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Elizabeth Warren

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U.S. Senate Committee on Finance  
“An Update on the TARP Program”  
Testimony of Elizabeth Warren  
Chair, Congressional Oversight Panel  
July 21, 2010

Thank you Chairman Baucus, Ranking Member Grassley, and members of the Committee for inviting me to testify on the Troubled Asset Relief Program (TARP). My name is Elizabeth Warren and I am chair of the Congressional Oversight Panel established under the Emergency Economic Stabilization Act of 2008 (EESA). The Panel is charged under the statute to report to Congress every 30 days on the Secretary of the Treasury’s use of his authority under EESA and the current state of financial markets. We share a commitment to bringing transparency and accountability to TARP, and I am pleased to assist your efforts in whatever way I can.

Before I begin, I should note that although I am the chair of the Panel, I cannot possibly reflect the thoughtful and independent views of each of my four other panelists. The testimony I will give today is my own and is not necessarily a reflection of the views of the entire Panel.

Since I last testified before this Committee, much has changed in both the financial markets and in TARP itself. One year ago, our country and indeed the global economy were in the midst of what we then believed to be a deepening financial crisis.

It is clear now that as part of a coordinated government response TARP had a profound effect bringing our economy back from the brink of collapse. It is easy to forget the panic that pervaded the financial markets in the fall of 2008 and the very real threat that it would spread to the broader economy, devastating families, small businesses and communities throughout the nation.

By the end of last year, however, there still remained the risk of unforeseen shocks to the marketplace that could disrupt the stability created through TARP. In his December 9, 2009, letter to Congress, Secretary Geithner extended TARP through October 3, 2010, noting the continued risks to financial stability as well as the unmet goals established by Congress in authorizing TARP to restart the flow of credit to small businesses and to help families keep their homes by minimizing foreclosures.

To date, the Treasury has committed to spend \$520.3 billion under TARP: \$249.9 billion in direct support to repair bank balance sheets, \$84.8 billion in support of the domestic automotive industry, \$69.8 billion in funding to support American International Group (AIG), \$50 billion for foreclosure prevention and \$65.8 for related financial stability efforts.

Of those funds, \$197.1 billion has been repaid, and the taxpayers have seen additional returns in the forms of dividends, warrant repurchases and fees of \$22.8 billion. A total of \$5.8 billion has been lost under the program due to funds committed prior to the structured bankruptcies of Chrysler and General Motors (GM) and the failure of four banks participating in the Capital Purchase Program (CPP). It is important to remember also that funds used to prevent foreclosures through the Home Affordable Modification Program (HAMP) and other efforts are not intended to be repaid. In the fifteen months that the program has been in effect, however,

only \$247.5 million of the \$47.9 billion dollars committed to HAMP—less than one-half of one percent—has been spent.

The twin themes of accountability and transparency have driven the work of the Congressional Oversight Panel since our first report to Congress in December 2008. The Panel will continue to recommend that Treasury release more data, establish internal metrics for measuring the success of TARP programs, and describe the legal and policy justifications of their authority in administering the TARP. In our oversight of Treasury there has been progress: Treasury staff now meets with Panel staff in preparation for our reports and Treasury officials now testify before the Panel on a regular basis.

The Panel received a commitment from Secretary Geithner to appear before the Panel quarterly and we hope to hear from him again before our work concludes.

Congress gave Treasury unprecedented authority when it passed TARP, but at the same time it coupled that authority with unprecedented oversight. That oversight has promoted a level of transparency and accountability that has benefited the taxpayers. We work closely with our oversight partners, the Special Inspector General for TARP (SIGTARP) and the Government Accountability Office (GAO), to complement, not duplicate, one another. Our goal is to make the whole of our work greater than the sum of its parts.

