA, FDIC, OCC, and Office of Thrift Supervision—play a key role in regulating and monitoring financial institutions, including most of the institutions that received exceptional amounts of financial assistance. Because Bank of America, Citigroup, the Enterprises, and GMAC are all regulated financial institutions, not only were they monitored by Treasury as an investor but they continued to be regulated and overseen by their primary federal regulator.¹⁹ Specifically, the Federal Reserve oversees bank holding companies—including Bank of America, Citigroup, and GMAC—to help ensure their financial solvency.²⁰ As regulated institutions, Bank of America, Citigroup, and GMAC were subject to ongoing oversight and monitoring before they received any government financial assistance and will continue to be regulated and supervised by their regulator after the assistance has been repaid. FHFA regulates and supervises the Enterprises and established their conservatorships in 2008.

The Federal Reserve’s program for supervising large, complex banking organizations is based on a “continuous supervision” model that assigns a team of examiners dedicated to each institution and headed by a central point of contact. The Federal Reserve regularly rates the bank holding

¹⁹GMAC did not become a bank holding company until after the Federal Reserve approved its application on December 24, 2008, and GMAC is now regulated and supervised by the Federal Reserve. Before GMAC became a bank holding company, GM and a private equity firm had owned a controlling interest in GMAC. GMAC applied to become a bank holding company on the conversion of its subsidiary industrial loan company to a commercial bank. The FDIC was the primary federal supervisor of GMAC’s subsidiary industrial loan company and has remained the primary federal supervisor of the successor commercial bank. An industrial loan company is an FDIC-supervised, state-chartered financial institution whose distinct features included the fact that it can be owned by a commercial firm.

²⁰Bank Holding Company Act of 1956, c. 240, 70 Stat. 13 (May 9, 1956) (codified, as amended, at 12 U.S.C. § 1841 *et seq.*).

company's operations, including its governance structure.²¹ Throughout the crisis, staff dedicated to the largest institutions have increased, as has the oversight and involvement in supervising the financial condition and operations of the institutions.

In addition to its bank holding company regulatory and supervisory responsibilities, the Federal Reserve conducts the nation's monetary policy by influencing the monetary and credit condition in the economy in pursuit of maximum employment, stable prices, and moderate long-term interest rates. Also, under unusual and exigent circumstances, the Federal Reserve has emergency authorization to assist a financial firm that is not a depository institution.²² The Federal Reserve used this authority to help address the recent financial crisis, which also resulted in the government acquiring an ownership interest in AIG.²³

Subsidiary banks of Bank of America, Citigroup, and GMAC are supervised by other federal regulators, including OCC and FDIC. For example, OCC supervises Citibank—Citigroup's national bank. In addition, FDIC oversees the banks' condition and operations to gauge their threat to the deposit insurance fund. It also is the primary federal supervisor of GMAC's bank. These bank supervisors generally use the same framework to

²¹Specifically, Federal Reserve Bank staff evaluate a bank holding company's risk management practices, financial condition, and the potential for negative impact that the bank holding company and its nonbank subsidiaries may have on the depository institutions controlled by the bank holding company. In assessing risk management, Federal Reserve Bank staff conduct assessments of a bank holding company's board and senior management oversight; its policies, procedures, and limit structures; its management information systems and risk monitoring mechanisms; and its internal control and audit processes. These assessments are conducted across five major risk factors, including: credit, market, liquidity, operational, and legal and compliance risks. In assessing the financial condition of a bank holding company, Federal Reserve Bank staff evaluate the bank holding company's capital, asset quality, earnings, and liquidity.

²²Section 13(3) of the Federal Reserve Act, c. 6, §13(3), 38 Stat. 251, 263 (Dec. 23, 1913) codified, as amended, at 12 U.S.C. § 343 (2006). This provision allows the Federal Reserve, in "unusual and exigent circumstances," to authorize any Federal Reserve Bank to extend credit in the form of a discount to individuals, partnerships, or corporations when the credit is "indorsed or otherwise secured" to the satisfaction of the Federal Reserve Bank, after obtaining evidence that the individual, partnership, or corporation is unable to secure adequate credit accommodations from other banking institutions.

²³The Office of Thrift Supervision was the consolidated supervisor of AIG because it was considered a thrift holding company. According to Office of Thrift Supervision, on the closure of the FRBNY loan, AIG no longer met the statutory definition of a thrift holding company. Thus, Office of Thrift Supervision does not regulate the AIG parent company and its only supervisory role is with the thrift that AIG owns.

examine banks for safety and soundness and compliance with applicable laws and regulations. As described above, they examine most aspects of the bank's financial condition, including the bank's management.

Finally, FHFA was created in 2008 to oversee the housing enterprises, Fannie Mae and Freddie Mac. It replaced the Office of Federal Housing Enterprise Oversight and the Federal Housing Finance Board, and the Department of Housing and Urban Development's mission authority was transferred to FHFA. The Enterprises are chartered by Congress as for-profit, shareholder-owned corporations, now currently under federal conservatorship.²⁴ Using a risk-based supervisory approach, FHFA examines the Enterprises, including their corporate governance and financial condition.²⁵

How the Federal Government Acquired Its Equity Interest Varies by Institution, but Resulted from Assistance Aimed at Stabilizing Financial Markets, Housing Markets, or Individual Market Segments

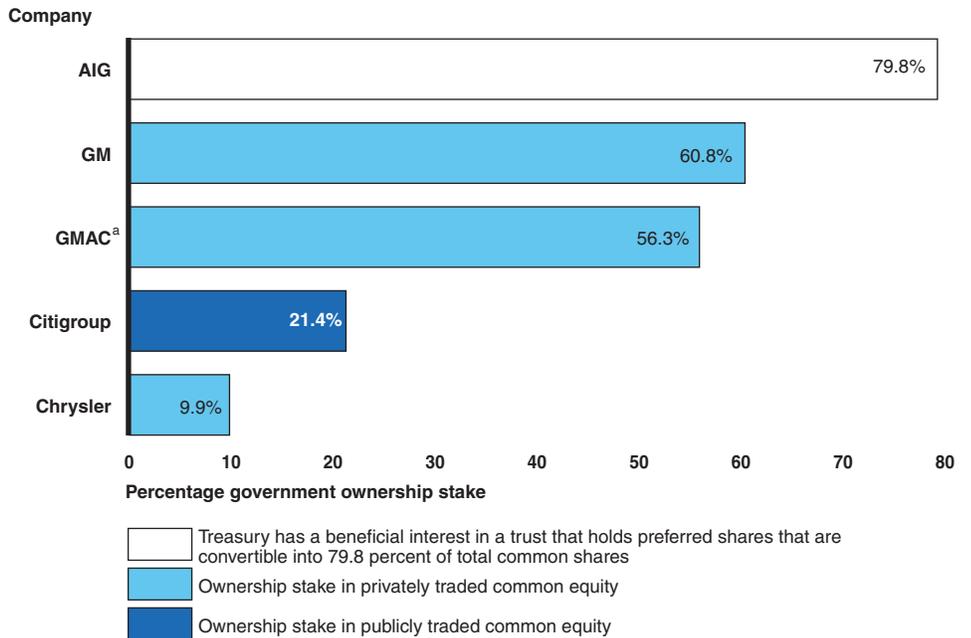
The federal government's equity interest was acquired in a variety of ways and resulted from assistance aimed at stabilizing markets or market segments. Moreover, the government's equity interest in the companies varies from company to company—ranging from preferred shares to common shares. In some cases, the government acquired an equity interest when it cancelled outstanding loans in exchange for common shares of the debtor. As of June 1, 2010, the government held an equity ownership interest in the form of preferred or common shares in the five major corporations—AIG, Chrysler, Citigroup, GM, GMAC—and the Enterprises. As shown in figure 1, the government holds the largest share of common stock in GM, but it also holds significant common stock in GMAC and smaller amounts, in terms of percentage, of Citigroup and Chrysler. It holds significant amounts of preferred shares, convertible preferred shares, or warrants for common shares in AIG and the Enterprises,²⁶ as a result of the assistance provided.

²⁴The primary role of the Enterprises is to stabilize and assist the U.S. secondary mortgage market and facilitate the flow of mortgage credit. To accomplish this goal, they issue debt and stock and use the proceeds to purchase conventional mortgages that meet their underwriting standards, known as conforming mortgages, from primary mortgage lenders such as banks or thrifts. Most of the purchased mortgages are packaged into mortgage-backed securities that are sold to investors. The Enterprises may also hold mortgages in these retained portfolios.

²⁵[GAO-09-782](#).

²⁶Fannie Mae and Freddie Mac were in conservatorship with FHFA before TARP was established.

Figure 1: Government's Share of Common Equity in Selected Companies, as of June 1, 2010



Source: GAO analysis of OFS documents and SEC filings.

^aIn addition to the common equity shares, Treasury holds mandatory convertible preferred shares which, if converted, would give Treasury more than 80 percent of GMAC's common equity.

Treasury Provided Funds to Bank of America and the Enterprises in Exchange for Preferred Stock

Treasury provided funds to Bank of America and the Enterprises in exchange for preferred stock with no voting rights except in limited circumstances, giving the federal government an equity interest in these companies. Specifically, the government's \$45 billion investment in Bank of America—which participated in CPP and TIP—gave Treasury ownership of nonvoting preferred shares in the company. Bank of America received \$25 billion in CPP funds and \$20 billion in TIP funds. The transactions were consummated pursuant to a securities purchase agreement, and the terms of the preferred shares acquired by Treasury included the right to payment of fixed dividends and no voting rights except in limited circumstances. On December 9, 2009, Bank of America repurchased all of its preferred shares previously issued to Treasury, ending the company's participation in TARP. The company, as required, also paid over \$2.7 billion in dividends to Treasury. On March 3, 2010, Treasury auctioned its Bank of America warrants for \$1.54 billion.

On September 6, 2008, when FHFA placed the Enterprises into conservatorships, Treasury provided financial assistance in consideration of equity interest.²⁷ Under the transaction agreements, the Enterprises immediately issued to Treasury an aggregate of \$1 billion of senior preferred stock and warrants to purchase common stock. The warrants allow Treasury to buy up to 79.9 percent of each entity's common stock, can be exercised at any time, and are intended to help the government recover some of its investments if the Enterprises become financially viable. Under the terms of the preferred shares, Treasury is to receive dividends on the Enterprises' senior preferred shares at 10 percent per year and, beginning March 31, 2010, quarterly commitment fees from the enterprises that have not yet been implemented. Further, the preferred share terms include restrictions on the Enterprises' authority to pay dividends on junior classes of equity, issue new stock, or dispose of assets. At the end of the first quarter 2010, Treasury had purchased approximately \$61.3 billion in Freddie Mac preferred stock and \$83.6 billion in Fannie Mae preferred stock to cover losses. Because of the continued deteriorating financial condition of the Enterprises, the amount of government assistance to them is likely to increase. The government's most substantive role is as conservator of the Enterprises, which is discussed later.

Treasury Provided Funds and Other Financial Assistance to Citigroup, GMAC, GM, and Chrysler, in Exchange for Common Stock

Treasury has provided funds and other financial assistance to Citigroup, GMAC, GM, and Chrysler in exchange for common shares with voting rights, giving the federal government an equity stake in these companies. For Citigroup and GMAC, the common stock strengthened their capital structure, because the markets view common equity more favorably than preferred shares. Initially, Treasury invested \$25 billion in Citigroup under CPP and an additional \$20 billion under TIP. Treasury also entered into a loss sharing arrangement with Citigroup on approximately \$301 billion of assets under AGP under which Treasury assumed \$5 billion of exposure

²⁷The funding liquidity that Treasury provides allows the Enterprises to continue to function within the realm of the conservatorship. Under HERA, FHFA also has the authority to place the Enterprises into receivership and sell all of their assets. Receivership must be imposed if the debts of an enterprise exceed its assets during a previous 60 day time frame, or if an enterprise has not been paying its debts. Some debts are due on an ongoing basis.

following Citigroup's first losses of \$39.5 billion.²⁸ In exchange for this assistance, Treasury received cumulative nonvoting preferred shares and warrants to purchase common shares. FDIC also received nonvoting preferred stock for its role in AGP. Citigroup subsequently requested that Treasury exchange a portion of the preferred shares held by Treasury for common shares to facilitate an exchange of privately held preferred shares for common shares. Taken together, Treasury and private exchanges improved the quality of Citigroup's capital base and thereby strengthened its financial position.²⁹ From July 2009 to September 2009, Treasury exchanged its preferred shares in Citigroup for a combination of shares of common stock and trust preferred shares, giving the government a 33.6 percent ownership interest in Citigroup. Treasury now has voting rights by virtue of its common stock ownership. On December 23, 2009, Citigroup repurchased \$20 billion of trust preferred shares issued to Treasury and the Federal Reserve, FDIC, and Treasury terminated the AGP agreement. FDIC and Treasury, collectively, kept approximately \$5.3 billion in trust preferred shares, including the warrants that were associated with this assistance, as payment for the asset protection provided under AGP. As of May 26, 2010, Treasury still owned almost 6.2 billion shares, or 21.4 percent, of Citigroup's common shares and warrants.³⁰

²⁸Under the AGP agreement, Treasury, FDIC, and FRBNY provided protection against the possibility of large losses on an asset pool of approximately \$301 billion which remained on Citigroup's balance sheet. The following loss-sharing terms applied to the transaction: (1) Citigroup was to absorb the first \$39.5 billion in losses and (2) losses more than the \$39.5 billion were to be shared by the U.S. government (90 percent) and Citigroup (10 percent) with the U.S. government piece being paid in the following order and amounts: First, Treasury in an amount up to \$5 billion, then FDIC in an amount up to \$10 billion, and lastly had Treasury and FDIC paid out the full amount of their commitments, Citigroup would have been able to obtain a one-time recourse loan from FRBNY secured by the remainder of the asset pool. The Citigroup AGP agreement has been terminated and no losses were paid by the U.S. government, and stock, warrants, and fees were obtained by the government and FRBNY in exchange for entering into the agreement.

²⁹The federal banking regulators expect all bank holding companies to have a level and composition of Tier 1 capital well in excess of the 4 percent regulatory minimum, and also to have common equity as the dominant element of Tier 1 capital. The amount and the composition of a bank holding company's capital contribute to its strength. The common equity is the first element of the capital structure to absorb loss and offers protection to more senior parties of the capital structure. A provision of EESA gives Treasury the authority to acquire common equity shares. Tangible common equity is equity capital minus the sum of perpetual preferred stock (net of related Treasury stock) and intangible assets.

³⁰Because Citigroup raised capital through new issuance in December 2009 and selling its common stock, overall stock holdings were diluted, including Treasury's investment. Moreover, Treasury began selling its shares in the secondary market in April 2010.

Treasury's AIFP assistance to GMAC, a bank holding company, resulted in the government owning more than half of GMAC by the end of 2009. After GMAC received approval from the Federal Reserve to become a bank holding company in December 2008, Treasury initially purchased \$5 billion of GMAC's preferred shares and received warrants to purchase an additional \$250 million in preferred shares. Treasury exercised those warrants immediately.³¹ At the same time, Treasury also agreed to lend up to \$1 billion of TARP funds to GM (one of GMAC's owners), to enable GM to purchase additional equity in GMAC. On January 16, 2009, GM borrowed \$884 million under that commitment, to purchase an additional interest in GMAC. Treasury terminated the loan on May 29, 2009, by exercising its option to exchange amounts due under that loan for an equity interest in GMAC.

The Federal Reserve required GMAC to raise additional capital by November 2009 in connection with SCAP. On May 21, 2009, Treasury purchased \$7.5 billion of mandatory convertible preferred shares from GMAC and received warrants that Treasury exercised at closing for an additional \$375 million in mandatory convertible preferred shares, which enabled GMAC to partially meet the SCAP requirements. On May 29, 2009, Treasury exercised its option to exchange its right to payment of the \$884 million loan it had made to GM for 35.4 percent of the common membership interests in GMAC. Treasury officials told us that exercising the option prevented the loan from becoming part of the GM bankruptcy process and therefore, was a measure intended to protect Treasury's investment. According to the Federal Reserve, the exercising of the option strengthened GMAC's capital structure. In November 2009, the Federal Reserve announced that GMAC did not satisfy the SCAP requirements because it was unable to raise additional capital in the private market and was expected to meet its SCAP requirement by accessing the AIFP. On December 30, 2009, Treasury purchased an additional \$1.25 billion of mandatory convertible preferred shares and received warrants that Treasury exercised at closing for an additional \$62.5 million in mandatory convertible preferred shares, and further purchased \$2.54 billion in GMAC trust preferred securities and received warrants that Treasury exercised at

³¹GMAC is a privately held institution. With respect to TARP investments, privately held institutions did not issue warrants to purchase shares of common stock. Instead, Treasury receives from privately held institutions warrants to purchase a specified number of shares of preferred stock, called warrant preferred stock, that pay dividends at 9 percent annually. Unlike the warrants issued by publicly held institutions, such as Bank of America or Citigroup, Treasury exercised these warrants immediately.

closing for an additional \$127 million in GMAC trust preferred securities, which were all investments under the AIFP.³² Also, in December 2009, Treasury converted \$3 billion of existing mandatory convertible preferred shares into common stock, increasing its equity stake from 35 percent to 56.3 percent of GMAC common stock. As of March 31, 2010, Treasury owned \$11.4 billion of GMAC mandatory convertible preferred shares and almost \$2.7 billion of its trust preferred securities.

Treasury's equity stake in GM and Chrysler was an outgrowth of the \$62 billion it loaned to the companies under AIFP before the companies filed for bankruptcy in June and April 2009, respectively. Through the bankruptcy process, these loans were restructured into a combination of debt and equity ownership in the new companies. As a result, Treasury owns 60.8 percent of the common equity and holds \$2.1 billion in preferred stock in "new GM." Also, Treasury owns 9.9 percent of common equity in the "new" Chrysler. As a common shareholder, Treasury has voting rights in both companies.

