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Troubled Asset Relief Program Status of Programs and Implementation of GAO Recommendations

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TROUBLED ASSET RELIEF PROGRAM

Status of Programs and Implementation of GAO Recommendations

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Applied Research and Methods

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Chairman Johnson, Ranking Member Shelby, and Members of the Committee:

I am pleased to be here today to discuss our work on the Troubled Asset Relief Program (TARP), which Congress established on October 3, 2008, in response to the financial crisis that threatened the stability of the U.S. financial system and the solvency of many financial institutions. Under the original TARP legislation, the Department of the Treasury (Treasury) had the authority to purchase or insure $700 billion in troubled assets held by financial institutions.[1] The Secretary of the Treasury extended the authority originally provided under EESA through October 3, 2010. However, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)—signed into law on July 21, 2010—set a new spending ceiling for TARP, in effect prohibiting Treasury from incurring any additional obligations for programs that had not been initiated prior to June 25, 2010.[2]

A broad range of activities have been initiated under TARP. Specific initiatives have injected capital into key financial institutions; implemented programs to address problems in the securitization markets; provided assistance to the automobile industry and American International Group, Inc. (AIG); and offered incentives for modifying residential mortgages, among other things. As TARP passes the 30-month mark, U.S. financial markets appear to be less volatile than they were in 2008. But questions about a sustained economic recovery continue, and certain areas of the economy still face significant challenges. For example, foreclosures and mortgage delinquencies continue to linger and small businesses still face tight credit conditions. As a result, TARP has been

[1]The Emergency Economic Stabilization Act of 2008 (EESA), Pub. L. No. 110-343, 122 Stat. 3765 (2008) (codified at 12 U.S.C. §§ 5201 *et seq.)*. 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 EESA by almost $1.3 billion, from $700 billion to $698.741 billion. EESA requires that the appropriate committees of Congress be notified in writing when the Secretary of the Treasury, after consultation with the Chairman of the Board of Governors of the Federal Reserve System, determines that it is necessary to purchase other financial instruments to promote financial market stability. Section 3(9) of EESA (codified at 12 U.S.C. § 5202(9)).

[2]The Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010), (1) reduced Treasury's authority to purchase or insure troubled assets to a maximum of $475 billion and (2) prohibited Treasury, under EESA, from incurring any additional obligations for a program or initiative unless the program or initiative had already been initiated prior to June 25, 2010.

transformed into a program that focuses primarily on preserving homeownership and improving financial conditions for small financial institutions and businesses. While many other programs have ended and begun winding down operations and some participating institutions have repaid part or all of their TARP funds, the prospect of repayment from some other institutions, both large and small, remains uncertain.

EESA required GAO to report at least every 60 days on findings from our oversight of actions taken under the programs.[3] We have been monitoring TARP programs since their inception and our reports have highlighted challenges facing many of these programs. To date, we have issued more than 40 reports and testimonies related to TARP and made more than 60 recommendations to Treasury and the Board of Governors of the Federal Reserve System (Federal Reserve) to improve the transparency and accountability of TARP operations.

This statement is primarily based on our January 12, 2011, report and focuses on (1) the status of TARP programs; (2) Treasury's progress in implementing an effective management structure for TARP, including staffing the Office of Financial Stability (OFS), overseeing contractors, and establishing a comprehensive system of internal controls; and (3) trends in key relevant economic indicators.[4] To do our work, we leveraged our prior reports, reviewed documents provided by Treasury's OFS, and conducted interviews with Treasury and OFS officials. We conducted this performance audit from March 2010 and January 2011 and updated selected information in March 2011 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

[3]Section 116 of EESA, 12 U.S.C. § 5226 (codified at 12 U.S.C. § 5226).

[4]GAO, *Troubled Asset Relief Program: Status of Programs and Implementation of GAO Recommendations*, GAO-11-74 (Washington, D.C.: Jan. 12, 2011).

Summary

Some TARP programs—Capital Assistance Program, Asset Guarantee Program, and Targeted Investment Program—have been terminated. Others, like the Capital Purchase Program (CPP) and the Term Asset-Backed Securities Loan Facility (TALF), have closed and are winding down operations, and several programs that focus on preserving homeownership and that have provided assistance to auto companies and AIG remain active.

- CPP, which closed in December 2009, had $30.8 billion outstanding as of March 9, 2011, and had received about $171 billion in full and partial repayments from CPP participants. However, Treasury faces various oversight and management challenges in addressing missed dividend and interest payments and monitoring repayment requests.

- Funding of TALF loans by the Federal Reserve Bank of New York (FRBNY) closed in June 2010, and no TARP funds had been expended as of March 9, 2011, to purchase collateral from FRBNY because no collateral had been surrendered to TALF LLC. TALF will continue to pose potential risks to Treasury until all loans are repaid to FRBNY and the program is terminated.

- While the Home Affordable Modification Program (HAMP) remains Treasury's primary program to assist homeowners facing foreclosure, the program had a slow start and has not performed as anticipated. Treasury announced several new programs in 2010. As of March 9, 2011, $1.2 billion, none of it recoverable, had been disbursed for TARP housing programs. Our most recent work shows there is more Treasury can do to better ensure the effective implementation of this program.

- The Automotive Industry Financing Program (AIFP) had an outstanding balance of just more than $44.2 billion as of March 9, 2011. At that time, approximately $29.5 billion had been repaid, but Treasury still owned 33.3 percent equity in General Motors (GM), 9.2 percent in Chrysler, and 73.8 percent in Ally. While the auto companies' financial conditions have shown signs of improvement, their ability to fully repay the AIFP debt and equity investments depends on a variety of factors, which will require Treasury's ongoing oversight.