Over the past year and a half, the Congressional Oversight Panel has issued 21 monthly reports and two special reports, as required by statute. Our topics have ranged from a dollars-and-cents analysis of the value of the bank warrants that Treasury was selling in the Capital Purchase Program to a review of the government's investment in specific companies, such as AIG, Chrysler and GM, and GMAC. All the reports, along with summaries and videos, are available online at [cop.senate.gov](http://cop.senate.gov). By way of review, I offer a summary of our four most recent reports, then a discussion of the broader themes the Panel has uncovered in our TARP oversight work:

### **Small Banks in the Capital Purchase Program**

The Panel's most recent report analyzed the participation of small banks in the CPP. Under the program, Treasury put money into 707 banks. The Panel found the experience of small banks differed substantially from that of the nation's largest financial institutions. Seventeen of the 19 U.S. banks and bank holding companies, with assets totaling more than \$100 billion, received the majority of funds (81 percent), most getting their money within weeks of the announcement of the program. Now 76 percent have repaid their TARP funds and returned to profitability. On the other hand, small banks entered the program more slowly, and ultimately most—about 90 percent—stayed out of TARP altogether. Notwithstanding the fact that those small banks that received TARP funds were required to prove their financial health, fewer than 10 percent have managed to repay their TARP obligations, and 15 percent have failed to pay at least one of their outstanding dividends. Their problems are substantial. Small banks face serious difficulties with the coming wave of commercial real estate loans resets. Moreover, small banks do not have the same access to the capital that larger banks have, and investors know that these regional and

local banks are not too big to fail. Worse yet, if they cannot exit from TARP in the next few years, they face a TARP dividend that will increase sharply from 5 to 9 percent.

### **The AIG Rescue, Its Impact on Markets, and the Government's Exit Strategy**

The Panel concluded in our June report that Treasury and the New York Federal Reserve Bank failed to explore all other options before committing \$85 billion in taxpayer funds to rescue AIG. Treasury also failed to address potential and perceived conflicts of interest, giving the impression that accountability and transparency were less important than rescuing Wall Street. Furthermore, the rescue of AIG distorted the marketplace by turning AIG's risky bets into fully guaranteed transactions. Instead of forcing AIG and its counterparties to bear the costs of the company's failure, the government shifted those costs in full onto taxpayers. Even today, nearly two years later, it remains uncertain whether taxpayers will be repaid. Because the rescue of AIG committed taxpayers to pay any price to prevent the collapse of one of America's largest financial institutions, it continues to have a poisonous effect on the marketplace, creating distortions in investment and competitive advantages for some players and disadvantages for others.

### **The Small Business Credit Crunch and the Impact of the TARP**

The Panel's May report examined the impact of TARP on small business lending and found that the program did not significantly increase small business lending. Between 2008 and 2009, large banks cut back on overall lending by 4 percent—but they cut back on small business lending by more than double that amount, 9 percent. Small banks have not been able to fill in the gap; they have also cut small business lending. The many difficulties facing small banks are reflected in their inability to support small business lending. Without access to credit, America's small businesses cannot meet demand or grow, potentially choking off a broader economic recovery. Furthermore, this disproportionate credit crunch risks tilting America's playing field against small businesses and in favor of their larger competitors.

### **Evaluating the Progress of TARP Foreclosure Mitigation Programs**

Our mandate under EESA specifically requires the Panel to report to Congress on the effectiveness of foreclosure mitigation efforts. To that end, the Panel's April report was our third focused on the HAMP program and the health of the residential mortgage market. When I last appeared before this Committee, I testified that the Panel had included in our March 2009 report a checklist of characteristics any successful foreclosure mitigation strategy must include. The Panel was concerned that Treasury's program was too small, that it was too slow and that it did not create permanent solutions. The Panel raised specific concerns about the program's failure to address second mortgages or homeowners who are "underwater"—that is, the balance of their mortgage exceeds the value of their home. While some progress has been made in these and

other areas of the program, HAMP continues to suffer from the constraints the Panel identified at the outset.