The Federal Reserve and Treasury Provided Funds to AIG in Exchange for Preferred Stock and a Warrant

The Federal Reserve and Treasury provided funds to AIG under a series of transactions that ultimately resulted in the federal government owning preferred stock and a warrant to purchase common stock. While the Federal Reserve is not AIG's regulator or supervisor, FRBNY assisted AIG by using its emergency authority under Section 13(3) of the Federal Reserve Act to support the government's efforts to stabilize systemically significant financial institutions. In the fall of 2008, the Federal Reserve approved assistance to AIG by authorizing FRBNY to create a facility to lend AIG up to \$85 billion to address its liquidity needs. As part of this agreement, AIG agreed to issue convertible preferred stock to a trust to be created on behalf of the U.S. Treasury (the AIG Credit Facility Trust). This was achieved through the establishment of an independent trust to manage the U.S. Treasury's beneficial interest in Series C preferred shares that, as of April 2010, were convertible into approximately 79.9 percent of the common stock of AIG that would be outstanding after the conversion of the Series C preferred shares in full.³³ While the Series C preferred shares initially represented 79.9 percent of the voting rights, after

³²According to GMAC, in December 2009, it exchanged existing preferred shares and mandatory convertible preferred shares for new mandatory convertible preferred shares with a total liquidation preference of \$10.1 billion.

³³The trust structure is discussed in greater detail later in the report.

Treasury's November 2009 TARP investment, the amount of Series C preferred shares voting rights to be acquired was reduced to 77.9 percent to account for the warrant to purchase 2 percent of the common shares that Treasury received in connection with that TARP investment. A June 2009 20 to 1 reverse stock split adjusted the exercise price and number of shares associated with the Treasury warrant, allowing warrants held by Treasury to become convertible into 0.1 percent common equity. Part of the outstanding debt was restructured, when as noted above, Treasury agreed to purchase \$40 billion of cumulative perpetual preferred stock (Series D) and received a warrant under TARP. The proceeds were used to reduce the debt owed to FRBNY by \$40 billion. To address rating agencies' concerns about AIG's debt-equity ratios, FRBNY and Treasury further restructured AIG's assistance in April 2009. Treasury exchanged its outstanding cumulative perpetual preferred stock (Series D) for perpetual preferred stock (Series E), which is noncumulative and thus, more closely resembles common equity than does the Series D preferred stock. Treasury has also provided a contingent \$29.8 billion Equity Capital Facility to AIG whereby AIG issued to Treasury 300,000 shares of fixed-rate, noncumulative perpetual preferred stock (Series F). As AIG draws on the contingent capital facility, the liquidation preference of those shares automatically increases by the amount drawn. AIG also issued to Treasury a warrant to purchase up to 3,000 shares of AIG common stock. As of March 2010, the government has a beneficial interest in the Series C preferred shares held by the AIG trust, which is convertible into approximately 79.8 percent of the ownership of the common shares and the trustees have voting rights with respect to the Series C preferred shares.³⁴

³⁴Treasury's beneficial interest is managed by three trustees. The three trustees who manage the trust are independent of the FRBNY, AIG, and Treasury. The trust agreement provides that the trust is for the sole benefit of the Treasury General Fund, which means that any property distributable shall be paid to Treasury for deposit into the U.S. Treasury General Fund as miscellaneous receipts. See AIG Credit Facility Trust Agreement, Section 1.01 (Jan. 16, 2009).

Federal Government Has Involved Itself in the Corporate Governance of the Companies Receiving Exceptional Amounts of Assistance, but Its Involvement in the Companies Has Varied

The government decided early on that in managing its ownership interest in private companies receiving exceptional TARP assistance, it would set up certain conditions in order to protect taxpayers, promote financial stability, and encourage growth.³⁵ As noted in a recent SIGTARP report, these conditions include requiring limits on or changes to the companies' governance structure such as boards of directors, senior management, executive compensation plans, lobbying and expense policies, dividend distributions, and internal controls and submission of compliance reports.³⁶ Treasury also decided early on that it would not interfere with the daily business of the companies that received exceptional assistance—that is, it would not be running these companies. However, the level of its involvement in the companies has varied depending on the role it has assumed—investor, creditor, or conservator—as a result of the assistance it has provided.

Government Involvement Has Prompted Changes to Some Boards of Directors and Senior Management at Companies Receiving Exceptional Assistance

Both Treasury and the federal regulators directed that strong boards of directors and qualified senior management be in place to guide the companies' operations. Treasury designated new directors and requested that some senior executives step down from their positions at some of the companies. Using its authority as conservator, FHFA appointed new members to the boards and senior management of the Enterprises. The federal regulators requested reviews of the qualifications of senior management at two of the companies.

Government Involvement Has Prompted Changes to Some Boards of Directors

A significant number of new directors have been elected to the governing boards of all companies that received federal assistance. Of the 92 directors currently serving on these boards, 73 were elected since November 2008 (table 2). The board of Chrysler, for instance, is made up entirely of new members, and more than half of current board members of the other companies were designated after the government provided assistance. Many of these new directors were nominated to their respective boards because it was determined that a change in leadership was required as a result of the financial crisis, while others were designated by the government and other significant shareholders as a result of their common share ownership. In addition, federal regulators

³⁵These conditions established by Treasury did not apply to Fannie Mae and Freddie Mac.

³⁶See SIGTARP, *Treasury's Monitoring of Compliance with TARP Requirements by Companies Receiving Exceptional Assistance*, SIGTARP-10-007 (Washington, D.C., June 29, 2010).

also asked the boards of directors at two of the companies to assess their oversight and evaluate management depth. The assessments were submitted to the regulators, and the board of directors subsequently made changes to their composition.

Table 2: Changes in Boards of Directors since November 2008, as of June 30, 2010

Company	Current number of board of directors ^a	New directors since November 2008	Government-designated directors
AIG	13	8 ^b	2
Bank of America	13	10 ^c	none
Citigroup	15	8	none
GM	13	13	10 ^d
Chrysler	9	9	3
GMAC	9	8	3
Fannie Mae	10	8	10
Freddie Mac	10	9	10
Total	92	73	38

Source: SIGTARP and GAO analysis of government's agreements and company-provided data.

^aIncludes the Chairman of the Board and the CEO.

^bAIG shareholders elected 10 directors since November 2008; one of these directors was subsequently elected as Chairman of the Board. In cooperation with AIG's board, the AIG trustees were actively involved in the recruitment of five new directors.

^cBank of America added 10 directors since November 2008; one of these directors was subsequently elected as Chairman of the Board. Due to retirement or resignation 9 of the newly-elected directors remain.

^dOf these designated directors, five were members of the "old GM" board of directors.

The terms of Treasury's agreements with AIG and Bank of America require the expansion of the board of directors of the company, if the relevant company fails to pay the dividends to Treasury for several quarters.³⁷ Treasury would then have the right to designate the directors to be elected to fill the newly created vacancies on the board. While Bank of America made the required dividend payments prior to exiting TARP, AIG did not

³⁷Treasury's agreements with Bank of America stipulated that if dividends were not paid for six quarters, whether consecutively or not, Treasury, along with holders of other parity preferred stock of Bank of America had the right to elect two additional directors to the company's board. With respect to AIG, Treasury may elect to the board the greater of two members, or 20 percent of the total number of directors, when the company misses four dividend payments.

pay its required dividends. As a result, Treasury designated two new directors for election to AIG's board on April 1, 2010. They were subsequently re-elected at the May 12, 2010, annual shareholders meeting. The trust agreement between FRBNY and the AIG trustees also provides the trustees with authority to vote the shares held in trust to elect or remove the directors of the company. In cooperation with AIG's board, the AIG trustees were actively involved in the recruitment of six new directors who have experience in corporate restructuring, retail branding, or financial services, and believe that these new members will help see AIG through its financial challenges. The board, in turn, has elected two additional members to replace departing board members. The trustees stated that they kept FRBNY and Treasury officials apprised of the recruitment efforts.

Treasury's common equity investment in Citigroup, GM, Chrysler, and GMAC also gives it voting rights on the election or removal of the directors of these governing boards, among other matters.³⁸ In addition, the agreements with GM, Chrysler, and GMAC specifically authorize Treasury to designate directors to these companies' boards.

- As authorized in a July 10, 2009, shareholder agreement with GM, Treasury, as the majority shareholder, designated 10 directors who were elected to GM's board, 5 of whom were former directors of "old GM." Based on the smaller number of common shares they owned in the company, two other GM shareholders—Canada GEN Investment Corporation (owned by the Canadian government) and a Voluntary Employee Beneficiary Association composed of GM's union retirees—each designated one director.
- As authorized in a June 10, 2009, operating agreement with Chrysler, Treasury designated three of nine directors, who in turn, collectively elected an additional member to the board. Chrysler's other shareholders designated the other five board members, for a total of nine directors. Chrysler's Voluntary Employee Benefit Association appointed one director, Fiat appointed three directors, and the Canadian government appointed one director. Under the operating agreement, the number of directors that Fiat has the right to designate increases as its ownership in

³⁸Treasury can also vote on certain major corporate transactions such as, mergers, sales of substantially all assets, and dissolution; issuances of equity securities that entitle shareholders to vote; and amendments to the charter or bylaws.

Chrysler increases, with a concomitant decrease in the number of directors designated by Treasury.

- As authorized in a May 21, 2009, governance agreement with GMAC, Treasury appointed two new directors to the board because it held 35 percent of the company's common stock. With the conversion of \$3 billion in mandatory convertible preferred shares of GMAC on December 30, 2009, Treasury's common ownership interest increased to 56.3 percent, authorizing it to appoint two more directors. On May 26, 2010, Treasury appointed a new director to GMAC (Ally Financial Inc., formerly GMAC Financial Services). The fourth director appointment is pending.

As conservator of the Enterprises, FHFA has appointed new members to the boards of directors. The Director of FHFA has statutory authority under HERA to appoint members of the board of directors for the Enterprises based on certain criteria. FHFA's former director, at the onset of conservatorships, decided to keep three preconservatorship board members at each Enterprise in order to provide continuity and chose the remaining directors for each board. Initially, on September 16, 2008, FHFA's former director appointed Philip A. Laskawy and John A. Koskinen to serve as new nonexecutive chairmen of the boards of directors of the Enterprises. On November 24, 2008, FHFA reconstituted the boards of directors for the Enterprises and directed their functions and authorities. FHFA's delegation of authority to the directors became effective on December 18-19, 2008, when new board members were appointed by FHFA. The directors exercise authority and serve on behalf of the conservator, FHFA. The conservator retains the authority to withdraw its delegations to the board and to management at any time.

Government Involvement Has Prompted Changes to Senior Management

In addition to changes in the boards of directors, the companies receiving exceptional assistance have also made a few changes to their senior management (table 3). Some of these decisions were made by the companies' boards of directors without consultation with Treasury or federal regulators. Specifically, Bank of America,³⁹ Citigroup, and GMAC executives stated that the decisions to replace their chief executive officer (CEO) or chief financial officer (CFO) were made by the companies' boards of directors without influence from Treasury or federal regulators.

³⁹According to Bank of America, Bank of America's board of directors and management worked together to replace its CEO upon Kenneth Lewis's announced retirement and to replace its CFO once new CEO Brian Moynihan moved the present CFO into a different role with the company.

However, federal regulators had directed the banks to assess their senior management’s qualifications. After receiving government assistance, Bank of America’s shareholders approved an amendment to the corporation’s bylaws prohibiting any person from concurrently serving as both the company’s chairman of the board and CEO. As a result, the shareholders elected Walter Massey to replace Kenneth Lewis as chairman of the board in April 2009. Citigroup’s board of directors also appointed a new CFO in March 2009 and again in July 2009.

Table 3: Selected Changes in Senior Management at Corporations Receiving Exceptional Assistance, from September 18, 2008, through May 1, 2010

Company	New senior management
AIG	<ul style="list-style-type: none"> Edward Liddy replaced Robert Willumstad as CEO on September 18, 2008 Robert Benmosche replaced Edward Liddy as CEO on August 10, 2009
Bank of America	<ul style="list-style-type: none"> Shareholders approved an amendment to the corporation’s bylaws to require an independent chairman of the board on April 29, 2009; Walter Massey replaced Kenneth Lewis as the new Chairman Kenneth Lewis retired on December 31, 2009; Brian Moynihan became CEO on January 1, 2010
Citigroup	<ul style="list-style-type: none"> Edward “Ned” Kelly became CFO on March 20, 2009; he was appointed Vice Chairman on July 09, 2009 John Gerspach became CFO on July 09, 2009
GMAC	<ul style="list-style-type: none"> Michael Carpenter (member of the Board of Directors) replaced Alvaro de Molina as CEO on November 16, 2009
GM	<ul style="list-style-type: none"> Frederick “Fritz” Henderson replaced Rick Wagoner as CEO on March 30, 2009 Edward Whitacre (also Chairman of the Board) replaced Fritz Henderson as CEO on December 1, 2009 Chris Liddell replaced Ray Young as CFO on January 1, 2010
Chrysler	<ul style="list-style-type: none"> Sergio Marchionne (also CEO of Fiat) replaced Robert Nardelli as CEO on June 10, 2009
Fannie Mae	<ul style="list-style-type: none"> Herbert M. Allison was put in place by FHFA as CEO, replacing Daniel Mudd on September 7, 2008 Michael Williams was promoted to CEO from his chief operations officer position on April 20, 2009, and replaced Herbert M. Allison, moving to Treasury to head the TARP program
Freddie Mac	<ul style="list-style-type: none"> In September 2008, David Moffett was appointed to replace Richard Syron and resigned as CEO and member of the board, effective on or before March 13, 2009 John A. Koskinen was named interim CEO on March 11, 2009, replacing Charles Haldeman became CEO on July 21, 2009

Source: SIGTARP and GAO analysis of Treasury and company information.

Note: This is a list of selected changes and is not comprehensive. Some of the companies experienced other changes that may not be reflected in the table.

The AIG trustees stated that they and the Treasury officials monitoring AIG’s investments were kept apprised of the selection of Robert Benmosche to replace Edward Liddy—who was put in place as AIG’s CEO on September 18, 2008, at the request of the government to help rehabilitate the company and repay taxpayer funds—as the new CEO in August 2009. Meeting minutes provided by the AIG trustees show that the

trustees and FRBNY and Treasury officials discussed the CEO search process as it was occurring. The trustees and Treasury officials also met with Benmosche before he was elected as AIG's new CEO. According to the trustees, they encouraged the AIG board to select the most qualified CEO, but that the final decision to elect Benmosche rested with the AIG's board of directors.

GM's selection of new senior managers during the restructuring process was directly influenced by Treasury. For example, in March 2009, Treasury's Auto Team⁴⁰ requested that Rick Wagoner, GM CEO at the time, be replaced by Frederick "Fritz" Henderson, then the GM president. According to a senior Treasury official, the Auto Team had determined that the senior leadership in place at that time was resistant to change. But, rather than appointing an individual outside GM to serve as CEO, the team asked Fritz Henderson to serve as the CEO to provide some continuity in the management team. Henderson resigned on December 1, 2009, but the same Treasury official said that the Auto Team did not request his removal. The GM board of directors named Ed Whitacre to replace Henderson. After the partnership between Chrysler and Fiat was completed, Sergio Marchionne (CEO of Fiat) was elected as Chrysler's new CEO on June 10, 2009. Subsequent to his election, all changes to Chrysler's senior management were made by new company leadership without Treasury's involvement.

As the conservator, the FHFA director has the authority to appoint senior level executives at both Enterprises. On September 7, 2008, FHFA's former director appointed Herbert M. Allison, Jr. as President and CEO for Fannie Mae and David M. Moffett as President and CEO of Freddie Mac. Michael Williams was promoted to CEO for Fannie Mae from his Chief Operation Officer position to replace Herbert M. Allison, Jr., who became Treasury's Assistant Secretary for Financial Stability. On March 11, 2009, FHFA appointed John A. Koskinen as Freddie Mac's interim CEO and on July 21, 2009, Charles Haldeman was appointed CEO of Freddie Mac.

⁴⁰Treasury's Auto Team was responsible for overseeing the investments made to the auto industry.

The Government Placed Restrictions on Executive Compensation and Other Activities

As a condition of receiving assistance under TARP, recipients must adhere to the executive compensation and other requirements established under EESA and under Treasury regulations (see table 4). In addition, Treasury's agreements with these companies included provisions requiring the companies to adopt or maintain policies regarding expenses and lobbying, report to Treasury on internal controls, certify their compliance with agreement terms, restrict the amount of executive compensation deductible for tax purposes, and limit dividend payments, among others.⁴¹ In prior reports, GAO and SIGTARP had reviewed Treasury's efforts in ascertaining the companies' compliance with the key requirements in financial assistance programs, such as CPP. GAO had recommended to Treasury that it develop a process to ensure that companies participating in CPP comply with all the CPP requirements, including those associated with limitations on dividends and stock repurchase restrictions.⁴² Overtime, Treasury addressed these issues and established a structure to better ensure compliance with the agreements.

Table 4: Key Requirements Imposed in Government Agreements

Key requirements	AIG	Citigroup	Bank of America	GMAC	GM	Chrysler
Executive compensation	✓	✓	✓	✓	✓	✓
Expense or luxury expenditures policies	✓	✓	✓	✓	✓	✓
Lobbying policy	✓	✓	✓	✓	✓	✓
Dividends and repurchases	✓	✓	✓	✓		
Internal controls and compliance reports	✓	✓	✓	✓	✓	✓

Source: SIGTARP and GAO's analysis of government's agreements.

Note: The Enterprises are restricted similarly in the area of corporate governance, but some of the restrictions were placed by FHFA through its authority as the conservator and not through a contractual agreement. The Enterprises have not received TARP funding; therefore, TARP restrictions would not apply to them.

⁴¹Other requirements include producing risk management and use of funds reports, complying with the Employ American Workers Act, and maintaining bank holding company status.

⁴²GAO, *Troubled Asset Relief Program: Status of Efforts to Address Transparency and Accountability Issues*, GAO-09-296 (Washington, D.C.: Jan. 30, 2009).

Restrictions on Executive Compensation

Companies must adhere to the executive compensation and corporate governance rules as a condition for receiving TARP assistance.⁴³ Treasury created the Office of the Special Master to, among other things, review compensation payments and structures for certain senior executive officers and most highly compensated employees at each company receiving exceptional TARP assistance. The Special Master is charged with determining whether these payments and structures under the plans are inconsistent with the purposes of the EESA executive compensation provisions and TARP or otherwise contrary to the public interest.

On October 22, 2009, the Special Master issued his first determinations with respect to compensation structures and payments for the “top 25” employees of companies receiving exceptional TARP assistance.⁴⁴ In reviewing the payment proposals the companies submitted for 2009, the Special Master noted that the companies in some cases (1) requested excessive cash salaries, (2) proposed issuance of stock that was immediately redeemable, (3) did not sufficiently tie compensation to performance-based benchmarks, (4) did not sufficiently restrict or limit financial “perks” or curb excessive severance and executive retirement benefits, and (5) did not make sufficient effort to fold guaranteed compensation contracts into performance-based compensation. As a result, he rejected most of these initial proposals and approved a modified set of compensation structures and payments.