- AIG has continued to receive assistance over the last year via an equity capital line established in 2009. As of March 9, 2011, AIG has repaid $9.1 billion to Treasury. This reduced the balance of Treasury's assistance to AIG to $58.7 billion, which included owning about 92.2 percent of the company. The government's prospects for recouping the assistance it has

provided largely rests with the return that Treasury earns when it sells its common stock in AIG.

- The Public-Private Investment Program (PPIP) continues to be an active program with $15.9 billion disbursed as of March 9, 2011, and $15.2 billion outstanding. Of this investment, Treasury had seen unrealized capital gains of approximately $750 million. Treasury still holds oversight responsibility for the fund managers until the fund no longer holds assets.

- The Community Development Capital Initiative (CDCI) and the SBA 7(a) Securities Purchase Program are small business programs that account for a small portion of TARP funding. CDCI closed in September 2010, and as of March 9, 2011, Treasury had provided about $570 million to 84 CDFIs, 28 of which had already participated in CPP. SBA 7(a) Securities Purchase Program closed in September 2010, and as of March 9, 2011, Treasury had made 31 purchases of SBA 7(a) securities totaling about $370 million.

Staffing remains important in OFS as some programs are still being implemented and others require continued monitoring, but staff retention could be a challenge for OFS going forward. OFS has begun to take steps that will help retain staff by addressing succession planning for critical senior positions, but its workforce plan has not been updated since March 2009. In addition, partly in response to our recommendations, OFS has strengthened its management and oversight of contractors and financial agents and its system of internal control for financial reporting and compliance with program requirements.

Indicators that we monitor to assess the effectiveness of TARP showed that credit markets have largely held the gains they achieved since October 2008. While the degree of effectiveness has varied across programs, some programs have reportedly had the desired effects, especially if stabilizing and restoring confidence in the financial system are considered the principal goals of the government's interventions. These effects included declines in perceptions of risks in various financial markets, such as asset spreads in asset-backed securities; declines in interest rates in interbank, mortgage, and bond markets; a renewed ability by banks to access capital markets; increasing securitizations; and price recovery for some legacy or "troubled" assets.

Some TARP Programs, Including Those That Have Ended and Those That Remain Active, Continue to Present Challenges

According to OFS, from the inception of TARP through March 9, 2011, it has disbursed $410 billion, and received more than $286 billion primarily from interest, dividends, and principal repayments on direct loans, repurchases of investments, and sales of investments. OFS reported $150 billion in gross direct loans and investments outstanding as of March 9, 2011 (see table 1).

Table 1: Status of TARP Programs, as of March 9, 2011 [unaudited]

Dollars in billions

Program	Asset purchase price[a]	Total cash disbursed[b]	Repayments	Write-offs and realized losses on sales[c]	Outstanding balanced	Additional proceeds[b]
CPP	$204.9	$204.9	$171.1	$2.6	$30.8	$24.6
Targeted Investment Program	40.0	40.0	40.0	0.0	0.0	4.4
AIFP	81.8	79.7	29.5	6.0	44.2	3.8
AIG	69.8	67.8	9.1	0.0	58.7	0.1
Housing programs	45.6	1.2	n/a	n/a	n/a	n/a
PPIP	22.4	15.9	0.7	0.0	15.2	0.6
SBA 7a	0.4	0.4	less than 0.1	0.0	0.4	less than 0.1
CDCI	0.6	0.2	0.0	0.0	0.6	0.0
TALF	4.3	0.1	0.0	0.0	0.1	0.0
Asset Guaranty Program	5.0	0.0	0.0	0.0	0.0	3.0
Total	**$474.8**	**$410.2**	**$250.4**	**$8.6**	**$150.0**	**$36.5**

Source: GAO analysis of Treasury (OFS) data.

[a]"Asset purchase price" reflects the aggregate amount Treasury agreed to pay to purchase or guarantee outstanding troubled assets subject to the $475 billion limit in section 115 of EESA, as amended by Section 1302 of the Dodd-Frank Act. This amount includes signed contract amounts not yet disbursed.

[b]"Additional proceeds" include dividends from equity securities, interest income from loans and securities, proceeds from repurchases of warrants and warrant preferred stock, and proceeds from warrant auctions. Treasury also received $31.9 billion in proceeds from sales of 7.7 billion shares of Citigroup common stock, of which $25.0 billion is included in "repayments," and $6.9 billion of proceeds in excess of cost is included in "additional proceeds."

[c]Treasury's write-offs include $2.3 billion in CPP investments relating to CIT Group and $1.6 billion in loans to Chrysler pursuant to a settlement agreement. Proceeds from the sale of 412 million shares of GM common stock amounting to $13.5 billion are included in "repayments" and Treasury reported $4.4 billion of realized losses (cost in excess of proceeds) on the sale of these securities.

[d]The "outstanding balance" amounts for CPP and CDCI include the effect of $0.4 billion in exchanges of investments under CPP for investments under CDCI.

The reported net cost of TARP transactions from inception through September 30, 2010, was $18.5 billion; however, the ultimate cost of TARP will change as a result of (1) differences between the estimated values of the direct loans and investments as of September 30, 2010, and the amounts OFS will ultimately realize (as the assumptions and estimates underlying the valuation of these assets are inherently subject to substantial uncertainty), and (2) further disbursements, such as those relating to the housing programs which are not subject to repayment.