Congress was clear when it passed TARP that Treasury should make foreclosure prevention a priority. The Panel found in our April report, however, that Treasury's response is lagging behind the pace of the crisis. For every family that Treasury has helped into a sustainable mortgage modification, ten other families have lost their homes to foreclosure. Foreclosures show no clear signs of abating. Treasury has lost its opportunity to get ahead of the problem. Instead, its programs trail behind, while millions of homeowners continue to receive foreclosure notices and the real estate market shows little sign of recovery.

While we hope the Panel's monthly reports have provided you with important information and critical analysis in your roles as policymakers, I want to highlight some of the broad themes that inform our oversight:

### **Marketplace Distortion**

As I testified earlier, TARP succeeded in preventing the spread of a financial panic. While nothing in my testimony should take away from that monumental achievement, it is important to understand how this result was achieved. The Panel has found repeatedly that market participants believe that TARP and other financial stability efforts signaled that the federal government stood ready, willing and able to ensure that the American taxpayer would pay any price and bear any burden to prevent the collapse of the nation's largest financial institutions. The unfortunate consequence, however, is that this has distorted the financial marketplace and infected pricing and calculations of risk.

One legacy of TARP will be the moral hazard it created among the nation's largest financial institutions. Because the market views these institutions as the beneficiary of an implicit government guarantee—in other words, policymakers fear they are “too big to fail”—market participants will assume greater risks and accept a different price than they would otherwise when transacting with these companies.

A clear example of this implicit guarantee can be found in the credit ratings assigned to the nation's largest commercial bank. On February 10, 2010, Standard & Poor's issued Citigroup's senior debt a credit rating of “A”—three grades higher than it would otherwise—“to reflect the likelihood that if further extraordinary government support were needed, it would be forthcoming.”

Citigroup received \$49 billion in TARP funds, including a guarantee of a pool of approximately \$301 billion in assets, along with access to other government financial stability support. This assistance is already factored into Citigroup's standalone credit profile. It is the market's expectation of additional government support in the future, should it be needed, that allows Citigroup and other institutions to raise capital and conduct other market transactions at a lower cost than they would otherwise. Similarly, AIG received a five-notch upgrade on its senior debt due to the assumption of further government support if necessary.

The opposite effect can be seen in the ability of small banks to raise capital and repay their TARP funds. Unlike their larger counterparts, small banks are not seen as beneficiaries of an implicit government guarantee. In combination with a distressed capital market for these institutions, it is nearly impossible for them to raise the funds in the private capital markets necessary to repay taxpayers and exit the program.

While the Panel has taken no position on a specific remedy for Congress to consider in dealing with the issue of “too big to fail”—including the recently passed Wall Street Reform and Consumer Protection Act—we do believe that a broad consensus exists that we need a new approach to systemic risk regulation.

### **Weak Banks, Weak Economy**

The Panel’s reports have also emphasized the interdependence between the health of the financial system and the health of the nation’s economy. The legislation authorizing the Secretary of the Treasury to spend \$700 billion to stabilize the financial sector does not grant these extraordinary powers for the sake of saving the banks themselves. The purpose of EESA is to save the economy as a whole. Congress certainly understood that, absent the orderly flow of credit and a functioning payments system administered by the nation’s financial institutions, the economy would quickly disintegrate, with devastating results for families and businesses. A healthy financial system is not a sufficient condition to ensure the health of the economy as a whole. In fact, the current fragile state of the broader economy continues to present a threat to financial stability, as many of our monthly oversight reports have shown.

TARP gets its name from the so-called “troubled assets” that were weighing down the balance sheets of the nation’s financial institutions. The meltdown in the subprime mortgage market—and the eventual spillover effects into the prime and alt-A mortgage markets—saddled banks with assets composed of or derived from residential mortgages. These securities became difficult to price and hard to sell. Nearly one year after the passage of TARP, the Panel reported that these same assets continued to impair bank balance sheets. Today, some of these same assets continue to encumber the balance sheets of many banks—especially smaller banks that are also heavily exposed to commercial real estate assets, as the Panel identified in our most recent report. So long as the residential housing market remains weak and homeowners continue to default on their mortgages and fall into foreclosure, these troubled assets will continue to pose challenges for financial institutions.