For the 2009 top 25 compensation structures and payments, table 5 shows that the Special Master required that AIG, Bank of America, and Citigroup reduce cash compensation for their top executives by more than 90 percent from the previous year. Although Bank of America repurchased

⁴³Section 111 of EESA, as amended by the Recovery Act, prescribes certain standards for executive compensation and corporate governance for recipients of exceptional TARP assistance. In June 2009, Treasury adopted an interim final rule to implement the executive compensation and corporate governance standards of EESA, as well as certain additional standards adopted under Treasury’s rulemaking authority. See 31 C.F.R. Part 30 (2009). The June 2009 interim final rule supersedes Treasury’s original executive compensation standards for companies participating in the TARP programs, which were adopted prior to ARRA.

⁴⁴The top 25 group includes 5 senior executive officers and 20 additional most highly compensated employees. However, the actual number of covered employees whose compensation was reviewed by the Special Master was less than 25 for some companies because of terminations, departures, and retirements between January 1, 2009, and October 22, 2009. Senior executive officer means a named executive officer who is an employee of a TARP recipient.

preferred shares on December 9, 2009, it agreed to remain subject to the Special Master’s determination for its top 25 employees for 2009. Similarly, Citigroup repurchased its TIP trust preferred shares on December 23, 2009, but also agreed to abide by all determinations that had been issued for 2009, including the Special Master’s requirement that Citigroup reduce its cash compensation by \$244.9 million, or 96.4 percent from 2008. While Citigroup had the largest percentage cash reduction, GMAC had the largest overall reduction in total direct compensation (both cash and stock)—GMAC was required to reduce its total direct compensation by \$413.3 million, or more than 85 percent of 2008 levels. Table 5 also shows that the Special Master approved a compensation structure for the most highly compensated executive at AIG that provides up to \$10.5 million in total direct compensation on an annual basis.

Table 5: Treasury Special Master’s Initial Determinations for Top 25 Employees for 2009

(Dollars in millions)

Company ^a	Decrease in cash compensation from 2008	Decrease in total direct compensation from 2008 ^b	Highest total direct compensation for covered executives for 2009 ^c
AIG	\$34.4 (90.8%)	\$28.4 (57.8%)	\$10.5
Bank of America	89.3 (94.5)	149.2 (65.5)	9.9
Citigroup	244.9 (96.4)	272 (69.7)	9.0
GMAC	10.4 (50.2)	413.3 (85.6)	8.5
GM	3.9 (31.0)	5.6 (24.7)	5.4
Chrysler	1.5 (17.9)	2.1 (24.2)	2.2

Source: SIGTARP and GAO analysis of Treasury data.

^aAlthough Chrysler Financial also had to abide by the Special Master’s determination (under Treasury regulations it was considered a recipient of “exceptional financial assistance” until May 2010 because of TARP obligations of affiliates), we did not include it in the table because it had repaid its direct TARP assistance in July 2009 and will wind down its operations in the near term.

^bTotal direct compensation equals cash salary, stock salary, and long-term restricted stock

^cAmounts reflected in the table do not include amounts the company has asserted to be payable under legally binding employment contracts.

On December 11, 2009, the Special Master released his second round of determinations on executive compensation packages for companies that received exceptional TARP assistance. These determinations covered compensation structures for the “next 75” most highly compensated employees including executive officers who were not subject to the October 22, 2009, decisions. Unlike the determination for the top 25 employees, which addressed the specific amounts paid to individuals, the

Special Master was required only to approve the compensation structure for this second group of employees. The determination covered four companies: AIG, Citigroup, GMAC, and GM.⁴⁵ The Special Master also rejected most of the submitted proposals and required that they be modified to include the following features.

- Cash salaries generally no greater than \$500,000, except in exceptional cases, as specifically certified by the company's independent compensation committee.
- Limits on cash compensation in most cases to 45 percent of total compensation, with all other pay in company stock in order to align executives' interests with long-term value creation and financial stability.
- In most cases, at least 50 percent of each executive's pay be held or deferred for at least 3 years, aligning the pay each executive actually receives with the long-term value of the company.
- Payment of incentives only if the executive achieves objective performance targets set by the company and reviewed by the Special Master that align the executives' interests with those of shareholders and taxpayers.
- Limits on total incentives for all covered executives to an aggregate fixed pool that is based on a specified percentage of eligible earnings or other metrics determined by the compensation committee and reviewed by the Special Master.
- A "clawback" provision covering incentive payments to covered executives that will take effect if the achievements on which the payments are based do not hold up in the long term or if an executive engages in misconduct.⁴⁶

On March 23, 2010, the Special Master released his determinations of compensation structures and payments (for 2010) for the top 25

⁴⁵Bank of America had already repurchased its preferred shares, so its next 75 employees were not subject to the review. Chrysler's and Chrysler Financial's next 75 employees generally were covered by the "safe harbor rule" provided in the Treasury regulations because their annual compensation, not including long-term restricted stock, did not exceed \$500,000.

⁴⁶Clawbacks are recovery by the company of amounts paid to an employee based on materially inaccurate financial statements or performance criteria.

employees at the five remaining firms that received exceptional TARP assistance from taxpayers: AIG, Chrysler, Chrysler Financial, GM, and GMAC. Examples of his determinations include a 63 percent decrease in cash compensation from 2009 levels for AIG, 45 percent decrease for GMAC, and 7.5 percent decrease for GM executives. Chrysler's 2010 cash salary rates for its executives remained at the same level as 2009. Similar to the determination for 2009, the Special Master approved an annual compensation structure for AIG's highest compensated executive that provides up to \$10.5 million in total direct compensation on an annual basis. Overall, the 2010 determinations included the following significant changes.

- On average, a 33 percent decrease in overall cash payments from 2009 levels for affected executives.
- On average, a 15 percent decrease in total compensation from 2009 levels for affected executives.
- Cash salaries frozen at \$500,000 or less, unless good cause is shown. Eighteen percent of executives subject to the March 2010 determinations (21 employees) were approved for cash salary rates greater than \$500,000.

HERA provides the Director of FHFA, in a conservatorship, the authority to establish executive compensation parameters for both the Enterprises. On December 24, 2009, the FHFA director approved Fannie Mae and Freddie Mac 2010 compensation packages. The compensation package for each chief executive officer was established at \$6 million with each package consisting of a base pay amount of \$900,000, deferred pay of \$3.1 million, and a long-term incentive pay of \$2 million. Twelve other Fannie Mae executives and 14 other Freddie Mac executives are covered by the same system, but will receive lesser amounts. The deferred pay will be paid quarterly in 2011 to executives still at the Enterprises, and half will vary based on corporate performance. The long-term incentive pay will vary according to individual and corporate performance. Pursuant to the preferred stock purchase agreements, FHFA consulted with the Special Master for TARP Executive Compensation with regards to the 2010 compensation packages. Compensation of the executives at the Enterprises is presented in the form of cash payments. According to the Special Master and the FHFA Acting Director, compensation in the form of stock was viewed as ineffective because of the questionable value of the shares and the potential incentives stock compensation might generate to take excessive risk in hopes of making the stock valuable.

Restrictions on Other Company Activities

In addition to executive compensation, Treasury also placed requirements pertaining to other business activities, including expense and luxury expenditures, lobbying, dividends and stock repurchases, and internal controls and compliance. For example, companies receiving exceptional assistance are required to implement and maintain an expense policy that covers the use of corporate aircraft, lease or acquisition of real estate, expenses related to office or facility renovations or relocations, expenses related to entertainment and holiday parties, hosting and sponsorship of conferences and events, travel accommodations and expenditures, and third-party consultations, among others. They are also required to implement and maintain a lobbying policy that covers lobbying of U.S. government officials, governmental ethics, and political activity.⁴⁷ Furthermore, until Treasury no longer owns company debt or equity securities (e.g. common, preferred, and trust preferred stock), the companies may not declare or pay any dividends; make any distribution on the company's common stock; or redeem, purchase, or acquire any of the company's equity securities. They are also prohibited from redeeming or repurchasing any preferred or trust preferred stock from any holder unless the company offers to repurchase a ratable portion of the preferred shares then held by Treasury on the same terms and conditions, with limited exceptions. Lastly, the companies agreed to establish appropriate internal controls with respect to compliance with each of the requirements in agreement. They are required to report to Treasury on a quarterly basis regarding the implementation of those controls and their compliance with the requirements (including any instances of noncompliance). They are also required to provide signed certifications from a senior officer attesting that, to the best of his or her knowledge, such report(s) are accurate.

The Government's Involvement in the Companies Varied Depending on Its Role as Investor, Creditor, or Conservator

Treasury states that it does not interfere with or exert control over certain activities of companies that received exceptional assistance. Nevertheless, SIGTARP and GAO found that the level of government involvement in the companies varied among the recipients, depending on whether Treasury and other federal entities are investors, creditors, or conservators.

For example, Treasury's involvement in Bank of America, Citigroup, and GMAC has been limited because, in exchange for its investments, Treasury—as an investor—initially received preferred shares that did not

⁴⁷The original transaction agreements with GM and Chrysler did not include restrictions on lobbying and dividends. Restrictions on lobbying were recently added to the agreements.

have voting rights except in certain limited circumstances, such as amendments to the company charter, in the case of certain mergers, and the election of directors to the companies' boards in the event that dividends are not paid for several quarters. As of April 30, 2010, Treasury still held an ownership interest in Citigroup because of the June 9, 2009, agreement that exchanged Treasury's preferred shares for common shares.⁴⁸ Treasury's initial investment in GMAC also came in the form of preferred shares with limited voting rights. As an up-front condition to its May 2009 investments in Chrysler and GMAC, Treasury played a central role in establishing the agreement reached between GMAC and Chrysler in April 2009 that made retail and wholesale financing available to Chrysler's dealer network.⁴⁹ Specifically, Treasury provided GMAC with \$7.5 billion on May 21, 2009, of which \$4 billion was to be used to support Chrysler's dealers and consumers. According to Treasury officials, this agreement was part of the initial restructuring of the companies that was done under the auspices of the bankruptcy court, a situation that is quite different from the Bank of America and Citigroup investments.

Senior executive officers at Bank of America, Citigroup, and GMAC agreed that Treasury was not involved in the daily operations of their companies, but they noted that the federal regulators—the Federal Reserve, FDIC, and OCC—had increased and intensified their bank examinations. The executives explained that the closer scrutiny was the result of the financial crisis, and was not directly tied to TARP assistance. GMAC's senior officers further explained that the Federal Reserve's involvement with their company had been due, in part, to its obtaining bank holding company status upon conversion of Ally Bank (formerly known as GMAC Bank) from an industrial loan company to a commercial bank. As a result of the conversion, GMAC has had to work closely with the Federal

⁴⁸In the exchange agreement, Treasury agreed that it would vote all of its common shares with respect to each matter on which holders of common shares are entitled to vote (other than certain designated matters, including certain business combinations, dissolution of the company, amendments to charter and by-laws, issuances of additional securities, and election of directors to the company's board), in the same proportion as all other common shares are voted with respect to such matter.

⁴⁹Treasury also holds common shares of GMAC. On January 16, 2009, GM used \$884 million loaned by Treasury to purchase common equity in GMAC. On May 29, 2009, Treasury exchanged this \$884 million loan to GM for a portion of GM's common equity interest in GMAC. Through that exchange, Treasury held 35.4 percent of GMAC's common shares. In December 2009, Treasury converted \$3 billion of existing mandatory convertible preferred shares, which increased its common shares in GMAC from 35 percent to 56.3 percent.

Reserve to establish policies, procedures, and risk management practices to meet regulatory requirements of a bank holding company.

As both an investor in and creditor of AIG, GM, and Chrysler, the government has been more involved in some aspects of the companies' operations than it has been with other companies. Treasury, FRBNY, and the AIG trustees closely interact with senior management to discuss restructuring efforts, liquidity, capital structure, asset sales, staffing concerns, management quality, and overall strategic plans for the company. Members of Treasury's AIG team meet regularly with AIG management, attend board committee meetings, and provide input on decisions that affect the direction of the company. Similarly, FRBNY (as creditor) also attends board meetings as an observer, and FRBNY and the AIG trustees (as overseers of the AIG Trust) receive various AIG financial reports, review the quality of senior management, and provide their opinions on company strategy and major business decisions.

Treasury officials continue to monitor GM and Chrysler's strength through monthly and quarterly financial, managerial, and operations-related reports, and regular meetings with senior management, but stated that they do not micro-manage the companies. However, the government's stated "hands-off" approach towards managing its equity interest applied only after GM and Chrysler exited bankruptcy. In the period before and during the bankruptcies, Treasury played a significant role in the companies' overall restructuring and certain overarching business decisions. For example, Treasury issued viability determinations in which it stated that GM needed to decrease its number of brands and nameplates, and Chrysler needed to improve the quality of its vehicles. Treasury's credit agreements with the automakers established additional requirements for the companies. For example, the companies are required to maintain their domestic production at certain levels,⁵⁰ abstain from acquiring or leasing private passenger aircrafts, and provide quarterly reports on internal controls.⁵¹ Treasury officials pointed out that another

⁵⁰Chrysler 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 2008 U.S. production volume. GM must use its commercially reasonable best efforts to ensure that the volume of manufacturing conducted in the U.S. is consistent with at least 90 percent of the level envisioned in GM's business plan.

⁵¹Not all of the requirements contained in GM's credit agreement are still in effect since the company repaid its debt obligation in full in April 2010, but some, including those listed here, will remain in effect until certain obligations or other milestones are met. All of the requirements in Chrysler's credit agreement are still in effect.

reason for differences is that AIG, GM, and Chrysler are not subject to the extensive federal regulations that Bank of America, Citigroup, and GMAC, as bank holding companies, face. Moreover, officials believe that the path to exit the investments in the case of AIG, GM, Chrysler, and GMAC is more complex than in the case of Bank of America and Citigroup.

Under HERA, FHFA has broad authority over the Enterprises' operations while they are in conservatorship. The law authorizes FHFA to

- appoint members of the board of directors for both Enterprises based on certain criteria;
- prescribe appropriate regulations regarding the conduct of conservatorship or receivership;
- immediately succeed to all powers, privileges, and assets of the regulated Enterprises;
- operate the Enterprises;
- provide for the exercise of any functions of any stockholder, officer, or director of the entity; and
- take any actions that may be necessary to put the entity into a solvent and operationally sound state and conserve and preserve the assets of the entity.

According to FHFA officials, the agency has generally delegated significant day-to-day responsibility for running the Enterprises to the management teams that the agency has put in place for two reasons: First, FHFA has limited staff resources. Second, the Enterprises are better positioned with the expertise and infrastructure necessary to carry out daily business activities, such as the routine purchases of mortgages from lenders and securitization of such loans. At the same time, FHFA maintains its fulltime examination and supervisory programs for the Enterprises.

However, FHFA, as the Enterprises' conservator and regulator, has instituted a number of requirements, policies, and practices that involve them in the Enterprises. For example:

- Lobbying activities for both Enterprises have been dismantled and prohibited, and FHFA directly reviews all the Enterprises' responses to congressional members.

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- Officials from FHFA’s Office of Conservatorship Operations attend the board meetings and senior executive meetings at both of the Enterprises.
 - FHFA reviews and approves performance measures for both of the Enterprises. Each Enterprise has developed scorecards with criteria that focus on safety and soundness issues while at the same time aligning loan modification goals.
 - FHFA reviews to confirm that they have no objections to SEC filings for both of the Enterprises. The Division of Enterprise Regulation within FHFA was established by a statutory mandate within HERA to examine all functions of the Enterprises, with the exception of those explicit accounting examinations that are handled by the Office of the Chief Accountant.
 - FHFA and Treasury work closely with the Enterprises to implement a variety of programs that respond to the dramatic downturn in housing finance markets. FHFA monitors the Enterprises’ implementation of Treasury’s Home Affordable Modification Program (HAMP).⁵² The Enterprises are acting as Treasury’s agents in implementing the program and ensuring that loan servicers comply with program requirements, with Fannie Mae as the program’s administrator and Freddie Mac as Treasury’s compliance agent for the program. FHFA has also provided advice and resources to Treasury in designing the Making Home Affordable Program. FHFA and Treasury stay in contact with the Enterprises on a daily basis about HAMP. Executives for FHFA meet with executives of both of the Enterprises on a weekly basis, and Treasury executives meet with the Enterprises’ leadership monthly.

⁵²HAMP is part of the administration’s broader Making Home Affordable Program.

Federal Government Continues to Take Steps to Monitor Its Investments and Develop Exit Strategies

As a shareholder with respect to TARP recipients, the government has taken a variety of steps to monitor its investments in each company receiving exceptional assistance, while at the same time considering potential exit strategies. First, Treasury developed a set of guiding principles that outline its approach for monitoring investments in the companies. Second, OFS has hired asset managers to help monitor its investments in certain institutions, namely Citigroup and Bank of America.⁵³ Third, Treasury's Auto Team (or other Treasury investment professionals) manages investments in GM, Chrysler, and GMAC made under AIFP.⁵⁴ Fourth, the Federal Reserve and FRBNY collaborate with Treasury in monitoring the Federal Reserve's outstanding loan to and the government's equity investments in AIG. Finally, because Treasury's ownership in the Enterprises is not part of TARP, staff outside of OFS is responsible for monitoring these investments. Given the varied forms of ownership interest and the complexity of many of the investments, Treasury will likely have to develop a unique exit strategy for each company. The divestment process, however, is heavily dependent on company management successfully implementing strategies discussed with their regulators and Treasury. Further, external factors, such as investors demand for purchasing securities of these companies receiving exceptional assistance and broader market conditions, must be considered when implementing exit strategies. Because most of the shares are expected to either be sold in a public offering or be redeemed or repaid using funds raised in the public markets, the financial markets must be receptive to government efforts. A public offering of shares, such as those considered for AIG subsidiaries American International Assurance Company, Ltd and American Life Insurance Company⁵⁵ emphasizes the importance of market demand.⁵⁶ Congressional action will be needed to determine the long-term structures and exit strategies for the Enterprises.

⁵³These asset managers also have a role in monitoring other CPP participants.

⁵⁴As we have seen, GMAC became a bank holding company before receiving assistance. Due to its previous relationship as a subsidiary of GM, GMAC received its assistance under AIFP rather than from OFS programs which were dedicated to provide assistance to financial institutions.