CPP Investments Present Continued Oversight Challenges for Treasury

Under CPP, Treasury invested $205 billion in over 700 financial institutions nationwide. Treasury provided capital to qualifying financial institutions from October 2008 to December 2009 by purchasing preferred shares or subordinated debentures.[5] In return for its investment, Treasury received preferred stock or debentures, which provided for dividend payments (if declared by the issuer) or interest payments, as well as warrants. As table 1 shows, through March 9, 2011, Treasury had received about $171 billion in full and partial repayments. However, Treasury continues to face challenges in managing its remaining investments. For example, a growing number of CPP participants have missed scheduled dividend or interest payments.[6] As of February 28, 2011, 189 institutions had not made at least one scheduled dividend or interest payment by the end of the reporting month in which the payments were due, for a total of 697 missed payments.[7] Over the past 2 years, the number of CPP institutions missing dividend or interest payments by quarter has increased steadily from 8 in February 2009 to 152 in February 2011, or about 27 percent of existing CPP participants. Although the number of CPP institutions missing dividend payments is large and increasing, they represent a small share of

[5]For the purposes of CPP, financial institutions generally include qualifying U.S.-controlled banks, savings associations, and both bank and savings and loan holding companies.

[6]Institutions are required to pay dividends only if they declare dividends, although unpaid cumulative dividends generally accrue and the institution must pay them before making payments to other types of shareholders, such as holders of common stock

[7]These figures differ from the number of dividend or interest payments outstanding because some institutions made their payments after the end of the reporting month. CPP dividend and interest payments are due on February 15, May 15, August 15, and November 15 of each year, or the first business day subsequent to those dates. The reporting period ends on the last day of the calendar month in which the dividend or interest payment is due.

the total dollar amount of original CPP investments.[8] Generally, if an institution has not paid in full a total of six dividend or interest payments, Treasury has the right to elect two members to the institution's board of directors. As of February 28, 2011, 32 institutions had at least six missed payments that remained unpaid, and Treasury had not yet exercised its right to nominate directors for these institutions. However, 31 CPP institutions that have missed at least five payments have agreed to have Treasury observers attend meetings of their boards of directors. As more institutions miss scheduled dividend payments, Treasury faces a significant challenge of determining the extent to which it will exercise its right to nominate board members. In August 2010, Treasury began addressing this challenge by publicly releasing information on its policies and procedures for nominating board members to these institutions. These plans include using OFS staff to observe board meetings of institutions missing at least five dividend or interest payments and using a variety of considerations—such as an institution's financial condition and function of its board of directors—to decide whether to nominate a board member.

In addition, in order to protect its interests in CPP investments and promote financial stability, Treasury has conducted a limited, but growing, number of exchanges and dispositions. Over the last 2 years, Treasury has restructured the assistance provided to 16 CPP participants by swapping its preferred stock for other forms of equity securities or selling the preferred stock to new investors involved in a merger or capital restructuring with a CPP institution. OFS finalized policies and procedures governing exchanges and dispositions of TARP securities, including CPP investments, in October 2009. OFS stated that it would consider various factors when assessing an institution's proposal for an asset exchange, including the impact on the institution's capital, the possible impact on Treasury's position relative to holders of similar securities, the U.S. government's overall economic position, and whether any premiums paid over market prices are reasonable and consistent with similar transactions in the marketplace.

Through February 2011, Treasury had received about $171 billion in full and partial repayments from 146 institutions, including 28 institutions that exchanged $363 million of their CPP investments for investments under

[8]According to Treasury, the total investment amount of CPP institutions with unpaid dividends or interest payments was $3.8 billion as of January 31, 2011, compared to a total outstanding investment amount of $49.4 billion and an original investment amount of $204.9 billion.

Treasury's CDCI program. However, questions about the health of smaller banks continue, and small institutions participating in CPP may face challenges in fulfilling the terms needed to exit the program. According to Treasury data, 75 percent of the total dollar amount of CPP investments in institutions under $10 billion in assets remains outstanding compared to only 10 percent for investments in institutions over $10 billion. Our recent report on CPP identified weaknesses in Treasury's monitoring of regulators' decisions to approve or deny requests to repay CPP investments.[9] The American Recovery and Reinvestment Act of 2009 included provisions modifying the terms of CPP repayments to require that Treasury allow any institution to repay its CPP investment subject only to consultation with the appropriate federal bank regulator. Treasury officials indicated that, as a result of these changes, they had not provided guidance or criteria to regulators on deciding when to allow institutions to repay CPP investments and had not collected information on the reasons for these decisions. However, according to Treasury, it helped facilitate meetings among the regulators in the spring of 2009 at which they discussed standards for permitting TARP recipients to repay.

Bank regulatory officials said they used existing supervisory procedures that were generally applicable to capital reductions as a basis for reviewing CPP repurchase requests. In our recent report, we found that while the decision ultimately lies with the regulators, without collecting information on or monitoring regulators' decisions, Treasury had no basis for determining whether decisions involving similar institutions were being made consistently and, thus, whether CPP participants were being treated equitably. Further, absent information on why regulators made repayment decisions, Treasury cannot provide feedback to regulators. Accordingly, we recommended that Treasury periodically collect and review certain information from bank regulators on the analysis and conclusions supporting their decisions on CPP repayment requests and provide feedback for the regulators' consideration on the extent to which regulators are evaluating similar institutions consistently. In its response, Treasury stated that it would consider ways to address the objectives of our recommendations while also noting the constraints presented by the law and principles of regulatory independence.

[9] GAO, *Troubled Asset Relief Program: Opportunities Exist to Apply Lessons Learned from the Capital Purchase Program to Similarly Designed Programs and to Improve the Repayment Process*, GAO-11-47 (Washington, D.C.: Oct. 4, 2010).

