BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

January 16, 2009

BEN S. BERNANKE
CHAIRMAN

The Honorable Barney Frank
Chairman
Committee on Financial Services
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

As Chairperson of the Financial Stability Oversight Board, I am pleased to submit the first report of the Oversight Board, under section 104(g) of the Emergency Economic Stabilization Act of 2008, for the quarter ending December 31, 2008. During this quarterly period, the Oversight Board has reviewed and monitored the policies established and the actions taken by the Treasury under the Troubled Asset Relief Program (TARP) to promote financial stability and achieve the other important objectives of the TARP. As discussed in the enclosed report, the Oversight Board believes that the actions taken by the Treasury under the TARP during the quarterly period had a significant stabilizing influence on the nation's financial system at a time of severe stress. Stabilizing the financial system and strengthening financial institutions are critical first steps to returning to more normal conditions that are supportive of lending to households and businesses.

Sincerely,

Enclosure

First Quarterly Report to Congress pursuant to section 104(g) of the Emergency Economic Stabilization Act of 2008

For the quarter ending
December 31, 2008

FINANCIAL STABILITY OVERSIGHT BOARD

Ben S. Bernanke, Chairperson
Chairman
Board of Governors of the Federal Reserve System

Henry M. Paulson, Jr.
Secretary
Department of the Treasury

Steve Preston
Secretary
Department of Housing
and Urban Development

Christopher Cox
Chairman
Securities and Exchange Commission

James B. Lockhart III
Director
Federal Housing Finance Agency

I. INTRODUCTION

This report constitutes the first quarterly report of the Financial Stability Oversight Board ("Oversight Board") pursuant to section 104(g) of the Emergency Economic Stabilization Act of 2008 ("EESA"). This report covers the period from October 3, 2008 (the date of enactment of the EESA), through the quarter ending December 31, 2008 (the "quarterly period").

The Oversight Board was established by section 104 of the EESA to help oversee the Troubled Assets Relief Program ("TARP") and other emergency authorities and facilities granted to the Secretary of the Treasury ("Secretary") under the EESA to help restore liquidity and stability to the U.S. financial system. The Oversight Board is composed of the Secretary, the Chairman of the Board of Governors of the Federal Reserve System ("Federal Reserve Board"), the Director of the Federal Housing Finance Agency ("FHFA"), the Chairman of the Securities and Exchange Commission ("SEC"), and the Secretary of the Department of Housing and Urban Development ("HUD").

Section 104(g) of the EESA provides that the Oversight Board shall report at least quarterly to the Congress regarding the Oversight Board's review of the Secretary's exercise of authority under the TARP, including —

i. the policies implemented by the Secretary and the Office of Financial Stability established within the Department of the Treasury ("Treasury") under the TARP, including the appointment of financial agents, the designation of asset classes to be purchased under the EESA, and plans for the structure of vehicles used to purchase troubled assets; and

ii. the effect of the actions taken by the Treasury in assisting American families in preserving home ownership, stabilizing financial markets and protecting taxpayers.

As provided in section 104(g) of the EESA, a copy of this report will be submitted to the Congressional Oversight Panel established by section 125 of the EESA.

As discussed further below, the Oversight Board during the past quarter has reviewed and monitored the policies developed by the Treasury to implement the TARP and promote financial stability in the United States, which is critical to the health of the U.S. economy, including the housing and housing finance markets, and the economic well-being of consumers and businesses. In addition, the Oversight Board has considered and discussed ways that the TARP might be used currently or in the future to achieve the objectives of the EESA.

During the first quarter of its operations, the Treasury, both independently and in conjunction with other agencies, has taken important actions under the authorities provided by the EESA to promote financial market stability and reduce systemic risk to

the financial system and the economy. These actions have, among other things, improved the ability of financial institutions to avoid severe funding market pressures that could have led to an escalation of stresses and disorderly failures. In addition, Treasury, through the TARP, has made capital available to a wide range of financial institutions to strengthen their financial positions, which reduced pressures to pull back from extending credit to households, businesses, and state and local governments. More generally, the actions taken under the TARP and the authorities granted by the EESA have helped promote confidence in the financial markets and U.S. financial institutions, which is a critical first step to the restoration of more normal financial market and economic activity. The Oversight Board believes that, without the actions taken by TARP during the quarterly period, the severity of the financial crisis and its impact on the U.S. economy, consumers, businesses, and state and local governments would be materially greater.

Significant challenges, however, lie ahead for the TARP, particularly in light of the continuing stresses in the financial sector and the weakened outlook for the U.S. economy. Initially, it is important that the remaining $350 billion in funds included in the EESA be made available so that the TARP has additional resources to continue to pursue the important objectives that Congress has established for the TARP. At the request of the President-elect, the Administration on January 12, 2009, submitted to the Congress the notification and report necessary to make these resources available. Careful consideration will need to be given as to how best to utilize any additional TARP resources to further improve liquidity and stability to the U.S. financial system and promote a restoration of economic growth in a manner that, consistent with the EESA: protects home values, college funds, retirement accounts and life savings; preserves homeownership; promotes jobs and economic growth; maximizes overall returns to the taxpayers of the United States; and provides public accountability.