⁵⁵American Life Insurance Company is under a definitive agreement to be sold to MetLife and according to Treasury, the transaction is expected to close before year end.

⁵⁶An initial public offering is a privately-owned company's first sale of its stock to the public. The result of the initial public offering is that the once privately owned firm becomes a publicly-traded company.

Federal Government Has Developed Guidance for Monitoring Its Investment in Companies

Treasury has stated that it is a reluctant shareholder in the private companies it has assisted and that it wants to divest itself of its interests as soon as is practicable. In managing these assets, Treasury has developed the following guiding principles.

- Protect taxpayer investment and maximize overall investment returns within competing constraints.
- Promote the stability of financial markets and the economy by preventing disruptions.
- Bolster markets' confidence to increase private capital investment.
- Dispose of the investments as soon as it is practicable and in a manner that minimizes the impact on financial markets and the economy.

Treasury Monitored Its Investments in Bank of America and Citigroup with the Assistance of Asset Managers but the Decision of When to Divest Was Not Always Treasury's

Treasury relied on its staff and asset managers to monitor its investments in Bank of America and Citigroup. Treasury officials said that the asset managers value the investments including the preferred securities and warrants. This valuation process includes tracking the companies' financial condition on a daily basis using credit spreads, bond prices, and other financial market data that are publicly available. Treasury also uses a number of performance indicators, including liquidity, capital levels, profit and loss, and operating metrics to monitor their financial condition. The asset managers report regularly to Treasury and provide scores that track the overall credit quality of each company using publicly available information. For the bank holding companies, Treasury monitors the values of its investments, whereas, the Federal Reserve and other regulators monitor the financial condition of these institutions as part of their role as supervisory authorities.

While federal regulators routinely monitor the financial condition of the financial institutions they supervise, this oversight is separate from the monitoring Treasury engages in as an equity investor. This supervisory monitoring is related to the regulatory authority of these agencies and not to investments made under TARP. For example, bank regulators had daily contact with Bank of America, Citigroup, and GMAC as they oversee the banks activities and help ensure their safety and soundness and monitor their financial condition. This daily interaction involves discussions about the institutions' financial condition and operations. Moreover, the Federal

Reserve and OCC officials said that they do not share supervisory information with Treasury to avoid a potential conflict of interest.⁵⁷

Rather than requiring the development of an exit strategy by Treasury, Bank of America and Citigroup, with the approval of their federal banking regulators, repurchased preferred shares and trust preferred shares from Treasury in December 2009. The holding companies and their regulators share the duty of identifying the appropriate time to repay the assistance provided through Treasury's purchase of preferred equity. The regulators leveraged their onsite examiners to provide information on the overall health of the banks and their efforts to raise capital. In September 2009, Bank of America and Citigroup initiated the process by informing the Federal Reserve that they wanted to redeem their TARP funds. Federal Reserve officials told us that in conjunction with FDIC and OCC, they reviewed Bank of America's and Citigroup's capital positions and approved the requests using primarily two criteria. First, the institutions had to meet the TARP redemption requirements outlined under SCAP.⁵⁸ Second, they had to raise at least 50 percent of the redemption amount from private capital markets. In December 2009, Bank of America and Citigroup redeemed the preferred shares and the trust preferred shares, respectively, that Treasury held.⁵⁹

In contrast to the process of unwinding trust preferred shares, in developing a divestment strategy for the common stock held in Citigroup, Treasury and its asset manager will evaluate market conditions and time

⁵⁷Treasury does not have access to nonpublic information collected by federal banking regulators on the financial condition of TARP recipients. According to Treasury officials, in terms of the financial institutions, there should be a separation between the responsibilities of Treasury as an investor and the duties of the government as regulator.

⁵⁸As discussed earlier, SCAP is a program managed by the Federal Reserve that conducted stress tests on 19 bank holding companies from February through May 2009 to measure the potential impact of various scenarios or market movements on asset, counterparty exposure, or the value of a firm's portfolio. As a result of the tests, several bank holding companies were required to raise additional equity capital.

⁵⁹Under the AGP termination agreement, FRBNY, Citigroup, FDIC, and Treasury agreed that FDIC and Treasury would retain approximately \$5.3 of the \$7.0 billion of trust preferred securities of Citigroup, as well as the warrants, and agreed that the FRBNY would receive a \$50 million termination fee. Treasury still holds \$2.2 billion of the trust preferred shares that it received as part of the AGP premium and may receive an additional \$800 million of Citigroup's trust preferred shares from FDIC. In connection with the early termination of the guarantee, Treasury agreed to cancel \$1.8 billion of the trust preferred securities. In terminating its AGP agreement with the government, Bank of America agreed to pay the government a termination fee of \$425 million.

the sale in an attempt to maximize taxpayers return. On December 17, 2009, Treasury announced a plan to sell its Citigroup common stock over a 6- to 12-month time frame. Treasury plans to use independent investment firms to assist in an orderly sale of these shares. A recent example of the difficulties that could be encountered occurred when Treasury announced plans to sell its Citigroup common shares in December 2009 following share sales by Bank of America and Wells Fargo. Market participants said at that time the supply of bank shares in the market exceeded demand and thus lowered prices. Selling the Citigroup shares in that market environment would have recouped less money for the taxpayers, so Treasury postponed the proposed sales. In March 2010, Treasury announced that it hired Morgan Stanley as its sales agent to sell its shares under a pre-arranged written trading plan. In April 2010, Treasury further announced that Citigroup had filed the necessary documents with SEC covering Treasury's plan sale. According to Treasury's press release, it began selling common shares in the market in an orderly fashion under a prearranged written trading plan with Morgan Stanley. Initially, Treasury provided Morgan Stanley with discretionary authority to sell up to 1.5 billion shares under certain parameters outlined in the trading plan. However, Treasury said that it expects to provide Morgan Stanley with authority to sell additional shares beyond this initial amount. According to Treasury officials, Morgan Stanley is providing on-going advice and ideas to Treasury regarding the disposition in order to assist Treasury in meeting its objectives.

Treasury Is Monitoring Its Assets and Is Responsible for Developing an Exit Strategy for Chrysler, GM, and GMAC, But the Strategy Depends on a Variety of External Factors

To manage its debt and equity investment in the automotive companies that received assistance and determine when and how to exit, Treasury monitors industry and broader economic data, as well as company-specific financial metrics. The information is important both for Treasury's management of its equity in the companies and the repayment of the companies' term loans, because it enables Treasury to determine how receptive the market will be to an equity sale—which affects the price at which Treasury can sell—and how likely it is that the companies will have sufficient liquidity to repay the loans. While the companies in the other categories discussed in this section also rely on the economic well-being of the country, consumer purchases of new cars are highly correlated with the health of the overall economy, making these broader measures especially relevant when discussing the automotive industry. In addition to monitoring industry and broader economic data, Treasury reviews financial, managerial, and operational information that the companies are required to provide under the credit and equity agreements with Treasury. Treasury will also be monitoring, as needed, information beyond that

which is delineated in these agreements with Treasury, for example updates on current events such as the sale of the Saab brand. The companies provide the information, as needed, and the items specified in the agreements to Treasury in monthly reporting packages.

Treasury officials said that they reviewed and analyzed the reports they received to identify issues, such as actual market share that lagged behind the projected market share, excess inventory, or other signs that business might be declining. While Treasury has maintained that it will not direct the companies to take specific actions, it does notify the companies' management and the Secretary of the Treasury if it sees any cause for concern in the financial reports, such as actual market share lagging behind projected market share. In addition to reviewing financial information, Treasury officials meet quarterly in person with the companies' top management to discuss the companies' progress against their own projections and Treasury's projections. Important findings that result from the review of financial reports or management meetings are conveyed to key staff in OFS and other Treasury offices with responsibilities for managing TARP investments. This level of access was the result of the various legal and other agreements with the companies.

Treasury will determine when and how to divest itself of its equity stake in GM, Chrysler, and GMAC. Treasury officials said that they would consider indicators such as profitability and prospects, cash flow, market share, and market conditions to determine the optimal time and method of sale. However, these efforts are complicated by the fact that Treasury shares ownership of GM and Chrysler with the Canadian government and other third parties.⁶⁰ Treasury has yet to announce a formal exit plan but has publicly stated that a public offering of its shares in GM is likely, and, in June 2010, provided guidance on its role in the exploration of a possible initial public offering of the common stock of GM. Treasury is still considering both a public offering and a private sale of the common stock it owns in Chrysler. The companies' term loans—the other component of Treasury's investment—were scheduled to be repaid by July 2015 for GM and by June 2017 for Chrysler. In April 2010, GM repaid the remaining balance on the \$6.7 billion loan from Treasury. GM made this payment using funds that remained from the \$30.1 billion Treasury had provided in June 2009 to assist with its restructuring.

⁶⁰[GAO-10-151](#).

Our November 2009 report on the auto industry noted that the value of GM and Chrysler 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 equity stake long enough for the companies to demonstrate sufficient financial progress. This report also included three recommendations related to Treasury's approach to managing its assets and divesting itself of its equity stake in Chrysler and GM. First, we recommended that Treasury ensure that it has the expertise needed to adequately monitor and divest the government's investment in Chrysler and GM, and obtain needed expertise where gaps are identified. Following this recommendation, Treasury hired two additional staff to work on the Auto Team, which is composed of analysts dedicated solely to monitoring Treasury's investments in the companies. Treasury also hired Lazard LLC in May 2010 to act as an advisor on the disposition of Treasury's investment in GM. Second, we recommended that Treasury should report to Congress on its plans to assess and monitor the companies' performance to help ensure that they are on track to repay their loans and to return to profitability. In response to this recommendation, Treasury stated that it already provides updates to TARP oversight bodies including the Congressional Oversight Panel and SIGTARP, concerning the status of its investments and its role in monitoring the financial condition of Chrysler and GM and that it will provide additional reports as circumstances warrant. Third, we recommended that Treasury develop criteria for evaluating the optimal method and timing for divesting the government's ownership stake in Chrysler and GM. In response to this recommendation, Treasury stated that members of the Auto Team are experienced in selling stakes in private and public companies and are committed to maximizing taxpayer returns on Treasury's investment. Treasury also stated that private majority shareholders typically do not reveal their long-term exit strategies in order to prevent other market participants from taking advantage of such information. However, we note that because Treasury's stakes in the companies represent billions of taxpayer dollars, Treasury should balance the need for transparency about its approach with the need to protect certain proprietary information, the release of which could put the companies at a competitive disadvantage or negatively affect Treasury's ability to recover the taxpayers' investment. Moreover, Treasury could provide criteria for an exit strategy without revealing the precise strategy.

Although GMAC is a bank holding company, it received assistance under AIFP. While investment in GMAC was previously managed by Treasury's Auto Team, the investment in GMAC is currently managed by other Treasury officials. This team uses many of the same indicators that are

used for bank holding companies. For instance, to monitor GMAC's condition, the Treasury's team views liquidity and capital levels at the company and observes management's strategic decision making. Due to it not being publicly traded and the challenges it faces in its transition to a more traditional bank holding company model, Treasury is more actively involved in managing and valuing its investment in the company.

As of January 27, 2010, Treasury had not decided how it would divest its GMAC preferred shares or recommended a time frame for the divestment. The Federal Reserve and FDIC will be involved in the approval process that would allow GMAC to exit TARP by repurchasing its preferred shares. Treasury could recover its investment in GMAC preferred shares through the same process used to exit its preferred equity investments in Citigroup and Bank of America, but other options exist. For example, Treasury could sell its preferred shares to a third party, convert its preferred shares into common equity and sell those shares, or hold the preferred shares to maturity. Throughout 2009, the company continued to experience significant losses as it attempted to follow through on its strategies as a relatively new, independent company. As we have seen, Treasury purchased \$3.8 billion in preferred shares (\$2.54 billion of trust preferred shares and \$1.25 billion of mandatory convertible preferred shares) from GMAC on December 30, 2009, because the company could not raise capital in the private markets to meet its SCAP requirements.

According to Treasury officials, for its common stock in GMAC, Treasury is continuing to explore many options to exit its investment, including an initial public offering or other alternatives. Divesting itself of GMAC's common stock will be more difficult because the shares are not currently publicly traded. Treasury could divest its GMAC common stock through multiple methods, including by making a public offering of its shares as company officials have suggested, selling the stock to a buyer or buyers through a private sale, or selling the stock back to the company as the company builds up capital.

The Federal Reserve, FRBNY, and Treasury Monitor AIG, But the Trustees and Treasury Are To Determine Their Exit Strategy Once AIG Repays Its Debt

The Federal Reserve, FRBNY, and Treasury share responsibility for managing the government's loan to and investment in AIG, but the trustees and Treasury must develop exit strategies for divesting their interest in AIG.⁶¹ The Federal Reserve and FRBNY have different roles than they do in overseeing the bank holding companies, because their relationship with AIG is not a supervisory one but a relationship between creditor and borrower. The Federal Reserve and FRBNY have acted to ensure that AIG maintains adequate capital levels after it suffered a severe loss of capital in 2008 that compromised its ability to sell certain businesses and maintain its primary insurance subsidiaries as viable businesses. A strengthened balance sheet, access to new capital, profitability, and lower risk levels are important in tracking AIG's progress in returning to financial health. In order to monitor this progress, the Federal Reserve, FRBNY, and Treasury use various indicators, including liquidity, capital levels, profit and loss, and credit ratings. Although each of these entities monitors AIG independently, they share information on such indicators as cash position, liquidity, regulatory reports, and other reports as necessary. AIG is also responsible for regularly providing periodic internal reports as specified in the FRBNY credit agreement and the Treasury securities purchase agreements. According to the AIG trustees, in monitoring AIG, they rely on information gathered by the FRBNY, Treasury, and AIG, and their respective outside consultants, to avoid, to the extent possible, redoing work that has already been done at unnecessary cost. The AIG trustees are responsible for voting the trust stock, working with AIG and its board of directors to ensure corporate governance procedures are satisfactory, and developing a divestiture plan for the sale or other disposition of the trust stock.

As we have seen, government assistance to AIG was provided by or is held by FRBNY, the AIG Trust, and Treasury, which are independently responsible for developing and implementing a divestment plan and must coordinate their actions. Over time, more of the government's credit exposure has been converted to equity that potentially poses greater risk to the federal government. For example, Treasury purchased \$40 billion of preferred shares and the proceeds were used to pay down the balance of the FRBNY Revolving Credit Facility. More recently, in December 2009,

⁶¹Office of Thrift Supervision was the consolidated supervisor of AIG because it was considered a thrift holding company. Federal statute no longer defined AIG as a thrift holding company at the closure of the Federal Reserve loan to AIG. AIG's domestic and life and property and casualty insurance companies are regulated by the state insurance regulators in which these companies are domiciled.

FRBNY accepted preferred equity interest in two AIG-created special purpose vehicles that own American International Assurance Company, Ltd and American Life Insurance Company—AIG’s leading foreign life insurance companies.⁶² In exchange, FRBNY reduced the amount AIG owed on the Revolving Credit Facility by \$25 billion. Repayment of AIG’s remaining \$27 billion debt will depend, in part, on the markets’ willingness to finance the company with new funds following its return to financial health.

According to officials at Treasury and the Federal Reserve, AIG must repay the FRBNY credit facility before the AIG Trust can, as a practical matter, divest its equity shares. As a result, the AIG trustees said that they would begin developing an exit strategy once AIG had repaid its debt to FRBNY, which is due no later than September 13, 2013. According to the AIG trustees and Treasury officials, while Treasury and the AIG Trust are responsible for developing independent exit strategies, they plan to coordinate their efforts. The Treasury team that manages the AIG investment has been running scenarios of possible exit strategies but has not decided which strategy to employ. A number of options are being considered by the AIG trust for divesting the Series C Preferred Stock, one of which is to convert the Series C Preferred Stock to common stock and divest such common stock through a public offering or a private sale. Treasury has multiple options available for divesting its preferred shares, including having AIG redeem Treasury’s shares, converting the shares to common stock that would subsequently be sold in a public offering, or selling the shares to an institutional buyer or buyers in a private sale. According to Treasury officials, Treasury is devoting significant resources to planning the eventual exit strategy from its AIG investments.

When AIG will be able to pay the government completely back for its assistance is currently unknown because the federal government’s exposure to AIG is increasingly tied to the future health of AIG, its restructuring efforts, and its ongoing performance as more debt is exchanged for equity. Therefore, as we noted in our April 2010 report on AIG, the government’s ability to fully recoup the federal assistance 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

⁶²American International Assurance Company is an international life insurance subsidiary of AIG with most of its business in Asia. American Life Insurance Company is an international life insurance subsidiary of AIG that conducts business world wide.

performance of the insurance sectors and the credit derivatives markets that are beyond the control of AIG or the government.⁶³ In March 2010, the Congressional Budget Office estimated that the financial assistance to AIG may cost Treasury as much as \$36 billion compared to the \$30 billion estimated in September 2009 by Treasury. While AIG is making progress in reducing the amount of debt that it owes, this is primarily due to the restructuring of the composition of government assistance from debt to equity.

FHFA and Treasury are Monitoring the Enterprises' Financial Performance and Mission Achievement, but Any Exit Strategy Will Need Congressional Action

FHFA, in its roles as conservator, safety and soundness supervisor, and housing mission regulator for the Enterprises, has adopted several approaches to monitoring their financial performance and operations. FHFA officials said that they have monitored the Enterprises' financial performance in meeting the standards established in the scorecards and will continue to do so. Further, FHFA monitors, analyzes, and reports on the Enterprises' historical and projected performance on a monthly basis. FHFA provides information based on public and nonpublic management reports, and the fair value of net assets is defined in accordance with generally accepted accounting principles. In addition, FHFA officials said that the agency's safety and soundness examiners are located at the Enterprises on a full-time basis, and also monitor their financial performance, operations, and compliance with laws and regulations through conducting examinations, holding periodic meetings with officials, and reviewing financial data, among others things.

FHFA is significantly involved as conservator with the Enterprises when it comes to reporting financial information and requesting funding from Treasury. FHFA puts together a quarterly request package that is reviewed through several levels of management, and it is ultimately signed off on by the Acting Director of FHFA before it is sent to the Under Secretary for Domestic Finance at Treasury for approval as the official request for funding.

Although the structure of the assistance to the Enterprises has remained constant, the amount of assistance has steadily increased. Treasury increased the initial funding commitment cap from \$100 billion to \$200 billion per Enterprise in February 2009, and the decision was made in

⁶³See GAO, *Troubled Asset Relief Program: Update of Government Assistance Provided to AIG*, [GAO-10-475](#) (Washington, D.C.: Apr. 27, 2010).

