Written Testimony of Herbert M. Allison, Jr., Assistant Secretary for Financial Stability Domestic Policy Subcommittee Oversight and Government Reform

United States: Department of the Treasury

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Chairman Kucinich, Ranking Member Jordan and members of the Subcommittee, thank you for the opportunity to testify before you today regarding efforts under the Emergency Economic Stabilization Act of 2008 (EESA) and the Troubled Asset Relief Program.

As a result of our efforts under EESA, confidence in our financial system has improved, credit is flowing, and the economy is growing. The government's emergency financial policies and taxpayers are being repaid. Indeed, the ultimate cost of those policies is likely to be significantly lower than previously anticipated – more than $15 billion in income so far – and we expect substantial additional income going forward.

You have asked me to discuss our common equity investments in American International Group, Inc. (AIG), Citigroup, General Motors (GM), and Chrysler. I am happy to talk with you about these subjects and look forward to your questions after my testimony.

Background to the Investments

In mid-September 2008, we were in the midst of one of the worst periods in our financial history. The economy was contracting sharply. Fear and depression froze markets and spurred businesses to lay off workers and pull back from investment and lending.

Immediate, strong action was needed to avoid a complete collapse of the financial system. The Treasury, Federal Reserve, Federal Deposit Insurance Corporation (FDIC), and other U.S. government bodies undertook an array of unprecedented steps to avert a collapse and the dangers posed to consumer finance and the broader economy. However, additional resources and authorities were needed to help address the severe conditions our nation faced.

Recognizing the need to take difficult but necessary action to confront a financial system on the verge of collapse, Congress enacted EESA and gave the Treasury Department authority to restore liquidity and stability to the U.S. financial system by purchasing and guaranteeing troubled assets in financial institutions.

Investments

Let me now give an overview of the government's investments in each of the four firms you have mentioned, and then discuss the particular issues raised.

AIG

The government's initial investments in AIG were not made by Treasury but were made by the Federal Reserve Bank of New York (FRBNY) be enacted. The circumstances that forced the government to act developed extremely quickly. Government officials within the Federal Reserve and the Treasury had no intention of providing support to AIG going into the weekend of September 13-14, 2008. After Lehman Brothers filed for bankruptcy on September 15, however, financial markets were shaken, AIG's condition worsened dramatically and the prospects of private sector support for AIG's preferred stock dropped sharply.

While the Treasury was not involved in the initial AIG investments, we are actively managing and monitoring those investments.

We are now the largest shareholder in AIG, owning approximately 80% of the company's common equity. AIG has been a challenging investment because it is a diversified multinational company with businesses in many lines of insurance and financial services.

We have been actively managing the investment, and our goal is to maximize the value of the investment to taxpayers. We have taken several steps to manage the investment and maximize its value. These include:

1. Understanding the business
2. Participating in strategic initiatives
3. Encouraging significant cost reductions
4. Playing an active role in AIG's regulatory compliance

We have also been working with AIG to ensure that it is a strong, viable company with a strong capital position and a robust risk management framework.

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We look forward to your questions.
vanished. Literally overnight, government officials were faced with a difficult choice, and a choice that had to be made immediately: either let GM and Chrysler go bankrupt and face the consequences. They chose, rightly, to act.

Thus, on September 15, the FRBNY agreed to provide a credit facility to AIG and also received the right to acquire convertible preferred stock of approximately 80% of the voting rights of the common stock. The FRBNY later deposited this convertible preferred stock into the AIG Credit Facility independent trust that was established solely for this purpose. That trust continues to own the stock today for the benefit of the U.S. taxpayer. The Treasury provided $30.1 billion to assist GM and $1.9 billion to assist Chrysler through their respective restructuring periods. Prior to Treasury's decision to provide initial assistance, GM and Chrysler had lost a considerable portion of their market value.

Notwithstanding this intervention, the rating agencies felt that AIG had too much debt, and so in November, pursuant to the TARP authority, the Treasury invested $25 billion and which currently has a market value of approximately $26.5 billion. Treasury also holds nonvoting preferred stock. The Treasury does not hold common stock in AIG.