About Half of the TALF Loans Have Been Repaid, but Continued Monitoring is Important

TALF provided loans to private investors to purchase asset-backed securities (ABS) and commercial mortgage-backed securities (CMBS) to encourage the issuance of new securitizations and provide liquidity for new consumer and business loans. To assist in this effort, Treasury provides credit protection for TALF. TALF made about $71 billion in loans from March 2009 through June 2010, with most of them secured by credit card ABS, auto loan ABS, legacy CMBS, and student loan ABS. According to the Federal Reserve, more than half of these loans have been repaid. Moreover, Treasury has not had to disburse any TARP funds to cover losses from unpaid loans. However, until all loans are repaid to FRBNY, it is important for Treasury to continue to monitor TALF to anticipate future needs for credit support.

Treasury has addressed concerns that we raised about Treasury's role in TALF, including monitoring risks related to commercial mortgage-backed securities, formalizing the decision-making process with the Federal Reserve, and conducting an assessment of how to track and report on assets that might be surrendered.

AIFP Illustrates both Progress and Ongoing Uncertainty in Recouping Assistance

From December 2008 through December 2009, Treasury announced $86.3 billion in funding available to help stabilize the auto industry and disbursed $79.7 billion of this funding, including (1) about $62 billion to fund Chrysler and GM while they restructured, (2) about $16.3 billion to provide capital assistance to Ally Financial, and (3) $1.5 billion to a special purpose vehicle (SPV) created by Chrysler Financial.[10] In return for its assistance to Chrysler and GM, Treasury received 9.85 percent equity in the reorganized Chrysler, 60.8 percent equity and $2.1 billion in preferred stock in the reorganized GM, and $13.8 billion in debt obligations between the two companies. In return for its investment in Ally Financial, Treasury received preferred shares equaling ownership of more than half of Ally Financial by the end of 2009 and almost three-quarters by the end of 2010.

[10]The total announced amount of $86.3 billion includes $5 billion for the Supplier Support Program announced in March 2009. However, in July 2009, the commitment for the Supplier Support Program was reduced by $1.5 billion, and in July 2010 an additional $3 billion was deobligated. As such, there is a $4.5 billion difference between the total AIFP announced amount of $86.3 billion and the asset purchase price of $81.8 billion referenced in table 1.

As of March 9, 2011, approximately $29.5 billion had been repaid[11] and Treasury owned 33.3 percent equity in GM, 9.2 percent in Chrysler, and 73.8 percent in Ally.[12] A substantial portion of these repayments come from GM, via its initial public offering (IPO). In total, Treasury sold over 412 million of its shares in GM's IPO, for which it received $13.5 billion in net proceeds to repay the government's initial investment.[13] In March 2011, Treasury sold $2.7 billion of trust preferred securities in Ally Financial.

Since emerging from bankruptcy in the summer of 2009, Chrysler and GM have shown signs of progress in returning to profitability; however, their ability to fully repay the AIFP debt and equity investments depends on a variety of factors, which will require Treasury's ongoing oversight.[14] One sign of progress is that vehicle sales increased substantially for both companies in January and February of 2011 compared to the prior year (23 percent and 49 percent for GM; 23 percent and 13 percent for Chrysler). In addition, in 2010 both companies released financial statements that, according to Treasury officials, exceeded Treasury's projections for revenues, operating earnings, and cash flows. Also, GM held an IPO in late 2010 and Chrysler expects to hold an IPO in 2011. Nevertheless, while GM's and Chrysler's financial conditions have improved, each faces challenges that could affect their financial future. For example, although sales are improving, volumes are highly dependent on economic and market conditions—such as unemployment levels, consumer confidence, and credit availability—that currently remain fragile. Similarly, high fuel

[11]In April 2010, GM repaid the remaining $4.7 billion of the $6.7 billion in debt by using funds that remained from the $30.1 billion Treasury had provided in June 2009 to assist with its restructuring. As of March 9, 2011, Chrysler has made $567 million in interest payments on its loan from Treasury.

[12]Treasury's current equity stake in Chrysler is 9.2 percent—down from the original 9.85 percent because Fiat increased its ownership stake, as a result of the company achieving the first of its three performance-related targets as agreed to with Treasury, thereby reducing Treasury's overall equity.

[13]GM held the IPO on November 17, 2010, with 478 million common stock shares held by several stockholders, including Treasury. On November 26, 2010, the underwriters for the IPO exercised the overallotment option, bringing the total number of shares sold to almost 550 million and raising $23.1 billion. As a result of selling 412 million shares, Treasury's ownership stake in GM has decreased from 60.8 percent to 33.3 percent.

[14]Treasury's oversight of GM and Chrysler, including its strategies for monitoring and divesting its financial interests in the companies, is discussed in GAO, *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).

prices could negatively impact sales of the companies' most profitable vehicles such as pickup trucks and sport utility vehicles. Furthermore, the companies' U.S. pension plans are underfunded, and they will face large future payments to their pension plans to make up this underfunding.

Ally Financial, a bank holding company, has also shown signs of an improved financial condition, posting $1.1 billion in profit in 2010, but the government's ability to recoup its investment in Ally relies on the health of the auto industry, as well as the company's ability to compete with other credit providers. Ally Financial's chief executive officer noted that the recent conversion of $5.5 billion of Treasury's shares to common equity should help the company in its efforts to conform its capital structure to that more typical of a bank holding company.[15] Treasury also reported the conversion may improve Ally's ability to raise debt financing. Regardless, Ally Financial could face increased competition for its business in the future, including potentially from GM, which acquired Americredit, an auto finance company. Treasury officials noted they are confident Ally Financial will hold an IPO and expected that it would likely take Treasury a year or 2 to sell all of its shares.