December 2009 to lift the caps to include losses from 2010 through 2012. Treasury stated it raised the caps when it did because its authority to purchase preferred shares under HERA expired on December 31, 2009. While Treasury did not believe the Enterprises would require the full \$200 billion authorized per Enterprise prior to December 31, 2009, it lifted the caps to reassure the markets that the government would stand behind them going forward. At the end of first quarter 2010, Treasury had purchased approximately \$61.3 billion in Freddie Mac preferred stock and \$83.6 billion in Fannie Mae preferred stock under the agreements.

While FHFA and Treasury are monitoring the Enterprises' financial performance and mission achievement through a variety of means, exit strategies for the Enterprises differ from those for the other companies that have also received substantial government assistance. Given the ongoing and significant financial deterioration of the Enterprises—the Congressional Budget Office projected that the operations of the Enterprises would have a total budgetary cost of \$389 billion over the next 10 years—FHFA and other federal officials have said that the Enterprises will probably not be able to return to their previous organizational structure as publicly-owned private corporations with government sponsorship.⁶⁴ Many observers have stated that Congress will have to re-evaluate the roles, structures, and performance of the Enterprises and to consider options to facilitate mortgage financing while mitigating safety and soundness and systemic risk concerns.

In a September 2009 report, we identified and analyzed several options for Congress to consider in revising the Enterprises' long-term structures.⁶⁵ These options generally fall along a continuum, with some overlap in key areas.

- *Establishing the Enterprises as government corporations or agencies.* Under this option, the Enterprises would focus on purchasing qualifying mortgages and issuing mortgage-backed securities but eliminate their mortgage portfolios. FHA, which insures mortgages for low-income and first-time borrowers, could assume additional responsibilities for promoting homeownership for targeted groups.

⁶⁴Congressional Budget Office, *CBO's Budgetary Treatment of Fannie Mae and Freddie Mac* (January 2010).

⁶⁵[GAO-09-782](#).

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- *Reconstituting the Enterprises as for-profit corporations with government sponsorship but placing additional restrictions on them.* While restoring the Enterprises to their previous status, this option would add controls to minimize risk. For example, it would eliminate or reduce mortgage portfolios, establish executive compensation limits, or convert the Enterprises from shareholder-owned corporations to associations owned by lenders.
 - *Privatize or terminate them.* This option would abolish the Enterprises in their current form and disperse mortgage lending and risk management throughout the private sector. Some proposals involve the establishment of a federal mortgage insurer to help protect mortgage lenders against catastrophic mortgage losses.

While there is no consensus on what the next steps should be, whatever actions Congress takes will have profound impacts on the structure of the U.S. housing finance system. The Enterprises' still-dominant position in housing finance is an important consideration for any decision to establish a new structure.

Exit Strategy Likely to Depend on the Company Involved and Type of Assistance Provided

Finally, some of the companies receiving exceptional assistance have taken a number of steps to repay the financial assistance owed the government and to repurchase their preferred shares in light of the significant restrictions put in place to encourage companies to begin to repaying and exiting the programs as soon as practicable. At the same time, the government continues to take steps to establish exit strategies for the remaining companies and in some cases the federal government's financial exposure to these companies may exist for years before the assistance is fully repaid. In other cases, the federal government may not recover all of the assistance provided. For example, where the government has an equity interest, its ability to recover what has been invested depends on a variety of external factors that are beyond the control of the institution and the government. Moreover, as of June 1, 2010, the Enterprises have continued to borrow from Treasury. However, ongoing monitoring of the institutions and the government's role continues to be important and other additional insights may continue to emerge as aspects of the crisis continue to evolve, including mortgage foreclosures and how best to continue to stabilize housing markets.

The Government's Recent Involvement in Private Markets Provides Important Lessons

Assistance that the federal government provided in response to the recent financial crisis highlights the challenges associated with government intervention in private markets. Building on lessons learned from the financial crises of the 1970s and 1980s, we identified guiding principles at that time that help to serve as a framework for evaluating large-scale federal assistance efforts and provided guidelines for assisting failing companies, including the government's actions during the most recent crisis.⁶⁶ These principles include (1) identifying and defining the problem, (2) determining national interests and setting clear goals and objectives that reflect them, and (3) protecting the government's interests. The government generally adhered to these principles during this recent crisis. But because of its sheer size and scope, the crisis presented unique challenges and underscored a number of lessons to consider when the government provides broad-based assistance. First, widespread financial problems, such as those that occurred in this crisis, require comprehensive, global actions that must be closely coordinated. For example, Treasury's decision to provide capital investments in financial institutions was driven in part by similar actions in other countries. Second, the government's strategy for managing its investments must include plans to mitigate perceived or potential conflicts that arise from the government's newly acquired role as shareholder or creditor and its existing role as regulator, supervisor, or policymaker. Acquiring an ownership interest in private companies can help protect taxpayers by enabling the government to earn returns when it sells its shares and the institutions repurchase their shares or redeem their warrants. But this scenario can also create the potential for conflict if, for example, public policy goals are at odds with the financial interests of the firm receiving assistance. Further, the federal government's intervention in private markets requires that those efforts be transparent and effectively communicated so that citizens understand policy goals, public expenditures, and expected results. The government's actions in the recent crisis have highlighted the challenges associated with achieving both. The government also needs to establish an adequate oversight structure to help ensure accountability. Finally, the government must take steps to mitigate the moral hazard that can arise when it provides support to certain entities that it deems too big or too systemically significant to fail. Such assistance may encourage risk-taking behavior in other market

⁶⁶GAO, *Guidelines for Rescuing Large Failing Firms and Municipalities*, [GAO/GGD-84-34](#) (Washington, D.C.: Mar. 29, 1984) and *Auto Industry: A Framework for Considering Federal Financial Assistance*, [GAO-09-247T](#) (Washington, D.C.: Dec. 5, 2008).

participants by encouraging the belief that the federal government will always be there to bail them out.

The Government Generally Adhered to Key Principles When Providing Federal Assistance during the Recent Financial Crisis

Building on lessons learned from the financial crises of the 1970s and 1980s, we identified guiding principles to help serve as a framework for evaluating large-scale federal assistance efforts and provided guidelines for assisting failing companies.⁶⁷

- Identifying and defining the problem, including separating issues that require immediate response from longer-term structure issues.
- Determining national interests and setting clear goals and objectives that reflect them.
- Protecting the government's, and thus the taxpayer's, interests by working to ensure not only that financial markets continue to function effectively, but also that any investments made provide the highest possible return. This includes requiring concessions from all parties, placing controls over management, obtaining collateral when feasible, and being compensated for risk.

During the recent financial crisis, the government faced a number of challenges in adhering to these three principles—which we identified during earlier government interventions in the private markets—when it provided financial assistance to troubled companies. First, the scope and rapid evolution of this crisis complicated the process of identifying and defining the problems that needed to be addressed. Unlike past crises that involved a single institution or industry, the recent crisis involved problems across global financial markets, multiple industries, and large, complex companies and financial institutions. For example, problems in mortgage markets quickly spread to other financial markets and ultimately to the broader economy. As the problems spread and new ones emerged, the program goals Treasury initially identified often seemed vague, overly broad, and conflicted. Further, because the crisis affected many institutions and industries, Treasury's initial responses to each affected

⁶⁷GAO/GGD-84-34.

institution often appeared ad hoc and uneven, leading to questions about its strategic focus and the transparency of its efforts.⁶⁸

During a financial crisis, identifying and defining problems involves separating out those issues that require an immediate response from structural challenges that will take longer to resolve. The most recent crisis evolved as the crisis unfolded and required that the government's approach change in tandem. Treasury created several new programs under TARP to address immediate issues, working to stabilize bank capital in order to spur lending and restart capital markets and seeking ways to help homeowners facing foreclosure. While banks have increased their capital levels and these companies have begun repaying the government assistance, constructing relevant solutions to address the foreclosure crisis has proved to be a long-term challenge. The recently enacted financial services reform legislation requires that systemically important financial companies be subject to enhanced standards, including risk-based capital requirements, liquidity requirements, and leverage limits that are stricter than the standards applicable to companies that do not pose similar risk to financial stability.⁶⁹ Also, the law creates a procedure for the orderly liquidation of financial companies if the Secretary of the Treasury makes certain determinations including a determination that the failure of the company and its resolution under otherwise applicable law would have serious adverse effect on financial stability.

Second, determining national interests and setting clear goals and objectives that reflect them requires choosing whether a legislative solution or other government intervention best serves the national interest. During the recent crisis the federal government determined that stabilizing financial markets, housing markets, and individual market segments required intervening to support institutions it deemed to be systemically significant. It also limited its intervention, stating that it would act only as a reluctant shareholder and not interfere in the day-to-day management decisions of any company, would exercise only limited voting rights, and would ensure that the assistance provided would not continue indefinitely. Further, Treasury emphasized the importance of

⁶⁸GAO, *Troubled Asset Relief Program: Additional Actions Needed to Better Ensure Integrity, Accountability, and Transparency*, [GAO-09-161](#) (Washington, D.C.: Dec. 2, 2008).

⁶⁹The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

having strong boards of directors to guide these companies, as discussed earlier. While the U.S. government developed goals or principles for holding large equity interest in private companies, its goals for managing its investment have at times appeared to conflict with each other. Specifically, Treasury announced that it intended to protect the taxpayer investment, maximize overall investment returns and that it also intended to dispose of the investments as soon it was practicable to do so. However, protecting the taxpayer investment may be at odds with divesting as soon as possible. For example, holding on to certain investments may bring taxpayers a higher return than rapid divestment. Recognizing the tension among these goals, Treasury has tried to balance these competing interests but ultimately, it will have to decide which among them is most important by evaluating the trade-offs.

Finally, protecting the government's and taxpayers' interest is an essential objective when creating large-scale financial assistance programs that put government funds and taxpayer dollars at risk of loss. Generally consistent with this principle, the government took four primary actions that were designed to minimize this risk.

- First, a priority was gaining concessions from others with a stake in the outcome—for example, from management, labor, and creditors—in order to ensure cooperation in securing a successful outcome. As we have pointed out previously, as a condition of receiving federal financial assistance, TARP recipients (AIG, Bank of America, Citigroup, GMAC, Chrysler, and GM) had to agree to limits on executive compensation and dividend payments, among other things. Moreover, GM and Chrysler had to use their “best efforts” to reduce their employees’ compensation to levels similar to those at other major automakers that build vehicles in the United States, which resulted in concessions from the United Auto Workers on wages and work rules.
- Second, exerting control over management became necessary in some cases—including approving financial and operating plans and new major contracts—so that any restructuring plans would have realistic objectives and hold management accountable for achieving results and protecting taxpayer interests. For example, under AIFP, Chrysler and GM were required to develop restructuring plans that outlined their path to financial viability. The government initially rejected both companies’ plans as not being aggressive enough but approved revised plans that included restructuring the companies through bankruptcy. The Federal Reserve has also reviewed AIG’s divestiture plan and routinely monitors its progress and financial condition. Finally, as conservator FHFA maintains

substantial control over the business activities of the Enterprises.

- Third, the government sought to ensure that it was in a first-lien position with AIG, GM, and Chrysler, which received direct government loans, in order to recoup the maximum amounts of taxpayer funds.⁷⁰ Treasury was not able to fully achieve this goal in the Chrysler initial loans because the company had already pledged most of its collateral, leaving little to secure the federal government's loans. Treasury was however able to obtain a priority lien position with respect to its loan to Chrysler post-restructuring. FRBNY was able to obtain collateral against its loans to AIG.
- Fourth, the government sought compensation for risk through fees and equity participation, routinely requiring dividends on the preferred shares it purchased, charging fees and interest on the loans, and acquiring preferred shares and warrants that provided equity. For example, the government required Bank of America and Citigroup to provide warrants to purchase either common stock or additional senior debt instruments, such as preferred shares, under their financial agreements. As a condition for providing a \$85 billion revolving loan commitment, for example, FRBNY initially required that AIG pay an initial gross commitment fee of 2 percent (approximately \$1.7 billion) and interest on the outstanding balance, plus a fee on the unused commitment, and in exchange, issue preferred shares (convertible to approximately 79.8 percent of issued and outstanding shares of common stock) into a trust for the benefit of the U.S. Treasury. Treasury's contractual agreements with the Enterprises detail the terms of the preferred shares, and require them to pay commitment fees, but Treasury has not implemented these fees due to the Enterprises' financial condition.

The Recent Crisis Presented Challenges and Underscored Additional Principles When Providing Assistance

The size and scope of the recent crisis were unprecedented and created challenges that highlighted principles beyond those based upon the lessons learned from the 1970s and 1980s. These include ensuring that actions are strategic and coordinated both nationally and internationally, addressing conflicts that arise from the government's often competing roles and the likelihood of external influences, ensuring transparency of and communicating effectively with the Congress and the public, ensuring that a system of accountability exists for actions taken, and taking measures to reduce moral hazard.

⁷⁰As of April 20, 2010, GM repaid the total \$6.7 billion in debt it owed to Treasury.

Challenges Faced by the
Federal Government Stemmed
From the Global Nature of the
Crisis Highlighting the Need for
Coordination of Global Actions
during Times of Crisis

Financial crises that are international in scope require comprehensive, global actions and government interventions that must be closely coordinated by the parties providing assistance—including agencies of the U.S. government as well as foreign governments—to help ensure that limited resources are used effectively. In prior work, we reported that overseeing large financial conglomerates has proven challenging, particularly in regulating their consolidated risk management practices and identifying and mitigating the systemic risks they pose.⁷¹ Although the activities of these large firms often cross traditional sector boundaries, financial regulators under the current U.S. regulatory system have not always had full authority or sufficient tools and capabilities to adequately oversee the risks that these financial institutions posed to themselves and other institutions. We have laid out several elements that should be included in a strengthened regulatory framework, including using international coordination to address the interconnectedness of institutions, operating cross borders, and helping ensure regulatory consistency to reduce negative, competitive effects.⁷² Initial actions during the crisis were taken and coordinated by the Federal Reserve, Treasury, and FDIC, and some were made in conjunction with similar actions by foreign governments. For example, the United States and several foreign governments took a variety of actions including providing liquidity and capital infusions and temporarily banning the short selling of financial institution stock.

On September 6, 2008, initial government actions that were taken to support the Enterprises were due to their deteriorating financial condition, with worldwide debt and other financial obligations totaling \$5.4 trillion, and their default on those obligations would have significantly disrupted the U.S. financial system and the global system.

Shortly afterwards, as several other large financial firms came under heavy pressure from creditors, counterparties, and customers, the Federal Reserve used its authority under Section 13(3) to create several facilities to support the financial system and institutions that the government would

⁷¹GAO, *Financial Regulation: A Framework for Crafting and Assessing Proposals to Modernize the Outdated U.S. Financial Regulatory System*, [GAO-09-216](#) (Washington, D.C.: Jan. 8, 2009).

⁷²[GAO-09-216](#).

not have been able to assist without triggering this authority, prior to the creation of TARP.⁷³

The global nature of these companies added to the challenges for the federal government and international community as it resolved these issues. Concerted federal government attempts to find a buyer for the company or to develop an industry solution for Lehman Brothers failed to address its financing needs. According to Federal Reserve officials, the company's available collateral was insufficient to obtain a Federal Reserve secured loan of sufficient size to meet its funding needs. In the case of AIG, after contacting the FRBNY on September 12, 2008, the U.S. government took action because of its relationships with other global financial institutions and coordinated with regulators in a number of countries. According to AIG's 2008 10-K, AIG had operations in more than 130 countries and conducted a substantial portion of its general insurance business and a majority of its life insurance business outside the United States. Because of its global reach, the company was subject to a broad range of regulatory and supervisory jurisdictions, making assisting the company with its divestment plans extremely difficult. In light of AIG's liquidity problems, AIG and its regulated subsidiaries were subject to intense review, with multiple foreign regulators taking supervisory actions against AIG. On September 16, 2008, the Federal Reserve and Treasury determined that the company's financial and business assets were adequate to secure an \$85 billion line of credit, enough to avert its imminent failure.

In October 2008, in an unprecedented display of coordination, six central banks—the Federal Reserve, European Central Bank, Bank of England, Swiss National Bank, Bank of Canada, and the central bank of Sweden—acted together to cut short-term interest rates. In a coordinated response, the Group of Seven finance ministers and central bank governors announced comprehensive plans to stabilize their banking systems—making a critical promise not to let systemically important institutions fail

⁷³Section 13(3) of the Federal Reserve Act, (codified, as amended, at 12 U.S.C. § 343). This provision allows the Federal Reserve, in "unusual and exigent circumstances," to authorize any Federal Reserve Bank to extend credit in the form of a discount to individuals, partnerships, or corporations when the credit is "indorsed or otherwise secured" to the satisfaction of the Federal Reserve Bank, after obtaining evidence that the individual, partnership, or corporation is unable to secure adequate credit accommodations from other banking institutions.

by offering debt guarantees and capital infusions, and increasing deposit insurance coverage.

Within 2 weeks of enacting TARP, consistent with similar actions by several foreign governments and central banks, Treasury—through the newly established Office of Financial Stability—announced that it would make available \$250 billion to purchase senior preferred shares in a broad array of qualifying institutions to provide additional capital that would help enable the U.S. institutions to continue lending. Treasury provided \$125 billion in capital purchases for nine of the largest public financial institutions, including Bank of America and Citigroup, considered by the federal banking regulators and Treasury to be systemically significant to the operation of the financial system. Together these nine financial institutions held about 55 percent of the U.S. banking assets and had significant global operations—including retail and wholesale banking, investment banking, and custodial and processing services—requiring coordinated action with a number of foreign governments.

Recent Federal Government Assistance to the Private Sector Highlights the Need to Address Conflicts and Manage External Influences That Can Arise from the Federal Government's At Times Competing Roles and Policy Actions

The government's ownership of common shares in private companies can create various conflicts and competing goals that must be managed. First, having an ownership interest in a private company gives the government voting rights that can influence the firm's business activities. However, Treasury has limited its voting rights to only matters that directly pertain to its responsibility under EESA to manage its investments in a manner that protects the taxpayer. For example, Treasury used its voting rights elect directors to Citigroup's board, approve the issuance of common shares, and a reverse stock split. Likewise, Treasury has designated directors to serve on Chrysler, GM, and GMAC's boards of directors.