Citigroup

Treasury invested $25 billion in Citigroup in October 2008. Citigroup was one of the first participants in the Capital Purchase Program (CPP) primary program established by the prior Administration under TARP. It provided for capital infusions into viable banks, and in return the Treasury received nonvoting preferred stock. This program was essential to averting a collapse of our financial system, as has now been acknowledged by the current Administration in its Congressional Oversight Panel in its most recent report. In November 2008, Treasury announced a further investment of $20 billion in Citigroup in December 2008. Treasury also agreed to guarantee certain Citigroup assets, in return for which it received nonvoting trust preferred stock in the AIG Credit Facility. In April Treasury restructured this investment and purchased additional preferred stock facility of $29.8 billion, of which only $5 billion has been drawn. Today, the Treasury has invested a total of $45 billion in Citigroup.

GM and Chrysler

Let me turn now to the automotive industry. Conditions in the credit markets made it hard for many households to finance the purchase of vehicles. The outlook for GM and Chrysler would likely have led to uncontrolled liquidations in the automotive industry, with widespread devastating effects on the repercussions of such liquidations could have included immediate and long-term damage to the U.S. manufacturing/industrial base, a significant increase in unemployment with direct harm to those both directly and indirectly related to the automotive industry, and further damage to our financial system, as a result of a material portion of overall financial activity. Chairman Bernanke stated that a disorderly bankruptcy of GM or Chrysler "likely would result in significant job losses and place further, meaningful downward pressure on U.S. economic performance" and that the state of the Detroit automakers pose an economic challenge.

Therefore, the previous Administration provided initial assistance late last year to the automotive companies pursuant to TARP, including loans to fund working capital and $4 billion to Chrysler. When the Obama Administration took office, it required the companies to develop long-term and viability plans before Treasury would provide additional assistance.

The Administration believed that requiring the companies to develop plans to become leaner and more efficient was the only way the companies could become more competitive and the only way to protect taxpayers' investments. On March 30, 2009, the Administration determined that the business plan submitted by Chrysler failed to demonstrate viability and announced that Chrysler would be allowed to file for bankruptcy. Treasury loaned an additional $6 billion to fund GM during this period. Treasury announced an Auto Warranty Program designed to give consumers considering new car purchases from domestic manufacturers the warranties on those cars would be honored regardless of the outcome of the restructuring process.

After acceptable plans were developed, certain assets of both GM and Chrysler (Old GM and Old Chrysler, respectively) were sold to newly created GM and Chrysler. When the Obama Administration took office, it required the companies to develop long-term and viability plans before Treasury would provide additional assistance.

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Treasury converted most of its loans to the Old GM into $2.1 billion of preferred stock, a 60.8 percent share of the common equity in the New GM’s billion debt security note. $360 million of Treasury's debt in the new GM was immediately repaid with the termination of the Auto Warranty Program and $600 million of loans outstanding.

Today, Treasury holds 60.8% of the common stock of GM, as well as $2.1 billion of preferred stock and $6.7 billion in loans. Treasury holds 9.2% of the common stock as well as a loan of $5.1 billion. On or after Dec. 31, 2014, GM may redeem the preferred shares at $25 per share plus any accrued dividends, subject to limited exceptions.

**Treasury as a Shareholder**

I would like to now turn to your question as to what objectives guide us in exercising our rights as a shareholder.

As noted earlier, Treasury does not own voting stock in AIG. The AIG Credit Facility Trust owns the voting stock, and you may wish to speak to the principles they follow in exercising those voting rights. The principles we follow with respect to our common stock investments in Citigroup shareholders as follows:

First, the U.S. government is a shareholder reluctantly and out of necessity. We intend to dispose of our interests as soon as practicable, with the objective of achieving financial stability and protecting the interests of the taxpayers.

Second, we do not intend to be involved in the day-to-day management of any company. Our responsibility is to protect the taxpayers' investment involvement in the day-to-day management of a company might actually reduce the value of these investments, impede the ability of the company to be privately owned, and frustrate attainment of our broader economic policy goals.

Third, establishing an effective board of directors that selects management with a sound, long-term vision should restore a company to profitability need for government support expeditiously. Where companies require a substantial amount of new government resources, Treasury reserves the right to be involved in the day-to-day management of any company, and we would like to speak to the principles they follow in exercising those voting rights. The principles we follow with respect to our common stock investments in Citigroup shareholders as follows:

Fourth, the government's role as a shareholder is to manage its investment, not to manage the company. We take a commercial approach to rights as a shareholder. We will vote only on core shareholder matters such as board membership, amendments to corporate charters or bylaws, liquidations, substantial asset sales, and significant common stock issuances.