When the Panel focused on the commercial real estate market earlier this year, we reported on a similar phenomenon. Commercial real estate loans—mortgages on apartments, office buildings, retail shopping centers and industrial facilities—continue to threaten the solvency of some financial institutions, especially small banks. When commercial properties fail, it creates a downward spiral of economic contraction: foreclosures trigger business failures and job losses, which in turn trigger deteriorating store fronts, office buildings and apartments, which in turn trigger the failure of the banks serving those communities.

In the area of small business lending, the trend continues. As Treasury continues to support the small banks that make the bulk of small business loans they may find that, even if lenders can lend, borrowers won't borrow. After such a severe recession, fewer businesses are creditworthy and looking to take on a loan.

### **The Value of Transparency**

Ultimately, it is the role of policymakers, not the Congressional Oversight Panel and our oversight partners SIGTARP and GAO, to authorize funding and carry out programs to address the challenges still facing the financial system and our broader economy. The Panel has found, however, that transparency has proven to produce better outcomes.

One example is illustrative. The Panel undertook a valuation exercise to determine the value of the securities received by Treasury in exchange for TARP assistance provided to first set of financial institutions. With minimal variation, the Panel's models demonstrated that Treasury made taxpayer money available at a substantial discount. Treasury received securities that at the time were worth substantially less than the amounts it had paid in return, given the financial condition of the institutions involved. In all, we documented in our February 2009 report that Treasury had overpaid by an estimated \$78 billion. By the time the financial analysis could be undertaken, the money had already gone out the door and it was not possible for the taxpayers to get a better deal in those transactions.

Six months later, however, the Panel undertook a similar valuation analysis of the warrants received under TARP. As the big banks recovered and began repurchasing their warrants, we swung into action. We released our results after only 11 smaller banks with an average TARP investment of \$75 million had repaid their CPP investments and repurchased their warrants. After we crunched the numbers, we concluded that the Treasury had received approximately 66 percent of our best estimate of the value of TARP warrants for these banks.

Shortly after the Panel issued its report, the negotiations shifted. JPMorgan Chase announced it would allow their warrants to be sold at public auction. Eight large banks, including Goldman Sachs and Morgan Stanley, repaid their TARP funds at dramatically higher prices, with Goldman Sachs, for example, paying slightly more than we had estimated was due. In total, Treasury has received \$7.2 billion from the disposition of its TARP acquired warrants, \$3.12 billion from negotiated repurchases and \$4.08 billion from auctions. The total received represents slightly more than 98 percent of our best estimate of the value of the warrants at the time they were sold or auctioned.

In short, transparency works. It adds up to savings for the taxpayers, as well as confidence in the programs. Our mandate under EESA specifically requires the Panel to report to you on "the extent to which the information made available on transactions under the program has contributed to market transparency." The work of our Panel has demonstrated that when Treasury has been forthcoming with goals for their programs, established metrics for determining success and provided verifiable data for assessing the results, transparency has produced better outcomes.

## **Conclusion**

TARP has become a pejorative four-letter word in the American lexicon. The program is better known across the country as the “Wall Street bailout.” Never before has the public been forced to bear the burden of a huge financial wreckage caused by private actors.

TARP succeeded in pulling the economy back from the brink, and the program has worked very well for the nation’s largest financial institutions. For small banks, small businesses and American homeowners, however, the results have been far more limited.

The Congressional Oversight Panel will continue to conduct vigorous oversight of Treasury’s administration of TARP. We hope our reports have shed some much needed light on this extraordinary commitment to stabilize the financial system and put forward concrete steps to minimize the costs to taxpayers and maximize the benefits. Notwithstanding our efforts to push Treasury for a better program, nothing in this should take away from TARP’s extraordinary achievement: ending a financial panic that very well could have led to economic collapse.

Thank you again for the opportunity to testify and I would be happy to answer any questions you may have.