Second, when the government is both investor and regulator for the same company, federal agencies may find themselves in conflicting roles. For instance, as noted in our April 2010 report on Chrysler and GM pensions, until Treasury either sells or liquidates the equity it acquired in each company, the government's role as shareholder creates potential tensions with its roles as pension regulator and insurer.⁷⁴ This can be illustrated by the conflicting pressures that would likely arise in two critical and interrelated scenarios: (1) how to decide when to sell the government's shares of stock and (2) how to respond to a decline in pension funding. If

⁷⁴GAO, *Troubled Asset Relief Program: Automakers' Pension Funding and Multiple Federal Roles Pose Challenges for the Future*, GAO-10-492 (Washington, D.C.: Apr. 6, 2010).

either or both companies return to profitability then the government's multiple roles are less likely to result in any perceived conflicts. However, if either company had to be liquidated, the government would face these perceived conflicts, because Treasury would have to make decisions relating to the value of its investments and the Pension Benefit Guaranty Corporation would need to make decisions related to the companies' pensions.

Additionally, on December 11, 2009, the Internal Revenue Service, a bureau within Treasury, issued a notice stating that under certain circumstances selling stock that Treasury received under any TARP program would not trigger an ownership change. As a result, when Treasury sells such shares there is no change in ownership for tax purposes, and the companies would not be required to make changes that limit net operating losses after a change in ownership.⁷⁵ Some in Congress have argued that this action created an additional subsidy to the financial institutions that received federal assistance and by reducing potential revenue from taxes, it conflicts with Treasury's duty to take actions that are in the best interest of the taxpayers.⁷⁶

The assistance to the Enterprises illustrates the potential challenges that can arise when the government uses its assistance to further its public policy goals—in this case, managing support for the home mortgage markets and efforts to preserve and conserve assets. Specifically, Treasury is pursuing public policy goals to address mortgage foreclosures through the Enterprises, but these actions could also potentially negatively affect the Enterprises' financial condition. For example, the Enterprises are participating in the administration's foreclosure prevention programs by modifying the terms of mortgages insured or owned by the Enterprises to prevent avoidable foreclosures by lowering the borrower's monthly mortgage payments. Treasury and FHFA have argued that such programs, by improving borrowers' financial condition, will also benefit the Enterprises, which have large holdings of delinquent mortgages. However, the Enterprises have stated in their financial disclosures that these programs may result in significant costs over time, such as incentive

⁷⁵Internal Revenue Service Notice 2010-2 (Dec. 11, 2009) (www.irs.gov/pub/irs-drop/n-10-02.pdf). The notice applies to all Treasury shareholdings, but the immediate application would likely be the planned sale of the Citigroup shares.

⁷⁶COP, *January Oversight Report: Exiting TARP and Unwinding its Impact on the Financial Markets* (Jan. 13, 2010).

payments made to servicers and borrowers over the life of the modification and losses associated with borrower redefaults on modified mortgages. Whether loan modifications would benefit both borrowers and the Enterprises or further jeopardize the Enterprises' financial condition is unknown and may depend in part on how the program is implemented and overseen by FHFA and Treasury over time. Overseeing the programs aimed at reducing costs to taxpayers remains a challenge.

Being both a creditor and a shareholder in private companies creates another conflict for the government. As a major creditor, the government is more likely to be involved in an entity's operations than it is if it is acting only as a shareholder, and operational decisions that it imposes could affect returns on taxpayer investments. For example, the government is currently both a creditor and shareholder in Chrysler and was both a creditor and shareholder in GM until GM repaid its \$6.7 billion loan on April 20, 2010. Treasury made initial loans to the companies to help them avert bankruptcy, then provided financing that was converted to equity to help them through the bankruptcy and restructuring process. As a creditor, the government obtained rights to impose requirements on the companies' business, including requiring them to produce a certain portion of their total production in the United States. These requirements established by Treasury as creditor, could negatively affect the companies' stock price, which in turn could negatively affect the return on investment earned by Treasury, as a shareholder.

To manage its different investments, the government has used different strategies—direct management and a trust arrangement—which have different implications for the government and the private companies that may affect how easily it can address conflicts of interest. Directly managing the investments offers two significant advantages. First, it affords the government the greatest amount of control over the investment. Second, having direct control over investments better enables the government to manage them as a portfolio, as Treasury has done under CPP. However, such a structure also has disadvantages. For example, as we have seen, having the government both regulate a company and hold an ownership interest in it can create a real or perceived conflict of interest. A direct investment also requires that the government have staff with the requisite skills to manage it. For instance, as long as Treasury maintains direct control of its equity investment in Citigroup, Chrysler, and GM, among others, it must have staff or hire contractors with the necessary expertise in these specific types of companies. In previous work, we raised concerns about Treasury's ability to retain the needed expertise to assess the financial condition of the auto companies and

develop strategies to divest the government's interests given the substantial decline in its staff resources and lack of dedicated staff providing oversight of its investments in the automakers.⁷⁷

In contrast, the government has used a trust arrangement to manage its investment in AIG. Such an arrangement puts the government's interest in the hands of an independent third party and helps to avoid potential conflicts that could stem from the government having both regulatory responsibilities for and ownership interests in a company. A trust also helps mitigate perceptions that actions taken with respect to TARP recipients are politically motivated or based on any "inside information" received from the regulators. While Treasury has interpreted TARP as prohibiting placing TARP assets in a trust structure, FRBNY created a trust to manage the government's ownership interest in AIG before TARP was established.⁷⁸

Finally, the varied and sometimes conflicting roles of the government as an owner, creditor, regulator, and policymaker also potentially subject private companies to greater government scrutiny and pressure than they might have otherwise experienced. In particular, the government's investments in these companies increases the level of government and public oversight and scrutiny these companies receive, as policymakers, elected officials, and regulators work to ensure that taxpayer interests are protected. The companies may also be subject to pressure from government officials to reconsider or alter business decisions that affect the companies' bottom lines. For example, Chrysler and GM faced pressure to reinstate many of the auto dealerships that had been slated for closure.⁷⁹

Government involvement could come from many different sources and in many different forms, including legislative actions and direct communications. To gauge the nature and scope of external influences, we interviewed officials from the six companies that received exceptional

⁷⁷GAO-10-151.

⁷⁸EESA § 101(c)(4) authorizes the Secretary of the Treasury to take all necessary actions to carry out its authorities under EESA, including, without limitation, "establishing vehicles that are authorized, subject to the supervision of the Secretary, to purchase, hold and sell troubled assets and issue obligations." Under a traditional trust structure, however, the assets of the trust would be under the supervision of trustees, not Treasury.

⁷⁹GAO-10-151.

financial assistance and reviewed legislation that would place requirements or restrictions on these companies.⁸⁰ We also reviewed letters sent to Chrysler and GM officials from legislative and executive branch officials and selected state government officials. We found that the issues receiving the most congressional scrutiny were executive compensation, transparency and accountability, mortgage modifications, and closures of automobile dealerships.

- *Executive compensation.* We identified 24 bills that members of Congress introduced in calendar years 2008 and 2009 involving restrictions on executive compensation or additional taxation of executive compensation at companies receiving TARP assistance. Also, AIG officials stated that the majority of congressional contacts they received related to executive compensation and bonuses.
- *Transparency and accountability.* We identified 16 bills introduced in calendar years 2008 and 2009 that would require the companies to take steps that would result in increased transparency or accountability, such as reporting on how TARP funds were used. For example, the TARP Transparency Reporting Act would require TARP recipients to report to Treasury on their use of TARP funds.⁸¹
- *Mortgage modifications.* Officials from the companies whose business includes mortgage financing told us that one of the most common subjects of congressional correspondence was requests for modifications to specific constituents' mortgages.
- *Automobile dealerships.* About 60 percent of the bills we identified that specifically targeted the auto industry sought to curtail or prevent the closure of automobile dealerships. One of these bills, which established an

⁸⁰We interviewed officials from all companies receiving exceptional assistance on the potential of external influence with the exception of the Enterprises.

⁸¹H.R. 1095, 111th Cong. (2009) and S. 133, 111th Cong (2009). Subsequent to this bill's introduction, SIGTARP made a recommendation that Treasury require all TARP recipients to report periodically on their use of TARP funds. In response to this recommendation, Treasury is implementing an annual use of funds survey, which will cover how each financial institution in the CPP program has used CPP funds. (CPP is the largest TARP program and has had several hundred participants. More information on this program is provided in the background section.) Treasury will post all answers that are collected from individual recipients as well as a summary of quantitative data on the Financial Stability Web site. Treasury sent the use of funds survey to CPP recipients in March 2010.

Recent Federal Intervention
into Private Markets Illustrates
the Need for Transparency and
an Effective Communication
Strategy

arbitration process for dealerships that want to appeal a closure decision, became public law.⁸² Furthermore, according to letters from members of Congress that Chrysler and GM provided to us, dealership closure was the most common subject. The letters usually either asked for an explanation of how the closure decisions had been made or for reconsideration of the closure of a particular dealership.⁸³ (See appendix III for more information on the nature and scope of communication with the auto industry.)

Company officials we interviewed told us that the level of government involvement—from requests for appearances at congressional hearings to letters from elected officials—had increased since their companies had requested and received financial assistance from the government. Company officials told us that this involvement was to be expected and did not cause them to make decisions that were in conflict with their respective companies' best interests. However, these officials also stated that addressing the government's involvement, such as responding to letters or requests for information, required increased company resources.

Federal government intervention in private markets not only requires that these efforts be transparent but also requires that the action include a strategy to help ensure open and effective communication with stakeholders, including Congress and taxpayers. The government's actions in the recent crisis have highlighted the challenges associated with achieving both of these objectives. Throughout the crisis, Congress and the public often stated that the government actions appeared vague, overly broad, and conflicted. For example, Treasury's initial response to the crisis focused on providing assistance to individual institutions and appeared ad hoc and uneven, leading to questions about its strategic focus and the transparency of its efforts.⁸⁴ Specifically, questions about the government's decision to assist Bear Stearns and AIG, but not Lehman Brothers, continued months after the decisions were made. Moreover, while TARP was created to provide a comprehensive approach to addressing the unfolding crisis, Treasury's decision to change the focus of the program

⁸²Consolidated Appropriations Act of 2010, P.L. No. 111-117, Div. C, Title VII, § 747, 123 Stat. 3034, 3219-3221 (2009).

⁸³Congressional ethics rules state that in communications with nonfederal entities, which would include the companies receiving exceptional assistance, members of Congress may request information and may also request reconsideration of decisions based on the merits of the case.

⁸⁴[GAO-09-161](#).

weeks after the passage of EESA from purchasing mortgage-backed securities and whole loans to injecting capital into financial institutions caught many in Congress, the markets, and the public by surprise and adversely affected these parties understanding of the program's goals and priorities which may have undermined the initial effectiveness of the program.

In general, transparency means more than simply reporting available information to interested parties, it involves such things as providing clearly articulated guidelines, decision points, and feedback mechanisms to help ensure an adequate understanding of the matters at hand. For the recent actions, transparency would include providing information on how the companies were to be monitored and the results of those activities. However, when considering any federal intervention, part of this decision-making process includes identifying what information can and should be made public and balancing concerns about the public's "need to know" against disclosing proprietary information in a competitive market. For example, while disclosing detailed information about Treasury's plans to sell shares of company stock may not be appropriate, the government should communicate its purpose in intervening in the private market and approach for evaluating the success of any federal action. Specifically, making information available to the public on the purpose of federal intervention and the decision to intervene could help ensure that the public understands the implications of not intervening and the expected results from the government's actions.

While EESA required Treasury to report information about TARP activities, Treasury's failure to adequately communicate the rationale for its actions and decisions early on caused confusion about the motivations behind these actions and decisions and long plagued the program. Treasury's lack of an effective communication strategy was, in part, the result of the unfolding nature of the crisis but even so, the nature of the unfolding crisis was not effectively communicated. For example, the multifaceted nature of the crisis resulted in numerous TARP programs to address specific problems in the markets; however, Treasury did not establish or adequately explain some of the programs until after assistance had already been announced. Specifically, Treasury announced assistance to Citigroup, Bank of America, and AIG before TIP and SSFI—now called the AIG Assistance Program—were established and announced in January 2009 and November 2008, respectively. Since the inception of TARP, we

Strong System for
Accountability Necessary to
Help Ensure Taxpayer Funds
Are Used Appropriately

have recommended that Treasury take a number of actions aimed at developing a coherent communication strategy for TARP.⁸⁵ In our previous reports, we have recommended that Treasury develop a communication strategy that included building an understanding and support for the various components of the TARP program.⁸⁶ While the actions we suggested were intended to address challenges associated with TARP—such as hiring a communications officer, integrating communications into TARP operations, scheduling regular and ongoing contact with congressional committees and members, holding town hall meetings with the public across the country, establishing a counsel of advisors, and leveraging available technology—most of these suggestions would be applicable when considering a communication strategy for any federal intervention. An effective communication strategy is especially important during rapidly changing market events and could help the public understand the policy goals that the government was trying to achieve and its rationale for spending public funds.

When considering government assistance to private companies, providing accountability for taxpayer funds is imperative. The absence of a system for accountability increases the risk that the interests of the government and taxpayers may not be adequately protected and that the programs' objectives may not be achieved efficiently and effectively. We first highlighted the importance of accountability in implementing TARP in December 2008, which has been reiterated by Congressional Oversight Panel and SIGTARP. Specifically, we noted the importance of establishing oversight structures, including monitoring and other internal controls that can help prevent and detect fraud.⁸⁷ Federal action in the midst of a crisis will undoubtedly require that actions be taken at the same time that programs are being established. In December 2008, we reported that a robust oversight system with internal controls specifically designed to deal with the unique and complex aspects of TARP would be key to helping OFS management achieve the desired results.⁸⁸ For example, OFS faced the challenge that it needed to develop a comprehensive system of internal controls at the same time that it was reacting quickly to changing financial

⁸⁵GAO, *Troubled Asset Relief Program: March 2009 Status of Efforts to Address Transparency and Accountability Issues*, [GAO-09-504](#) (Washington, D.C.: Mar. 31, 2009).

⁸⁶[GAO-09-504](#).

⁸⁷[GAO-09-161](#).

⁸⁸[GAO-09-161](#).

Providing Federal Assistance to the Private Sector Creates Moral Hazard, which Has to be Mitigated

market events and establishing the program. One area that took time to develop was establishing a plan to help ensure that participating institutions adhered to program requirements or to monitor companies' compliance with certain requirements, such as executive compensation and dividend restrictions. Therefore, when making any decision to intervene in private markets, Congress and the government must take efforts to provide an appropriate oversight structure.

While the federal government's assistance may have helped to contain a more severe crisis by mitigating potential adverse systemic effects, it also created moral hazard—that is, it may encourage market participants to expect similar emergency actions, thus weakening private or market-based incentives to properly manage risks and creating the perception that some firms are too big to fail.

We recently reported that while assisting systemically significant failing institutions may have helped to contain the crisis by stabilizing these institutions and limiting potentially systemic problems, it also may have exacerbated moral hazard.⁸⁹ According to regulators and market observers, such assistance may weaken the incentives for large uninsured depositors, creditors, and investors to discipline large complex firms that are deemed too big to fail. In March 2009, Federal Reserve Chairman Bernanke told the Council on Foreign Relations that market perceptions that a particular institution is considered too big to fail has many undesirable effects. He explained that such perceptions reduce market discipline, encourage excessive risk-taking by the firm, and provide artificial incentives for firms to grow. He also noted these beliefs do not create a level playing field, because smaller firms may not be regarded as having implicit government support. Similarly, others have noted how such perceptions may encourage risk-taking. For example, some large financial institutions may be given access to the credit markets at favorable terms without consideration of their risk profile.

Before a financial crisis, the financial regulatory framework could serve an important role in restricting the extent to which institutions engage in excessive risk-taking activities resulting from weakened market discipline. For instance, regulators can take pre-emptive steps to mitigate moral

⁸⁹GAO, *Federal Deposit Insurance Act: Regulators' Use of Systemic Risk Exception Raises Moral Hazard Concerns and Opportunities Exist to Clarify the Provision*, [GAO-10-100](#) (Washington, D.C.: Apr. 15, 2010).

hazard by taking the necessary regulatory actions to help ensure that companies have adequate systems in place to monitor and manage risk taking. Any regulatory actions that the government takes to help ensure strong risk management systems at companies of all sizes would help to lessen the need for government intervention.

In general, mitigating moral hazard requires ensuring that any government assistance includes terms that make it a last resort and undesirable except in the most dire circumstances and specifying when the government assistance will end. During the recent crisis, the government has included provisions that attached such costs to the provision of assistance, including limiting executive compensation, requiring dividends, and acquiring an ownership interest. Further, while uncertainty about the duration of the crisis makes it difficult to specify timetables for phasing out assistance and investments, it is important to provide a credible “exit strategy” to prevent further disruption in the financial markets when withdrawing government guarantees. While Treasury has articulated its exit strategy for some of the companies we reviewed, the government’s plans for divesting itself of investments in AIG and the Enterprises are less clear. Because the government’s involvement in the private sector creates moral hazard and perpetuates the belief that some institutions are too big or interconnected to fail, critics expressed concern that it can encourage risk-taking.

While the debate about whether the government should intervene in private markets to avert a systemic crisis continues, only the future will reveal whether the government will again be faced with the prospect of having to intervene in private markets to avert a systemic crisis. As with other past crises, experience from the most recent crisis offers additional insights to guide government action, should it ever be warranted. Specifically, the government could protect the taxpayer’s interest in any crisis by not only continuing to follow the principles that we have discussed earlier (i.e., identifying and defining the problem, determining a national interest and setting clear goals, and protecting the government’s and taxpayer’s interests) but also by adhering to five additional principles based on the federal government’s experience with the current crisis.

- Develop a strategic and coordinated approach when comprehensive and global governmental action is required.
- Take actions to ensure the government has a strategy for managing any investments resulting from its intervention in order to help mitigate

perceived or potential conflicts and manage external influence.

- Ensure that actions are transparent and effectively communicated to help ensure that the public understands what actions are being taken and for what purpose.
- Establish an adequate oversight structure to ensure accountability.
- Take steps to mitigate moral hazard by not only ensuring that regulatory and market-based structures limit risk taking before a crisis occurs, but also by creating strong disincentives to seek federal assistance through utilization of stringent requirements.