We have incorporated these principles into legal documents in the case of Citigroup and GM, where we are substantial shareholders. The Shareholders Agreement between Treasury and Citigroup provides that Treasury will exercise its right to vote only on matters that involve major corporate transactions such as mergers, sales of substantially all assets, and dissolution, securities where shareholders are entitled to vote, and amendments to the charter or bylaws. On all other matters, Treasury will vote its shares proportion (for, against or abstain) as all other shares of the company's stock are voted. We do not have any board seats in the case of Citigroup.

We own 60.8% of the common stock of GM. The other shareholders are: GM Voluntary Employee Benefit Association (17.5 percent), the Car (11.7 percent), Old GM's unsecured bondholders (10 percent). We have designated 10 of the 13 of the directors. We expect our ownership to remain at 60.8% if GM goes public. The Shareholders Agreement between Treasury and GM provides that after GM's expected public offering, Treasury will vote only on certain matters. These matters consist of the election or removal of directors (provided that Treasury will vote in favor of individuals nominated by the GM Voluntary Employee Benefit Association), certain major corporate transactions such as mergers, sales of substantially all assets, and dissolution, amendments to the charter or bylaws, and matters in which Treasury's vote would be required to be taken action (in which case the shares will be voted in the same proportion (for, against or abstain) as all other shares of the company's stock).

In the case of Chrysler, we have 9.9% of the common stock. Approximately 67.7% is owned by the Chrysler Voluntary Employee Benefit Association and 2.5% by the Government of Canada. We have designated three of Chrysler nine directors, and our designees, in turn, have designated a director.

**Oversight and Compliance**

Although we do not participate in day-to-day management of Citigroup, AIG, Chrysler and GM, I'd like to point out several additional protection reporting requirements that help ensure accountability and protect the value of our investments in these entities.

**Executive Compensation**

First, with respect to compensation, in June 2009, Treasury published the Interim Final Rule (the "Rule") on executive compensation, promulgated as amended by the American Recovery and Reinvestment Act of 2009. The Rule contains distinct requirements for recipients of TARP funding programs, including CPP participants and recipients of exceptional assistance. Citigroup, AIG, GM and Chrysler are all recipients of exception subject to these special requirements.

The Rule established the Office of the Special Master for TARP Executive Compensation (Special Master), and provided the Special Master with the authority to ensure that executive pay at these firms is in line with long-term value creation and financial stability. For recipients of exceptional programs, Special Master is required to review and approve compensation structures, including payments made pursuant to those structures, for the seni 20 next most highly paid employees, and to review and approve compensation structures, but not payments made pursuant to those structures, for the six next most highly paid employees. The Special Master is supposed to make sure, among other things, that it does not result in excessive risk taking, that it is linked to performance, that it is competitive and that the firms whose compensation he reviews government for the investments.

The Special Master will automatically approve proposed compensation to employees whose total annual compensation is not more than $500,000. The Special Master will automatically approve proposed compensation to employees whose total annual compensation is not more than $500,000. This "safe harbor" rule is designed to encourage TARP recipients to use structures that link compensation to long-term firm value.

On October 22, 2009, the Special Master, Kenneth R. Feinberg released determinations on the compensation packages for the top executives. Office of the Special Master generally rejected the companies' initial proposals for the top 25 executives and approved a modified set of competencies with the following features:
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- Cash salaries generally no greater than $500,000, with the remainder of compensation in equity.
- Most equity compensation paid as vested “stock salary,” which executives must hold until 2011, after which it can be transferred in three installments (subject to acceleration on the company’s repayment of TARP funds).
- Annual incentives payable in long-term restricted stock, which requires three years of service, in amounts determined based on objective criteria. Actual payment of the restricted stock is subject to the company’s repayment of TARP funds (in 25% installments).
- $25,000 limit on perquisites and “other” compensation, absent special justification.

On December 11, 2009, the Special Master released his second round of rulings on executive compensation packages for firms that received exceptional assistance. These determinations cover compensation structures for the next 75 most highly compensated employees plus executive officers, subject to the October 22 decisions, and are designed to protect long-term value creation and financial stability.

The determinations cover AIG, Citigroup and GM. Chrysler was exempt from the Special Master’s review during this round because total pay for executives does not exceed the $500,000 “safe harbor” in the Rule.