In our ongoing monitoring of AIFP, we have made several recommendations to help Treasury monitor and assess its investment in the auto companies, and we are working with Treasury to help ensure their implementation.[16] We are continuing to monitor the financial condition of the industry, and are reviewing the current financial condition and outlook of GM and Chrysler in ongoing work. As part of that ongoing work, we also are reviewing the status of the federal government's efforts to assist workers and communities that have relied on the auto industry for their economic viability.

[15]On December 30, 2010, Treasury converted $5.5 billion of its preferred stock in Ally Financial into common stock, raising its total common equity stake in the company to 73.8 percent.

[16]GAO-10-151.

Treasury's Exposure to AIG Under TARP is Tied to the Current and Future Health of the Company and the Insurance Industry

In November 2008, Treasury began providing assistance to AIG, and with the closing of AIG's recapitalization plan in January 2011, this assistance has risen still further, but AIG has recently started repaying its debt to Treasury. On January 14, 2011, AIG closed on a plan to recapitalize the company, which included several transactions that terminated FRBNY's direct assistance to the company while increasing Treasury's equity interests to $67.8 billion, which included owning about 92.2 percent of the company. On March 8, 2011, AIG repaid $6.9 billion to Treasury, which included $1.4 billion for Treasury's remaining preferred interests in the American Life Insurance Company (ALICO) SPV and $5.5 billion for Treasury's remaining preferred interests in the AIA Group Limited (AIA) SPV, leaving Treasury with preferred interests of $11.3 billion in the AIA SPV. This repayment reduced the outstanding balance of AIG's assistance to $58.7 billion.

Since early 2009, we have been monitoring the status of federal assistance to AIG and the company's financial condition using GAO-developed indicators and have issued three reports that have included information on them.[17] In our January 2011 report, our indicators showed that AIG's financial condition had generally remained relatively stable or showed signs of improvement, largely due to the federal assistance from the Federal Reserve and Treasury.[18] Federal assistance has continued to play a key role in stabilizing AIG's liquidity, equity structure, and credit ratings. The government's prospects for recouping the assistance it has provided largely rests with the return that Treasury earns when it sells its common stock in AIG. We will continue to monitor the government's investment and the status of AIG's repayment efforts. In addition, our ongoing work on AIG also includes a review of the Federal Reserve facilities implemented to assist AIG.

[17] GAO, *Troubled Asset Relief Program: Status of Government Assistance to AIG*, GAO-09-975 (Washington, D.C.: Sept. 21, 2009), *Troubled Asset Relief Program: Update of Government Assistance to AIG*, GAO-10-475 (Washington, D.C.: Apr. 27, 2010), *Troubled Asset Relief Program: Third Quarter 2010 Update of Government Assistance Provided to AIG and Description of Recent Execution of Recapitalization Plan*, GAO-11-46 (Washington, D.C.: Jan. 20, 2011).

[18] GAO-11-46.

Treasury Has Faced Challenges in Implementing its Making Home Affordable Program and Relatively Few Borrowers Have Received Permanent Loan Modifications

As we have noted in our past reports, Treasury's efforts to help borrowers facing potential foreclosures continue to face challenges.[19] Since Treasury first announced the framework for its Making Home Affordable (MHA) program over 2 years ago, the number of homeowners facing potential foreclosure has remained at historically high levels. The Home Affordable Modification Program (HAMP), the key component under MHA, seeks to help eligible homeowners avoid foreclosure by reducing their monthly mortgage payments to more affordable levels—specifically to 31 percent of the homeowner's income. As of December 31, 2010, there were a total of 143 active MHA servicers.[20] Through January 2011, $29.9 billion in TARP funds had been committed to these servicers for modification of non-government-sponsored enterprise (GSE) loans.[21] Based on the MHA Servicer Performance Report through January 2011, nearly 1.8 million HAMP trial modifications had been offered to borrowers of GSE and non-GSE loans as of the end of January 2011, and nearly 1.5 million of these had begun HAMP trial modifications.[22] Of the trial modifications that had begun, approximately 145,000 were in active trial modifications, roughly 539,000 were in active permanent modifications, roughly 740,000 trial modifications had been canceled, and roughly 68,000 permanent modifications had been canceled. Recently, the number of new trial and permanent modifications started each month has declined (fig. 1). As of December 31, 2010, $1 billion in TARP funds had been disbursed for TARP-funded housing programs, of which $840 million has been disbursed for HAMP-related activity.