Agency Comments and Our Evaluation

We provided a draft of this report to FHFA, the Federal Reserve, OFS, OCC, and FDIC for their review and comment. In addition, we provided excerpts of the draft of this report to the companies receiving exceptional assistance—AIG, AIG Trust, Bank of America, Chrysler, Citigroup, and GMAC—to help ensure the accuracy of our report.

Treasury and FHFA provided us with written comments which are reprinted in appendices IV and V, respectively. Treasury agreed with the report's overall findings. In its letter, Treasury acknowledged that the additional guiding principles for providing large-scale federal assistance should be considered in any future broad-based government assistance and agreed to weigh these new principles going forward. FHFA, in its letter, acknowledged, as we pointed out in our report, the financial assistance provided to the Enterprises illustrates the potential challenges that can arise when the government uses its assistance to further its public policy goals, particularly the Enterprises' participation in the administration's loan modification efforts, such as HAMP. However, the letter noted that the loan modification efforts are central to the goals of the conservatorships and EESA. The letter further explained that efforts like HAMP may help to mitigate the credit losses of the Enterprises because a loan modification is often a lower cost resolution to a delinquent mortgage than foreclosure.

The Federal Reserve, FHFA, and Treasury provided us with technical comments that we incorporated as appropriate. In addition, AIG, the AIG Trust, Bank of America, Chrysler, Citigroup, and GMAC also provided us with technical comments that we incorporated as appropriate.

We are sending copies of this report to interested congressional committees and members. In addition, we are sending copies FHFA, the Federal Reserve, Treasury, OCC, FDIC, financial industry participants, and other interested parties. 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 Orice Williams Brown at (202) 512-8678 or williamso@gao.gov. Contact points for GAO's Office of Congressional Relations and Public Affairs may be found on the last page of this report. Staff who made major contributions to this report are listed in appendix VI.

A handwritten signature in black ink that reads "Gene L. Dodaro". The signature is written in a cursive style with a long horizontal stroke extending to the right from the end of the name.

Gene L. Dodaro
Acting Comptroller General of the United States

List of Committees

The Honorable Daniel K. Inouye
Chairman
The Honorable Thad Cochran
Vice Chairman
Committee on Appropriations
United States Senate

The Honorable Christopher J. Dodd
Chairman
The Honorable Richard C. Shelby
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable Kent Conrad
Chairman
The Honorable Judd Gregg
Ranking Member
Committee on the Budget
United States Senate

The Honorable Max Baucus
Chairman
The Honorable Charles E. Grassley
Ranking Member
Committee on Finance
United States Senate

The Honorable David R. Obey
Chairman
The Honorable Jerry Lewis
Ranking Member
Committee on Appropriations
House of Representatives

The Honorable John M. Spratt, Jr.
Chairman
The Honorable Paul Ryan
Ranking Member
Committee on the Budget
House of Representatives

The Honorable Barney Frank
Chairman
The Honorable Spencer Bachus
Ranking Member
Committee on Financial Services
House of Representatives

The Honorable Sander M. Levin
Acting Chairman
The Honorable Dave Camp
Ranking Member
Committee on Ways and Means
House of Representatives

Appendix I: Objectives, Scope, and Methodology

The objectives of our report were to (1) describe how and why the government obtained an ownership interest in the companies, (2) evaluate the extent of government involvement in companies receiving exceptional assistance, (3) describe the government’s monitoring of the companies’ financial viability and exit strategies, and (4) discuss the implications of the government’s ongoing involvement in the companies. The report focused on companies receiving exceptional assistance from the federal government, including American Insurance Group (AIG), Bank of America Corporation (Bank of America), Chrysler Group LLC (Chrysler), Citigroup, Inc. (Citigroup), General Motors Company (GM), and GMAC, Inc. (GMAC), as well as its involvement in Fannie Mae and Freddie Mac (Enterprises).

To address the first objective, we reviewed the monthly transactions reports produced Department of Treasury’s (Treasury) Office of Financial Stability (OFS) that lists the structure of federal assistance provided by Treasury to the companies considered receiving exceptional assistance (AIG, Bank of America, Chrysler, Citigroup, and GM) and documentation from Federal Housing Finance Agency (FHFA) to determine the financing structure for the Enterprises. In addition, we reviewed the Board of Governors of the Federal Reserve System’s (Federal Reserve) “Factors Affecting Reserve Balances” H.4.1 documents to determine the assistance provided by Federal Reserve Bank of New York (FRBNY) to AIG. We reviewed the contractual agreements between the government and the companies that governed the assistance. In addition, we reviewed selected Securities Exchange Commission (SEC) filings, Treasury’s Section 105 (a) reports, and other GAO reports on the Troubled Asset Relief Program (TARP).

To address the second objective, we reviewed the Emergency Economic Stabilization Act of 2008 (EESA) and the Housing and Economic Recovery Act of 2008 (HERA) to understand the legal framework for any potential government involvement in the companies receiving exceptional assistance, including the establishment of the conservatorship and the contractual agreements established between the government and the companies. We reviewed the credit agreements, securities purchase agreements; assets purchase agreements, and master agreements. To understand the trust structure established for AIG we reviewed the AIG Credit Trust Facility agreement between FRBNY and the AIG trustees. We conducted interviews with officials and staff from the Federal Reserve Board, FHFA, FRBNY, Federal Reserve Bank of Chicago, (FRB-Chicago), Federal Reserve Bank of Richmond, (FRB-Richmond), OFS, the Office of the Comptroller of the Currency (OCC), Federal Deposit Insurance Corporation (FDIC), and SEC. In addition, we interviewed senior

management—primarily the Chief Executive Officers and the Chief Financial Officers—for most of the companies in our study, including the Enterprises, and interviewed the AIG trustees to understand their role in the governance of AIG.

To address the third objective on evaluating the government’s monitoring of the companies’ financial viability and exit strategies, we interviewed officials from FDIC, Federal Reserve, FHFA, FRBNY, FRB-Chicago, FRB-Richmond, OCC, and OFS. We also interviewed the asset managers who are responsible for monitoring and valuing the equity shares held by Treasury under the Capital Purchase Program, the Targeted Investment Program and the Asset Guarantee Program. We reviewed Treasury documents, such as asset manager reports, TARP transaction reports, and press releases; Treasury testimonies; and press releases from the companies. We also reviewed the contractual agreements between the government and the companies including credit agreements, securities purchase agreements, asset purchase agreements, and master agreements in order to understand the companies’ responsibilities in reporting financial information and the government’s responsibility for monitoring and divesting its interests. Finally, we reviewed a Congressional Oversight Panel report relating to Treasury’s approach on exiting TARP and unwinding its impact on the financial markets.

To address the fourth objective relating to the implications of the government’s ongoing involvement in the companies, we reviewed prior GAO work on principles for providing large-scale government assistance and assessed the degree to which the government’s activities under TARP adhered to these principles. To identify actions the government is taking with the potential to influence the companies’ business decisions, we reviewed legislation that would affect TARP recipients and determined what, if any action the legislation would require the companies to take. To identify the nature and scope of contacts TARP recipients received from executive branch agencies, members of Congress, and state government officials, we interviewed government relations staff at AIG, Bank of America, Chrysler, Citigroup, GM, and GMAC. These interviews also provided us with information on the extent of government involvement and influence in the companies’ business operations. For Chrysler and GM, we obtained 277 letters that the companies received from members of Congress, which was the number of letters the companies received during calendar year 2009 and kept on file. We reviewed each of the letters to determine their topic and whether they sought to influence the companies’ business decisions. We also obtained more than 2,300 e-mails that certain senior executives of Chrysler and GM received from congressional and

state government officials during calendar year 2009, including 1,221 from Chrysler and 1,098 from GM.¹ Due to the large number of these e-mails, we reviewed a random probability sample of 251 from the 2,319 e-mails the companies provided us with to create estimates about the population of all the e-mails. Because we followed a probability procedure based on random selections, our sample is only one of a large number of samples that we might have drawn. Since each sample could have provided different estimates, we express our confidence in the precision of our particular sample's results as having a margin of error at the 95 percent confidence level of plus or minus 8 percentage points or less. This is the interval that would contain the actual population value for 95 percent of the samples we could have drawn. With this probability sample, each member of the study population had a nonzero probability of being included, and that probability could be computed for any member. Finally, we obtained 264 e-mails that certain senior executives at the companies received from White House and Treasury officials in calendar year 2009. After removing e-mails that were out of scope and duplicates, we were left with 109 e-mails, including 89 sent to Chrysler and 20 sent to GM. We reviewed these e-mails to determine their purpose and topic and whether they sought to influence the companies' business decisions.

We provided a draft of this report to FHFA, the Federal Reserve, OFS, OCC, and FDIC for their review and comment. In addition, we provided excerpts of the draft of this report to the companies receiving exceptional assistance—AIG, AIG Trust, Bank of America, Chrysler, Citigroup, and GMAC—to help ensure the accuracy of our report.

We conducted this performance audit from August 2009 to August 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 provided a reasonable basis for our findings and conclusions based on our audit objectives.

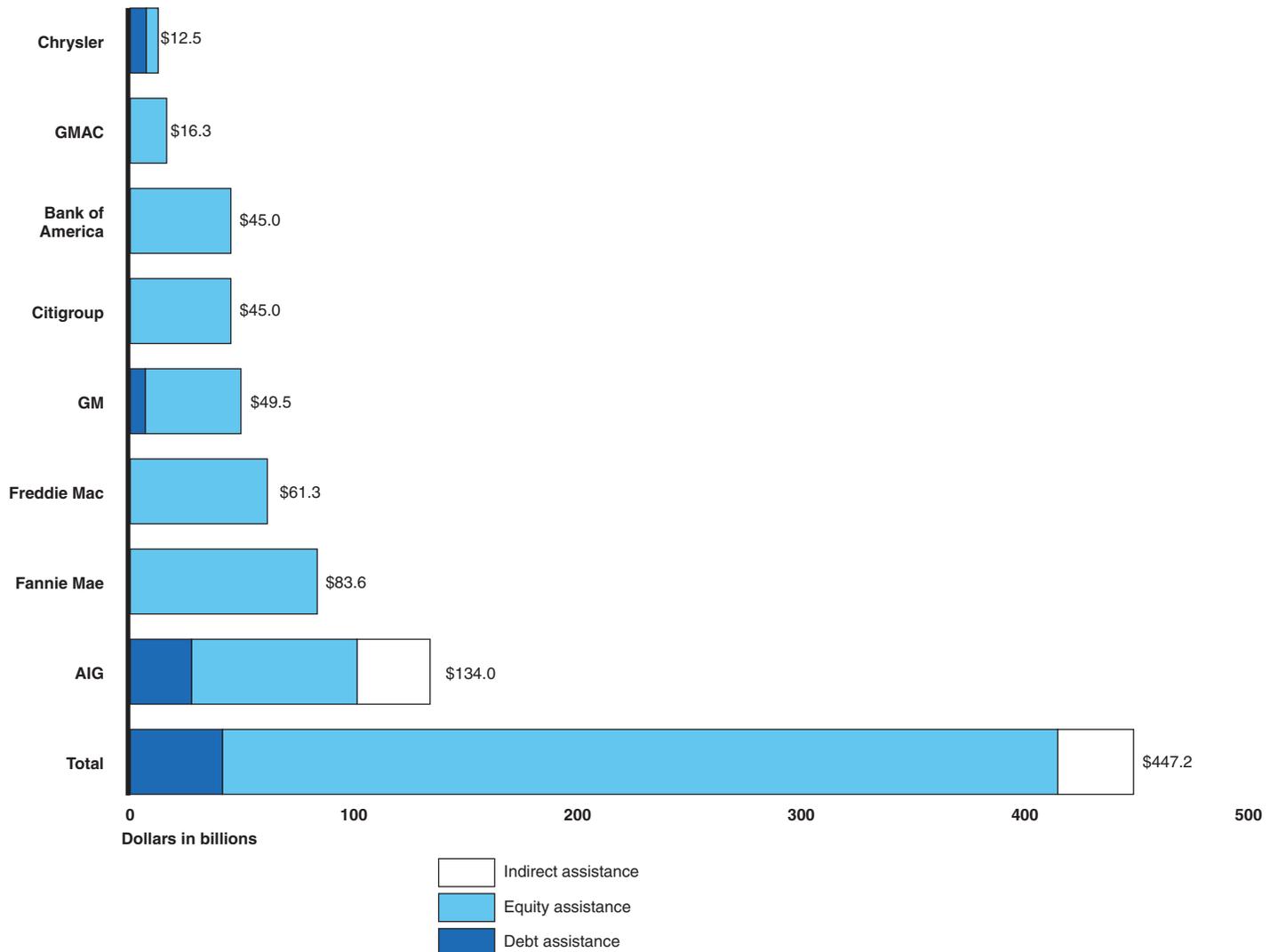
¹GM officials told us that the e-mails the company receives are auto-deleted after 60 days, but that the e-mails it sends out are not. Thus, GM officials were able to identify e-mails received from government officials over the course of 2009 by locating them in e-mails the company sent in response.

Appendix II: Government Assistance and Outstanding Balances of the Companies

Since the fall of 2008, a number of large financial institutions and companies have received more than \$447 billion in financial assistance leaving the government with a significant ownership interest in a number of companies. The government provided assistance or funds to American International Group (AIG); Bank of America Corporation (Bank of America); Chrysler; Citigroup, Inc (Citigroup); Fannie Mae and Freddie Mac (Enterprises); General Motors (GM); and GMAC, Inc (GMAC). As of March 31, 2010, the government owned substantial amounts of preferred or common shares in seven companies—AIG, Chrysler, Citigroup, GM, GMAC, and the Enterprises. The total amounts of assistance disbursed to each company are shown in figure 2. The federal government assisted these companies by infusing capital through the purchase of preferred shares, direct loans, guarantees, stock exchanges, or lines of credit that led to the government owning preferred and common shares.

Appendix II: Government Assistance and Outstanding Balances of the Companies

Figure 2: Government Assistance Provided to Selected Companies, as of March 31, 2010



Source: GAO analysis of Office of Financial Stability, Federal Reserve, and Federal Housing Finance Agency documents and U.S. Securities and Exchange Commission filings.

Notes:

When the government provided debt assistance, the companies received the assistance in the form of loans.

The government provided equity assistance initially in the form of preferred shares. Warrants that the government received as a part of these transactions are not included in the equity totals.

**Appendix II: Government Assistance and
Outstanding Balances of the Companies**

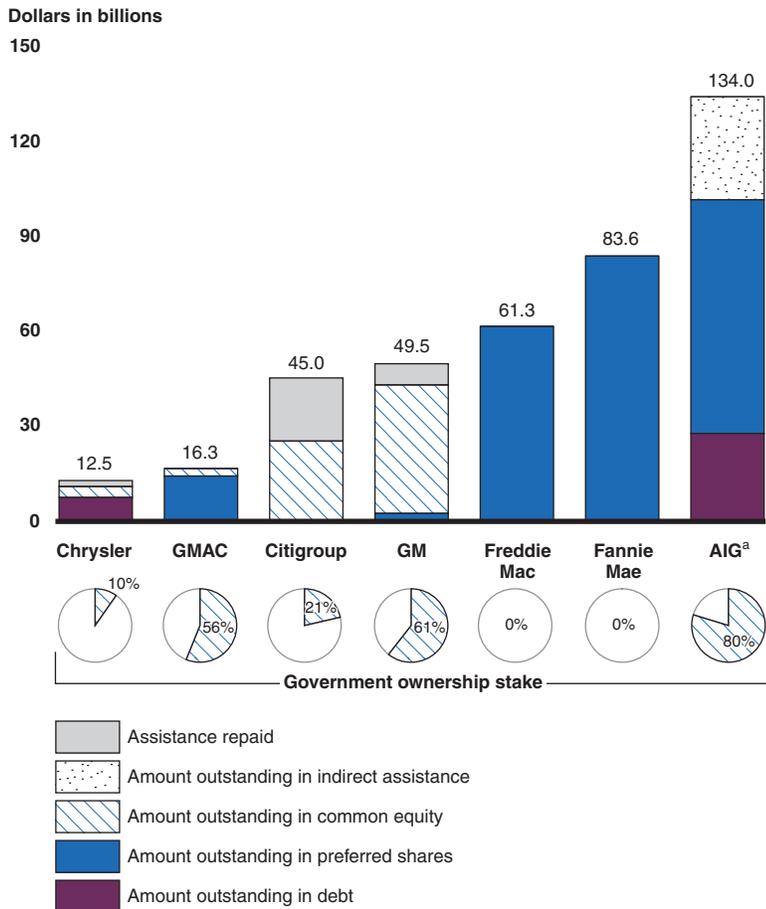
Part of the government assistance includes Maiden Lane II LLC and Maiden Lane III LLC, which were created as part of the assistance to stabilize AIG. FRBNY provided credit to each Maiden Lane facility to purchase from AIG and AIG counterparties residential mortgage-backed securities and multi-sector collateralized debt obligations (which enabled AIG to terminate existing credit default swaps).

Figure 3 shows the variation in the amount of government ownership interest in the companies and the outstanding balance that is owed to the government. The financial institutions and the companies have begun to pay down some of the assistance.¹ GM has repaid the entirety of the debt owed to Treasury under its post-bankruptcy credit agreement, and Chrysler has repaid a portion of its loan from Treasury. As previously noted, whether the government will be recovering all its investment or assistance to Chrysler and GM is unknown. For companies where the government has an ownership stake, the amount of recovery depends on a number of external factors, including the financial health of the companies and the market value of their stock as well as the companies' ability to repay loans or repurchase preferred shares. Similarly, Treasury still holds common shares in Citigroup. The Enterprises have not repaid any portion of the assistance Treasury has provided and as of June 2010 continued to borrow from Treasury.

¹Bank of America completely paid off its assistance—\$45 billion that the Department of the Treasury (Treasury) purchased in preferred shares—and exited from Troubled Asset Relief Program (TARP).

Appendix II: Government Assistance and Outstanding Balances of the Companies

Figure 3: Amount Outstanding and Government Equity Interest, as of June 1, 2010



Source: GAO analysis of Office of Financial Stability, Federal Reserve, and Federal Housing Finance Agency documents and U.S. Securities and Exchange Commission filings.

^aAIG does not owe the government the amounts outstanding to Maiden Lane II and III. Those loans are to be repaid with proceeds from the sale of assets in each facility.