The Special Master announced a set of compensation structures with the following features:

- Cash salaries generally no greater than $500,000, except in exceptional cases as specifically certified by the company’s independent committee.
- Cash is limited in most cases to 45 percent of total compensation. All other pay must be in company stock to align executives’ interest value creation and financial stability, and therefore taxpayer interests.
- At least 50 percent of each executive’s pay must be held for at least three years, aligning the pay each executive actually receives with that realized by the firm.
- Incentives may be paid only if the company sets, and the executive achieves, objective performance measures, reviewed by the Specific executives’ interests with those of shareholders and taxpayers.
- The total incentives for all of the covered executives will be strictly limited to an aggregate “pool” based on a specified percentage of all other metrics determined by the compensation committee and reviewed by the Special Master. A larger payment to one executive will be the basis for a clawback if the results giving rise to that payment do not align with the pay each executive actually receives with the firm.
- At least half of the incentive compensation must be paid in the form of company stock that must be held for at least three years.
- Any incentive compensation paid to the covered executives will be subject to “clawback” if the results giving rise to the payment do not long term or an executive engages in misconduct.

Like all recipients of TARP funds, Citigroup, AIG, GM and Chrysler must also adhere to the general corporate governance standards and limits set forth in EESA. These executive compensation requirements state that bonuses or incentive compensation paid to any of the senior executives must be based on materially accurate earnings must be repaid. No golden parachute payments may be executive officer or any of the next five most highly compensated employees, compensation in excess of $500,000 per executive may not be paid purposes, and the companies must establish a compensation committee of independent directors to review employee compensation plans and these plans.

**Other Reporting Requirements**

Next, with respect to enhanced reporting, Chrysler and GM must provide financial information on a regular basis to Treasury, including a report setting forth in reasonable detail the actual use of the TARP funding they received upon exiting from bankruptcy. Treasury uses this information to monitor risk and performance at both the overall portfolio level and the individual investment level, and conduct sensitivity analysis.

Chrysler and GM must also report to Treasury if actions occur that could result in the companies failing to meet the minimum funding requirements of their pension plans, or if the companies plan to terminate any of their plans.

AIG and Citigroup, as recipients of exceptional assistance, must maintain and implement comprehensive written policies, approved by Treasury, that set forth executive compensation, lobbying, governmental ethics and political activity, and must maintain internal controls with respect to compliance with these requirements.

**Other Requirements**

With respect to U.S. production volume, Chrysler and GM must produce a portion of their vehicles in the United States. Chrysler must either maintain its U.S. sales volume in the United States or its U.S. production volume must be at least 90% of its 2008 U.S. production volume. GM agreed to the monthly sales volume at least 90% of its planned U.S. sales volume.

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**Portfolio Management Approach**

Now, I’d like to turn to your question about our portfolio management approach.

In managing the TARP investments, Treasury takes a disciplined portfolio approach, and employs a mix of dedicated professionals and external experts. Treasury employees monitor risk, performance, and conduct sensitivity analysis using public information on a periodic basis.

Treasury tracks the fair market value of the assets in the TARP portfolio, measuring the value of publicly-traded common stock by market quotations of other assets with market-based valuation models it developed in consultation with external asset managers and in compliance with **Risk Assessment**

Treasury has developed risk assessment procedures to identify TARP recipients that are in a significantly challenged financial condition. Treasury managers review publicly available information to identify recipients for which pre-tax, pre-provision earnings and capital may be insufficient to support the company’s ongoing operations and maintain required capital. Treasury is prepared to take appropriate action in these circumstances to preserve the taxpayers’ investment author’s name. 10/10/2018, 2:18 PM
stability. We will work with management and other security holders to improve the financial condition of the company, including through recap
restructurings, and take other actions that would be taken by large private investors dealing with troubled investments.

**Exit Strategy**
The TARP investments were not made to make money but to help avert a collapse of our financial system. Treasury used its authority under TARP to inject capital into banks and restart markets that are critical to financing American households and businesses. As financial conditions have improved, Treasury is now in a position to begin winding down TARP programs that helped put large banks on a sounder footing and to begin exiting from these investments. Our exit strategy for TARP balances the dual mandates of EEESA: financial stability and protect the interests of taxpayers. We will exit these investments, and return TARP funds to the Treasury, as soon as is consistent with the objective of avoiding further market and economic disruption.

**Exit Strategy – AIG**
Treasury holds preferred stock in AIG. AIG is presently engaged in a restructuring initiative that would allow it to sell AIA and Alico, its internal businesses, in an initial public offering or a negotiated sale to a third party buyer, and use the proceeds to pay off its obligations to the FRBNY. In anticipation of those sales, AIG and the FRBNY recently completed an exchange of debt for preferred equity interests in AIA and Alico, entitling the first dollars from the sale of those businesses. We anticipate that those sales will occur sometime in 2010 or early 2011. Upon the repayment in full its debt to the FRBNY, AIG will then focus on building value in its remaining insurance businesses, Chartis, Domestica Retirement Services and American General and Valic, as well as ILFC, its aircraft leasing business, and American General, its consumer finance businesses. AIG is continuing to make progress in the "wind down" of its financial products unit. The unit's notional exposure is now $1 trillion, versus $2 trillion at the peak in 2008. It is now anticipated that the wind down process will be substantially completed by the end of 2010.