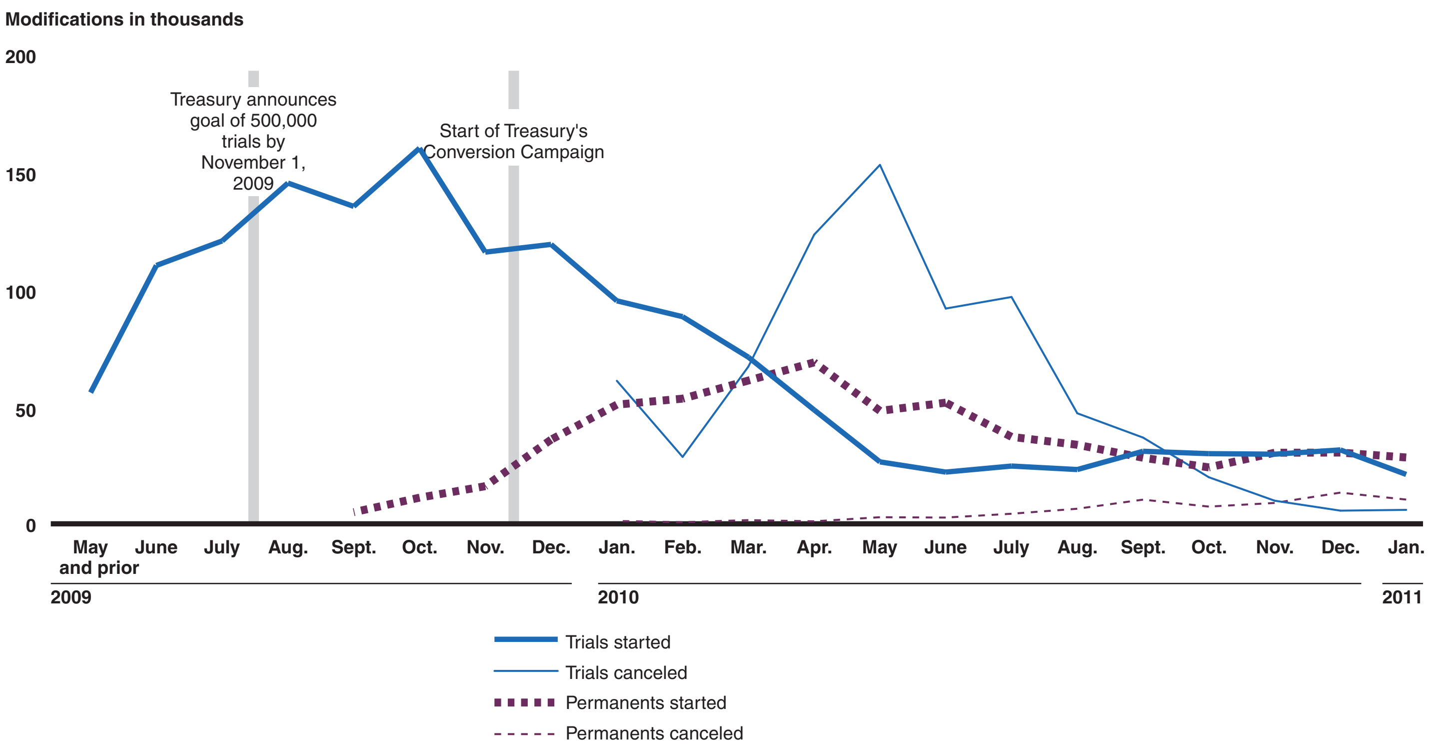
[19]GAO, *Troubled Asset Relief Program: Treasury Actions Needed to Make the Home Affordable Modification Program More Transparent and Accountable*, GAO-09-837 (Washington, D.C: July 23, 2009) and GAO, *Troubled Asset Relief Program: Further Actions Needed to Fully and Equitably Implement Foreclosure Mitigation Programs*, GAO-10-634 (Washington, D.C: June 24, 2010).

[20]The GSEs have directed all of their approximately 2,000 servicers to implement parallel HAMP programs on first-lien mortgages owned or guaranteed by the GSEs.

[21]The balance of the difference between this amount and the $45.6 billion allocated to housing programs was allocated to the Federal Housing Administration Short Refinance Program and the Housing Finance Agency Hardest Hit Fund.

[22]Roughly 46 percent of borrowers who were either in trial or permanent modifications as of September 30, 2010, had non-GSE loans and, therefore, fell under the TARP-funded portion of HAMP.

Figure 1: GSE and Non-GSE HAMP Trial and Permanent Modifications Made and Canceled Each Month, through January 2011



Source: GAO analysis of Treasury data.

In July 2009 and June 2010, we reported on the challenges Treasury faced in implementing HAMP and made recommendations to improve the transparency and equitable implementation of the program.[23] For example, in July 2009 we noted that while Treasury required borrowers with high levels of total debt to agree to obtain counseling before receiving a HAMP modification, it was not monitoring whether these borrowers, in fact, received counseling. In addition, we noted that Treasury had yet to establish a comprehensive system of internal control for HAMP, including metrics and benchmarks for servicers' performance. Three out of the six recommendations we made in July 2009 have yet to be fully implemented and, as such, remain open.

In June 2010, we reported on several inconsistencies in the way servicers treated borrowers under HAMP that could lead to inequitable treatment of

[23] GAO-09-837 and GAO-10-634.

similarly situated borrowers. These inconsistencies involved how servicers solicited borrowers for the program, how they evaluated borrowers who were not yet 60-days delinquent on their mortgage payments, and how they handled borrower complaints. In addition, we noted that while Treasury had taken some steps to ensure servicer compliance with program requirements, it had not yet finalized consequences for servicer noncompliance. We made eight recommendations to improve the transparency and accountability of HAMP in June 2010. Treasury stated that it intended to implement some of the recommendations, but little action has been taken to date.

In addition to the HAMP first-lien modification program, Treasury has begun implementing several other TARP-funded programs for struggling homeowners under the MHA program, including the Second-Lien Modification Program (2MP), the Principal Reduction Alternatives (PRA) program for borrowers who owe more on their mortgages than the value of their homes, and the Home Affordable Foreclosure Alternatives (HAFA) program for those who are not successful in HAMP modifications.[24] As noted in the report we are issuing today, the implementation of 2MP, HAFA, and PRA has been slow and limited activity has been reported to date (see table 2).[25] This slow pace is attributed in part to several implementation challenges. For example, servicers told us that the start of 2MP had been slow due to problems with the database Treasury required them to use to identify potentially eligible loans. Additionally, borrowers may not be aware of their potential eligibility for the program. While Treasury recently revised its guidelines to allow servicers to bypass the database for certain loans, servicers could do more to alert HAMP first-lien modification borrowers about the new second-lien program. Implementation of the foreclosure alternatives program has also been slow due to program restrictions, such as the requirement that borrowers be evaluated for a first-lien modification even if they have already identified a potential buyer for a short sale. Although Treasury has

[24]Treasury has also put in place the Federal Housing Administration (FHA)-HAMP, Rural Development-HAMP, the FHA Short Refinance Option, the Housing Finance Agency Innovation Fund for the Hardest -Hit Markets, and the Home Affordable Unemployment Program. Information on the progress made by these TARP-funded programs in stemming avoidable foreclosures will be discussed in a future report.