To provide some additional protection for the taxpayer, Treasury required the companies to commit to certain financial terms and actions. For example, in exchange for the capital infusions in the form of preferred shares, Treasury required AIG, Bank of America, Citigroup, the Enterprises, GM, and GMAC to pay dividends. The dividend rate varied across the seven companies ranging from less than 5 percent to 10 percent for AIG and the Enterprises. As shown in table 6, as of March 31, 2010, Treasury had collected a total of more than \$16.2 billion in dividends from Bank of America, Citigroup, the Enterprises, GM, and GMAC. AIG was

**Appendix II: Government Assistance and
Outstanding Balances of the Companies**

required to pay dividends at an annual rate of 10 percent on series D cumulative preferred shares prior to when they were exchanged for series E noncumulative preferred shares, but it had not paid any dividends to Treasury as of March 31, 2010. Series D unpaid dividends were capitalized, thereby increasing the liquidation preference of the Series E shares for which they were exchanged.

Table 6: Additional Company Payments to the Treasury, as of March 31, 2010

(Dollars in billions)

Company	Dividends paid	Interest paid	Proceeds from warrant sale	Total
AIG	\$0.00	\$0.00 ^a	\$0.00	\$0.00
Bank of America	2.73	n/a	1.54	4.27
Chrysler	n/a	0.13	n/a	0.13
Citigroup	2.82	n/a	0.00	2.82
Fannie Mae	4.03	n/a	0.00	4.03
Freddie Mac	5.57	n/a	0.00	5.57
GM ^b	0.13	0.25	n/a	0.38
GMAC	1.01	n/a	n/a	1.01
Total	\$16.29	\$0.38	\$1.54	\$18.21

Sources: GAO analysis of Office of Financial Stability and Federal Housing Finance Agency documents, and [GAO-10-475](#).

^aAll repayments by AIG, thus far, have been applied to principal. Accrued interest and commitment fees amounted to \$5.7 billion as of March 31, 2010.

^bOn April 20, 2010, GM repaid the remaining balance on the \$6.7 billion from Treasury.

The government or, in the case of AIG, FRBNY requires that AIG and Chrysler pay interest on the loans provided. Moreover, Treasury currently holds warrants obtained in connection with the preferred shares that it holds for AIG, Citigroup, and the Enterprises. Because GMAC is a privately held company, Treasury exercised its warrants immediately. On March 3, 2010, Treasury received more than \$1.5 billion from its auction of Bank of America's warrants.

Appendix III: Legislation and Government Communication with GM and Chrysler

To further examine the extent of government involvement in companies receiving Troubled Asset Relief Program (TARP) assistance, we reviewed legislative proposals and government communications with General Motors Company (GM) and Chrysler Group LLC (Chrysler). We examined the following: (1) proposed legislation that would place requirements or restrictions on the companies due to their status as TARP recipients, (2) letters from members of Congress to the companies, and (3) e-mails from congressional offices, state government, White House, and Department of the Treasury (Treasury) officials sent to certain company officials whom we designated.

Chrysler and GM officials told us that the level of government involvement—from requests for appearances at congressional hearings to letters from elected officials—had increased since their companies had requested and received financial assistance from the government. They emphasized that the congressional letters and e-mails did not cause them to make decisions that were in conflict with their best interests. However, these officials stated that addressing the government’s involvement, such as responding to letters, audits, or other requests for information, required increased company resources.

Proposed Federal Legislation That Would Affect TARP Recipients in the Auto Industry Focuses on Dealership Closures and Executive Compensation

We identified 38 bills introduced from October 2008, when the Emergency Economic Stabilization Act of 2008 (EESA) was enacted, through January 2010 that would impose requirements or restrictions on GM and Chrysler as TARP recipients. Action on the majority of these bills has been limited since their introduction in Congress, with two having become law.¹ Although the bills cover a range of topics, those among the most commonly addressed by the legislation were dealership closures and executive compensation and bonuses.

Dealerships

We identified eight bills that addressed, among other issues, the closure of auto dealerships, a topic specifically directed at automakers accepting TARP funds. Closing dealerships was a way for the companies to reduce their operating costs in an attempt to return to profitability, but since these closures would occur in communities across the country, they prompted considerable congressional interest. The bills generally aimed to

¹Certain provisions of the Consolidated Appropriations Act of 2010 and the American Recovery and Reinvestment Act, as discussed below, affected GM and Chrysler due to their status as TARP recipients. See the following footnotes for citations.

curtail or prevent the closure of auto dealerships, as well as plants and suppliers. One of the bills that became public law requires Chrysler and GM to provide to the dealers specific criteria for the closures and gives dealers the right to pursue binding arbitration concerning their closures.² The Automobile Dealer Economic Rights Restoration Act of 2009, as introduced in the House and Senate, would require the automakers to restore a dealership based on the dealer's request.³ As of July 30, 2010, this bill has not been enacted.

Executive Compensation

We identified 17 bills affecting executive compensation and bonuses for TARP recipients in both the auto and financial industries.⁴ Most of these bills would require restrictions on or repeals of executive compensation and bonuses for TARP recipients. For example, the American Recovery and Reinvestment Act, which became law in February 2009, calls for, among other things, limits on compensation to the highest paid executives and employees at firms receiving TARP funding.⁵

Other Topics

Other less commonly addressed topics and an example of a bill related to each category are shown in table 7. As of July 30, 2010, these bills have not been enacted.

²Consolidated Appropriations Act of 2010, Pub. L. No. 111-117, Div. C, Title VII, § 747, 123 Stat. 3034, 3219-3221 (2009).

³H.R. 2743, 111th Cong. (2009) and S. 1304, 111th Cong. (2009).

⁴All of the executive compensation bills included in this analysis apply to the financial sector as well as the auto sector; none specifically apply to the auto sector. Although not included in this analysis, several bills were introduced that would exclusively target the financial sector. For example, we identified seven bills that would repeal or limit executive compensations or bonuses exclusively for TARP recipients in the financial sector, such as the American Insurance Group (AIG) or Bank of America. We further observed that the number of bills that would repeal or limit executive compensation and bonuses for TARP recipients in any industry increased during March 2009 when AIG officials had announced they would be distributing bonuses to executives. That month showed the most bills introduced from the time EESA was enacted to the end of December 2009.

⁵Pub. L. No. 111-5, Div. B, Title VII § 7001, 123 Stat. 115, 516-520 (2009). This act, which amends EESA, requires, among other things, that annual incentive compensation be paid in long-term restricted stock and provides an exception for contractually obligated bonuses agreed on or before February 11, 2009.

Table 7: Topics of Other Bills Placing Requirements or Restrictions on TARP Recipients in the Auto Industry

Topic of legislation	Example of introduced bill
Company investments and financial operations	H.R. 2633 would prohibit auto manufacturers receiving TARP funds from opening a new foreign subsidiary or expanding their current foreign subsidiaries.
Transparency or accountability requirements	H.R. 1472 would require recipients of TARP or American Recovery and Reinvestment Act funds to report to the Secretary of the Treasury upon receipt or redistribution of the funds or contract agreements that use such funds.
Conditions or prohibitions on the compensation and employment of nonexecutive staff	H.R. 1714 would require at least one member of the board compensation committee of financial institutions receiving TARP funds to be an employee whose compensation is within the lowest 20 percent of compensation of all employees and executives.
The use of TARP funds for lobbying or political purposes	S. 133 would prohibit TARP recipients from using TARP funds for lobbying expenditures or political contributions.

Source: GAO analysis of TARP-related legislation.

Chrysler and GM Have Received Numerous Letters from Members of Congress

Between May and December 2009, Chrysler and GM received 277 letters from members of Congress, including 65 sent to Chrysler and 212 to GM. Company officials told us that the volume of congressional letters they received sharply increased in the spring of 2009, after the companies received TARP assistance and when many operational changes that were part of their restructuring—such as plant and dealership closures—were being made. In total, 188 individual members of Congress sent letters to the companies over this time period.

In terms of the content of the letters, many dealt with specific constituent concerns, with the closing of auto dealerships being the most common topic. Of the letters sent to Chrysler and GM, 68 percent pertained to dealership closures, and the majority of these requested information on specific dealerships in the member’s district or state or provided information for the companies’ consideration when determining whether or not to close specific dealerships. For example, one letter stated that closing a particular dealership would result in customers having to drive up to 120 miles round trip to service their existing vehicle or purchase a new one. Other topics most commonly discussed in the letters included the renegotiation of union contracts with companies that haul cars from manufacturing plants to dealerships (17 percent) and the closure of manufacturing plants (5 percent). None of the letters pertained to executive compensation.

Across all letters, 56 percent either explicitly requested a change to the companies’ operations or stated a desired change. Just as dealerships were the focus of most of the letters, dealerships were the focus of the majority of requests for changes as well, with 62 percent suggesting that the

companies reconsider the decision to close a particular dealership. The remainder of letters that requested changes pertained to car-hauling contracts (16 percent), plant closures (5 percent), or other business decisions and operations such as the sale of brands (21 percent).⁶

Chrysler and GM Senior Executives Received E-mails from Federal and State Officials about the Companies' Business Operations and Other Topics

We also reviewed e-mails that the companies' chief executive officers and most senior state and federal government relations officers had received from federal and state officials during calendar year 2009.⁷ Our review included e-mails sent by White House officials, the Treasury Department's chief advisors to the Presidential Task Force on the Auto Industry,⁸ members of Congress or their staff, and officials from the five states with the highest proportion of manufacturing in the auto sector.⁹ For the purpose of analysis, we grouped the e-mails into federal executive branch officials—Treasury and White House—because these individuals had a defined role in the assistance to the companies, and federal legislative and state officials. For each group, we recorded information on the purpose and topic of each e-mail.

⁶Note that percentages do not add to 100 because some letters were about multiple topics.

⁷GM officials told us that they could not necessarily provide us with all the e-mails received during calendar year 2009, as we requested, because the company automatically deletes received e-mails after 60 days unless either (1) the auto-delete function is suspended due to some external requirement, such as pending litigation or an outstanding investigation, or (2) the recipient of the e-mail acts to preserve a specific e-mail. Moreover, even where the auto-delete function has been suspended (as it had been for many of the e-mail recipients included in our document request) individuals still may delete e-mail where there is no business purpose or other requirement to retain them. In an effort to satisfy our request, GM provided us with e-mails retained in the in-boxes of individual recipients. GM also searched outgoing e-mails for messages that were responses to e-mails originally received from government officials. This yielded additional records because in some instances recipients did not retain the original incoming message but did retain e-mails responding to or forwarding the original e-mail message. Government e-mails to which GM officials did not send a response and were received outside of the 60-day auto-delete window were not available to us for analysis.

⁸The task force was established in February 2009 to assess Chrysler and GM's restructuring plans and to discuss issues including financial and operational restructuring, improving competitiveness of wage and benefit structures, and progress toward creating low-pollution vehicles. We requested that the companies provide us with e-mails they had received from members and designees of the task force. The documentation we received from the companies contained one e-mail from one member of the task force and no e-mails from designees. Because this official serves on the Presidential task force, we consider him a White House official for the purpose of this analysis.

⁹The states included in our analysis are Alabama, Indiana, Kentucky, Michigan, and Ohio.

White House and Treasury
Department E-mails

According to the documentation the companies provided to us, the designated officials at Chrysler received 89 e-mails from White House and Treasury officials. The designated officials at GM received 20 e-mails. About 60 percent of the e-mails were from Treasury officials and about 40 percent were from White House officials. Sixty-six percent of the e-mails were sent for the purpose of either arranging a call or a meeting between company and government officials (35 percent) or requesting information or input from the companies (31 percent). About 26 percent of the e-mails were sent to provide information to the companies. The topic of more than 33 percent of the e-mails was unclear and more than 60 percent of the e-mails with an unclear topic were sent for the purpose of arranging a call or meeting. Of the e-mails with identifiable topics, the highest number pertained to bankruptcy or restructuring (29 percent of all e-mails) followed by manufacturing plants (12 percent), and dealerships (7 percent). Most of the e-mails that pertained to bankruptcy or restructuring were sent for the purpose of either providing information to or requesting information from the companies (34 percent each). For example, one e-mail requested that Chrysler review and provide comments on a set of talking points on Chrysler's restructuring. Two of the e-mails—less than 2 percent—requested a change to the companies' operations or stated a desired change, such as an e-mail concerning GM's negotiations in a proposed sale of a company asset.

Congressional and State E-
mails

Chrysler identified 1,221 e-mails it had received from congressional offices of both parties, mostly from staff, and state officials; GM identified 1,098. Due to the number of e-mails, we reviewed a random probability sample of them in order to develop estimates about the entire group of e-mails.¹⁰ Based on this review, we estimate that 86 percent of these e-mails came from congressional offices and the remaining 14 percent from government officials in the five states included in our analysis. The records in the sample showed that most of the congressional e-mails were sent from staff rather than from members of Congress.

The purpose of the vast majority of congressional and state e-mails varied from requesting information to arranging a call or meeting to simply

¹⁰To calculate estimates about all of the e-mails provided to us, we randomly selected a probability sample of 251 of the e-mails. Estimates calculated from probability samples are subject to sampling errors. All percentage estimates from the e-mail review presented in this report have margins of error at the 95 percent confidence level of plus or minus 8 percentage points or less unless noted otherwise. For detailed information on our sampling and estimating methodology, see appendix I.

thanking the recipient. Most common were e-mails sent to provide information to the recipient (38 percent), followed by e-mails sent to request information (31 percent), and e-mails to arrange a call or meeting between government and company officials (22 percent). We estimate that 13 percent of the e-mails were sent for other reasons, such as to thank the recipient, or for reasons that could not be determined based on the content of the e-mail. Roughly 1 percent of the congressional and state e-mails—either explicitly requested or stated a desired change to the companies' operations. The topics of the e-mails varied, with 27 percent focusing on dealerships and 11 percent on manufacturing plants. Thirty-six percent—the largest group—did not reference a specific topic. For example, many of the e-mails sent for the purpose of arranging a call or meeting did not indicate the reason for the requested call or meeting.

Appendix IV: Comments from the Department of the Treasury



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

July 21, 2010

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 Department of the Treasury ("Treasury") appreciates the opportunity to review the GAO's latest report on the Troubled Asset Relief Program ("TARP"), titled *Financial Assistance: Ongoing Challenges and Guiding Principles Related to Government Assistance for Private Sector Companies* ("Draft Report").

We are pleased that the Draft Report finds that Treasury generally adhered to the three guiding principles regarding large-scale federal assistance that the GAO had identified based on the financial crises of the 1970s and 1980s, while facing the unique and considerable challenges presented by the recent crisis. Although the Draft Report contains no recommendations, it describes additional guiding principles to consider in any future instance of broad-based government assistance. We thank you and your staff for your analysis of our efforts to date and will weigh these new guidelines going forward.

We look forward to continuing this constructive dialogue.

Sincerely,

A handwritten signature in black ink, appearing to read "Herbert M. Allison".

Herbert M. Allison
Assistant Secretary
Office of Financial Stability

Appendix V: Comments from the Federal Housing Finance Agency



FEDERAL HOUSING FINANCE AGENCY
Office of the Director

July 22, 2010

Ms. Orice Williams Brown
Director
Financial Markets and Community Investment
Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Ms. Williams Brown:

Thank you for the opportunity to review and comment on the Government Accountability Office (GAO) Report, *Financial Assistance: Ongoing Challenges and Guiding Principles Related to Government Assistance For Private Sector Companies*. Federal Housing Finance Agency (FHFA) staff provided technical comments directly to GAO staff.

The GAO study notes that assistance provided to Fannie Mae and Freddie Mac (the Enterprises) illustrates the potential challenges that can arise when the government uses its assistance to further its public policy goals. In particular, the study highlighted the Enterprises' participation in the Administration's loan modification efforts, and the potential negative impact on the Enterprises' financial condition. I would like to comment here regarding those efforts.

Since September 2008, the Enterprises have been operating in conservatorship with financial support from the Treasury Department. The purpose of conservatorship is to preserve and conserve each company's assets to enable them to fulfill their mission and mitigate the systemic risk that contributed to instability in financial markets.

Central to the goals of conservatorship is the mitigation of credit losses. The Enterprises' foreclosure prevention efforts – including loan modifications and refinances as well as short sales and deeds in lieu of foreclosure – are essential to meeting those goals. These efforts also fulfill the Emergency Economic Stabilization Act of 2008 (EESA) mandate that FHFA, as conservator, act to “maximize assistance for homeowners” while minimizing losses to the Enterprises themselves. FHFA reports monthly to Congress on the full range of Enterprise foreclosure prevention activities through its Foreclosure Prevention / Federal Property Manager's Report. In pursuit of the goal of minimizing credit losses and fulfilling this statutory mandate, FHFA and the Enterprises worked with the Administration to design and implement the Making Home Affordable program (MHA), including the Home Affordable Modification Program (HAMP).

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Loan modifications and other loss mitigation activities are a key focus for FHFA as the Enterprises' conservator because these strategies are consistent with the Enterprises' public mission and are central to the purpose and goals of the conservatorships. In the current environment, conserving the assets of the Enterprises requires, first and foremost, minimizing their credit losses from delinquent mortgages. Fannie Mae and Freddie Mac have played a key role in the development and implementation of HAMP because a well-designed loan modification is often a lower cost resolution to a delinquent mortgage than foreclosure, and these alternatives to foreclosure save the Enterprises' and taxpayers' money. As with other participants in HAMP, the Enterprises' modifications under the program are based on a net present value test, which is designed to test whether a modification will be in the Enterprises' long-term economic interest.

The broader adoption of loan modification programs has benefits beyond reducing losses directly on the Enterprises' resolutions of their delinquent loans. Since the Enterprises own or guarantee about half the mortgages in the country, the successful widespread adoption of HAMP by others, which is improving the modification process, benefits the Enterprises by improving stability in housing markets and reducing credit exposure.

Thank you again for the opportunity to comment on this study. If you have any additional questions please let me know.

Sincerely,



Edward J. DeMarco
Acting Director

Appendix VI: GAO Contacts and Staff Acknowledgments

GAO Contacts

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Staff Acknowledgments

In addition to the contacts named above, Heather Halliwell, Debra Johnson, Wes Phillips, and Raymond Sendejas (lead Assistant Directors); Carl Barden; Emily Chalmers; Philip Curtin; Rachel DeMarcus; Nancy Eibeck; Sarah Farkas; Cheryl Harris; Grace Haskins; Damian Kudelka; Ying Long; Matthew McDonald; Sarah M. McGrath; Michael Mikota; Susan Michal-Smith; SaraAnn Moessbauer; Marc Molino; Omyra Ramsingh; Christopher Ross; Andrew Stavisky; and Cynthia Taylor have made significant contributions to this report.

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