**Exit Strategy – Citigroup**
Treasury holds common stock in Citigroup. Treasury also holds Citigroup trust preferred securities, which are senior in right of repayment to preferred equity interests. The preferred stock is redeemable, subject to a determination by the Federal Reserve that Citigroup has repaid Treasury.

This week, the Federal Reserve agreed to allow Citigroup to repay Treasury for $20 billion of the trust preferred securities and to terminate its agreement with Treasury. To facilitate the repayment, Citigroup proposes to issue $20.5 billion of securities, comprised of $17 billion of common stock and $3.5 billion of units.

Citigroup also entered into a loss sharing agreement with Treasury, the FDIC and the Federal Reserve Board under which the U.S. government share in the losses on a pool of assets that was initially $300 billion. Citigroup will terminate the U.S. government's obligations under this agreement originally would have run for 10 years. The government will retain $5.2 billion of the $7.0 billion in trust preferred securities issued to the U.S. government as the premium for this 10 year insurance. As a result of the repayment, Citigroup will no longer be deemed to be a beneficiary of "assistance" under TARP beginning in 2010.

Following completion of the repayment and cancellation of the loss-sharing agreement, Treasury will continue to hold Citigroup common stock of approximately $26.5 billion. We expect to sell these common shares in an orderly fashion within six to twelve months subject to an initial 90-day after the secondary offering.

**Exit Strategy – Auto Companies**
Treasury investments in GM and Chrysler consist of loans and equity investments. The loans must be repaid by certain dates. The GM loan remained to require quarterly mandatory prepayments of $1 billion from existing escrow amounts in addition to the obligation for such funds to the loan by June 30, 2010, unless extended. In addition, the loan matures in July 2015. A portion of the Chrysler loan also matures in December 2010. Chrysler plans to repay the loan fully prior to maturity.

Treasury holds common stock and preferred stock in GM and common stock in Chrysler. Because the companies are not publicly traded, the common stock at this time. Pursuant to its operating agreement, GM will attempt a reasonable best efforts initial public offering by July 10, 2010, unless extended. In addition, the loan matures in July 2015. A portion of the Chrysler loan also matures in December 2011. Chrysler plans to repay the loan fully prior to maturity.

**Need for Reform**
Treasury and other institutions of government have accomplished a great deal in a short amount of time to achieve financial stability, a necessary but insufficient condition for restoring the resumption of economic growth. As we look ahead, we must also not forget the lessons we have learned from this period. We need to reframe our regulatory system in a way that is stronger and better suited to manage risk and ensure safety and soundness must be our highest priority. We have proposed a number of measures in this regard.

To make the system more stable, we have proposed requiring financial institutions to hold more capital and manage liquidity risk more effectively; eliminating regulatory loopholes; requiring stronger federal supervision of all major financial firms; putting the market for over-the-counter derivatives under a comprehensive regulation; and creating a Financial Stability Oversight Council to bring together all regulators to identify emerging risks and coordinate responses.

And to provide the government better tools to respond to future crises like those facing us in the fall of 2008, without disrupting the broader financial system, the Administration has proposed giving the government new emergency authority to respond to crises. We propose giving the government the power to send a financial institution back to its creditors to force it to new capital or recapitalization effort and to stabilize the financial system.
Conclusion

Ending the financial crisis is not primarily about helping banks, but about restoring the flow of credit to consumers and businesses and alleviating hardships that Americans face every day. Healthy and vibrant financial institutions are critical for this, as they are the key sources of a range of that we depend on every day. Without healthy banks, consumers cannot access the credit they need to buy a home, finance an education, pay expenses or make other financial commitments. Small businesses cannot buy the new equipment, raw materials and inventory that they need. Businesses cannot make the continuous adjustments required to function in a changing global marketplace.

It is with these goals in mind that we have created the programs under the TARP and the Financial Stability Plan. As I work with my dedicated Treasury on these programs, we will continue to manage these investments prudently on behalf of the American people, and dispose of them as practicable.

Thank you.

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