[25]GAO, *Troubled Asset Relief Program: Treasury Continues to Face Implementation Challenges and Data Weaknesses in Its Making Home Affordable Program*, GAO-11-288 (Mar. 17, 2011).

recently taken action to address some of these concerns, the potential effects of its changes remain unclear.

Table 2: Activity Under the 2MP, Foreclosure Alternative, and PRA as of December 31, 2010

Program	Date announced	Implementation date	Funding allocation	Reported activity as of December 31, 2010
2MP	March 2009	March 2010	Nearly $133 million	$2.9 million in incentives paid
Home Affordable Foreclosure Alternatives	March 2009	April 5, 2010	$4.1 billion	$9.5 million in incentives paid
PRA	March 2010	October 1, 2010	$2.0 billion	Activity not yet reported[a]

Source: Treasury.

[a]PRA incentives are paid on an annual basis contingent upon successful performance of the modified mortgage during the preceding 12 months.

Our most recent work shows there is more Treasury can do to ensure the effective implementation of these programs, including ensuring that servicers have sufficient capacity to implement them and that borrowers are notified about potential eligibility for second-lien modifications. We also believe it will be important for Treasury to have clear and accurate information on the dispositions of borrowers who are denied or fall out from HAMP modifications. Without accurate reporting of borrower outcomes, Treasury cannot know the actual extent to which borrowers who are denied, canceled, or redefaulted from HAMP are helped by other programs or evaluate the need for further action to assist this group of homeowners. We continue to believe there are opportunities to improve the transparency, accountability, and effectiveness of MHA.

Assets under PPIP Have Shown Positive Returns, but Continued Monitoring is Important

Treasury still has important monitoring responsibilities for PPIP investments. The legacy securities program of PPIP, announced in March 2009, was designed to facilitate price discovery in markets for these assets, repair balance sheets throughout the financial system, and increase the availability of credit to households and businesses through the purchase of “legacy” residential mortgage-backed securities (RMBS) and CMBS. Through the program, Treasury and private-sector fund managers and investors partnered to purchase eligible securities from banks, insurance companies, mutual funds, pension funds, and other eligible sellers—though the fund managers have sole discretion in making purchases and investment decisions according to the terms of the agreements between Treasury and the Public Private Investment Funds (PPIF). Treasury still holds oversight responsibility for the fund managers until the funds no longer hold assets.

The eight PPIFs have had positive returns and have invested in a variety of legacy assets, including CMBS, subprime RMBS, prime RMBS, Alt-A RMBS, and option adjustable-rate RMBS. The PPIFs paid $228 million in interest and dividends to Treasury over fiscal year 2010. But returns could fluctuate over time, as they are subject to market risk factors until the PPIFs close. As of March 9, 2011, Treasury's investments accounted for about $15.9 billion of about $22.4 billion available to fund PPIP. Of this investment, about $15.2 billion remained outstanding. Treasury had seen unrealized capital gains of approximately $750 million.

Treasury Initially Launched Programs under TARP to Assist Small Businesses but Has Shifted These Efforts outside of TARP

Given the importance of small businesses to the overall economy, Treasury created several programs under TARP to help address small business credit constraints. The existing TARP programs that are intended to assist small businesses focused on capitalizing certain depository institutions and stabilizing secondary markets for SBA-guaranteed loans. They included:

- CDCI, which was announced in October 2009 and closed in September 2010. As of March 9, 2011, Treasury had provided about $570 million to 84 CDFIs, 28 of which had already participated in CPP.

- SBA 7(a) Securities Purchase Program, which was announced in March 2009 and closed in September 2010. As of March 9, 2011, Treasury had made 31 purchases of SBA 7(a) securities totaling about $370 million.

- TALF, which was announced in November 2008 and closed in June 2010. TALF loans secured by SBA 7(a) and 504 securitizations represented 3 percent of TALF loans. The Federal Reserve estimates that about 850,000 small business loans were financed in part by securities supported by TALF.

Treasury has taken steps to address concerns we identified about the implementation of some of these programs. For example, although the purpose of CDCI was initially unclear to some participants, public communications about the dual purposes of the program—to assist small business lending and to support the mission of Community Development Financial Institutions—was clarified toward the end of the program.

Treasury has addressed concerns that we raised about Treasury's role in TALF, including monitoring risks related to commercial mortgage-backed securities, formalizing the decision-making process with the Board of Governors of the Federal Reserve System, and conducting an assessment of how to track and report on assets that might be surrendered.

Given concerns about the TARP stigma, Treasury shifted its efforts to assist small businesses outside of TARP by proposing a separate Small Business Lending Fund. The Small Business Jobs Act of 2010 created a $30 billion bank capital support program encouraging small and midsize banks to lend to small businesses and contains metrics for measuring increases in small business lending. We are currently reviewing the fund, as required by the Small Business Jobs Act of 2010.

OFS has Made Progress in Staffing Key Positions, but Needs to Finalize Its Workforce Plan

OFS has continued to make progress in staffing key positions, managing its contracts, and maintaining internal controls. While OFS's organizational structure has stabilized as it moves into maintenance mode, more could be done to address retention of key staff as TARP winds down. Treasury continues to rely on a network of financial agents and contractors for certain activities and will likely do so as the program comes to a close. Finally, Treasury has taken steps to develop a system of internal control.

OFS Staffing Has Stabilized, but OFS Has Not Finalized a Plan for Addressing Staff Retention Challenges as TARP Winds Down

In the last year, OFS staffing and its organizational structure have stabilized. Over the past 2 years, the number of OFS employees has increased steadily with the number of employees increasing and the number of detailees decreasing. In addition, Treasury has filled key leadership positions in OFS, including the position of Chief of the Homeownership Preservation Office. However, this stability is uncertain as OFS faces new challenges. For example, the Assistant Secretary of Financial Stability resigned in September 2010 and this key leadership position is temporarily filled.

With more than 200 employees, staffing at OFS remains important. As we have seen, some programs are still being implemented and others, while having been closed or terminated, have assets that must be managed, repaid, and divested. More than half of OFS's employees, including key leaders, are term appointments (many with 4-year term limits). OFS has begun to take steps that will help to retain staff. OFS is also addressing succession planning for critical senior positions, and in response to our recommendation in the January 2011 report is finalizing its Human Capital

Strategic Plan. According to OFS, this plan is a roadmap to ensure that OFS manages its workforce effectively and continues to attract, develop, and retain high caliber employees.

Treasury Continues to Strengthen Management and Oversight of Financial Agents and Contractors and Is Addressing Conflicts-of-Interest Requirements

Since the inception of TARP, Treasury has continued to rely on private-sector resources to assist OFS with a variety of activities. Treasury has used two mechanisms for engaging private-sector firms. First, Treasury has exercised its statutory authority to retain 15 financial agents (depository and related financial institutions designated to perform assigned functions on its behalf). Second, Treasury has entered into contract and blanket purchase agreements under the Federal Acquisition Regulation for a variety of legal, investment consulting, accounting, and other services and supplies. According to Treasury's data, as of September 30, 2010, Treasury had 81 contracts and blanket purchase agreements, up from 39 from the previous year. In total, Treasury had 96 financial agency agreements and contractual arrangements with a total potential value of almost $841 million, as of September 30, 2010.

When Treasury set up OFS in 2008 and quickly began to implement numerous TARP initiatives, OFS lacked complete procurement procedures and internal controls to oversee its growing number of contractors and financial agents, as well as a comprehensive compliance system to monitor and fully address vendor-related conflicts of interest. We made a series of recommendations between December 2008 and June 2009 that were intended to strengthen Treasury's management and oversight of its vendors and improve the transparency of contracted operations. One year after implementation, OFS had put in place an appropriate infrastructure to manage and monitor its network of financial agents and contractors, as well as a system to oversee conflicts of interest that may arise with financial agents or contractors seeking or performing work under TARP. OFS has continued to make management and oversight enhancements.

OFS Has Taken Steps to Develop a System of Internal Control for TARP Programs

Treasury has taken steps to develop an internal control system to ensure compliance with program requirements, including limitations on executive compensation, stock repurchase, and dividends. OFS's Office of Internal Review has a key role in helping to ensure such compliance. Treasury also relies on financial agents to perform additional oversight responsibilities. Although Treasury has generally developed an overall system of internal control for compliance with program requirements, we have identified areas in which certain controls for specific programs, such as HAMP, could be improved. In particular, Treasury has not fully implemented our recommendation to develop a comprehensive system of internal control for HAMP, including developing benchmarks or goals for specific HAMP performance measures such as conversion and redefault rates. We will continue to monitor Treasury's actions to address identified deficiencies.

In addition, our 2010 financial audit report concluded that although certain internal controls could be improved, OFS maintained, in all material respects, effective internal control over financial reporting as of September 30, 2010. These controls provided reasonable assurance that misstatements, losses, or noncompliance material in relation to the financial statements would be prevented or detected and corrected on a timely basis.[26] Our opinion on internal control over financial reporting is based on criteria established under 31 U.S.C. §3512 (c), (d), commonly known as the Federal Manager's Financial Integrity Act.

Indicators Suggest That Credit Markets Have Largely Held the Gains They Achieved since October 2008

The concerted actions by Treasury, the Federal Reserve, and others since the crisis began have been credited with helping to avert a more severe financial crisis, but the ultimate impact of the interventions on the economy as a whole remains to be seen. Since the passage of EESA, indicators generally suggest that credit markets have improved and while the effectiveness of the TARP programs have varied, some have reportedly had the desired effects, especially if stabilizing the financial system and restoring confidence was considered to be the principal goal of the intervention. However, the strength of the economic recovery remains uncertain, and the ultimate impact of the interventions on the real economy remains to be seen.

While movements in most of these indicators during the second year of TARP are likely more reflective of other non-TARP market developments, some metrics we have monitored for programs with later start dates (PPIP, HAMP, and to a lesser extent TALF) show some improvements. For example, PPIP indicators show substantial improvement and TALF indicators continue to improve. However, indicators for MHA continue to highlight the challenges in the area of residential housing. Finally, our indicators suggest that credit markets have largely held the gains achieved since October 2008, despite the unwinding of TARP programs, the early

[26] GAO, *Financial Audit: Office of Financial Stability (Troubled Asset Relief Program) Fiscal Year 2010 and 2009 Financial Statements*, GAO-11-174 (Washington, D.C.: Nov. 15, 2010).

termination of TARP's authority, the general exit from other government interventions, and the turmoil in Europe. Over time, analysis of the exits from remaining TARP programs will provide a more complete assessment of the resilience of the financial system.

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

For further information on this testimony, please contact Thomas J. McCool on (202) 512-2642 or mccoolt@gao.gov, or Orice Williams Brown on (202) 512-8678 or williamso@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement.

Related GAO Products

Troubled Asset Relief Program: Treasury Continues to Face Implementation Challenges and Data Weaknesses in Its Making Home Affordable Program, GAO-11-288, March 17, 2011.

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