The Oversight Board believes it will be important for the Treasury to be able to continue to take actions under the TARP to stabilize financial markets, help strengthen financial institutions, improve the functioning of the credit markets, and address systemic risks, given the disproportionate consequences that instability of the nation's financial institutions and markets may have for the broader economy. As additional resources become available, the Oversight Board also believes that it will be important for the TARP to continue to pursue effective strategies for providing resources in support of reducing preventable foreclosures due to the harm that such foreclosures may have on the affected borrowers, communities, the housing market, and the financial system and broader economy. Moreover, as the program evolves, it will be important for TARP to continue to pursue strategies designed to allow the TARP to exit from its financial interests in a timely manner consistent with the objectives of the EESA.

During the first quarter of operations under the TARP, the Treasury has taken important steps to develop the infrastructure, internal controls, and compliance, monitoring and reporting programs necessary for the TARP to operate effectively, transparently, and in the public interest. For example, Treasury quickly hired or retained qualified staff and outside experts to facilitate the prompt development and

implementation of policies and programs to help stabilize the financial system and address systemic risks. In addition, Treasury has taken important steps to promote transparency in the operations of the TARP, including through the posting of the terms of investments, standardized contractual agreements, and periodic reports on the Treasury's special EESA website. Going forward and particularly as the scope of the TARP expands, it will be important for the TARP to continue to develop its infrastructure, internal controls, and compliance, monitoring and reporting programs to promote public accountability and transparency and, accordingly, public confidence in the TARP and its vitally important activities and objectives.

This report is divided into five parts. Following this Introduction (Part I), Part II (Overview of the TARP) provides a brief overview of the authorities granted the Secretary under the TARP and related conditions and limitations. Part III (Oversight Activities of the Financial Stability Oversight Board) highlights the key oversight activities and administrative actions taken by the Oversight Board during the quarterly period. Part IV (Discussion of the Activities Taken by Treasury Under the TARP During the Quarterly Period) provides a more detailed description of the programs, policies and administrative actions taken, and financial commitments entered into, under the TARP during the quarterly period. Finally, Part V presents the Oversight Board's evaluation of the effects thus far of the policies and programs implemented by the TARP.

II. OVERVIEW OF THE TARP

In light of the extraordinary events occurring in the financial markets and the substantial risks such events posed to financial stability and the U.S. economy, Congress passed the EESA and it was signed into law by President Bush on October 3, 2008. The primary purpose of the EESA was "to immediately provide authority and facilities that the Secretary of the Treasury can use to restore liquidity and stability to the financial system of the United States."[1] In addition, the EESA provides that the Secretary should use the emergency authorities and facilities granted by the statute in a manner that (i) protects home values, college funds, retirement accounts, and life savings; (ii) preserves homeownership and promotes jobs and economic growth; (iii) maximizes overall returns to the taxpayers of the United States; and (iv) provides public accountability for the exercise of such authority.[2]

Among other things, the EESA authorizes the Secretary to establish the TARP and purchase troubled assets from financial institutions on such terms and subject to such conditions as the Secretary may establish in accordance with the EESA. The statute provides that, if the Secretary purchases troubled assets under the TARP, the Secretary also must establish a program to guarantee troubled assets. Currently, the aggregate amount of troubled assets that the Secretary may hold or guarantee at any one time under

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[1] 12 U.S.C. § 5201.

[2] See id.

the TARP is limited to $350 billion. However, this aggregate limit may be increased to $700 billion in accordance with the procedures established by section 115 of the EESA.

The statute broadly defines the term "troubled assets" to mean residential or commercial mortgages, and securities, obligations or instruments based on or related to such mortgages, that were originated or issued on or before March 14, 2008, the purchase of which the Secretary determines would promote financial market stability. Importantly, the statute also provides that the term "troubled assets" includes any other financial instrument that the Secretary, after consultation with the Chairman of the Board of Governors of the Federal Reserve System, determines the purchase of which is necessary to promote financial market stability.[3] The EESA generally defines a "financial institution" as any institution established and regulated in the United States or its territories and which has significant operations in the United States, including, but not limited to, banks, savings associations, credit unions, securities brokers or dealers and insurance companies.

The EESA includes several important limitations and conditions designed to protect the interests of taxpayers. For example, section 110 of the EESA generally requires that the Secretary obtain warrants or comparable debt instruments from any financial institution from which the TARP acquires troubled assets. In addition, section 111 of the EESA requires that the Secretary develop and impose certain executive compensation restrictions on financial institutions from which the TARP purchases troubled assets, and related provisions of the EESA limit the ability of certain financial institutions that participate in the TARP to deduct executive compensation expenses for federal tax purposes.

The EESA also establishes several bodies or mechanisms to help oversee the implementation of the TARP by the Treasury. Besides creating the Oversight Board, the EESA also (i) directs the Government Accountability Office ("GAO") to oversee the TARP and audit the TARP and its annual financial statements; (ii) establishes a Special Inspector General for the Troubled Assets Relief Program, and (iii) establishes a five-member Congressional Oversight Panel that, among other things, is charged with reporting on the implementation of the TARP by the Secretary.

III. OVERSIGHT ACTIVITIES OF THE FINANCIAL STABILITY OVERSIGHT BOARD

The Oversight Board held its first meeting on October 7, 2008 - only four days after passage of the EESA - and met five additional times during the quarterly period. To promote transparency, the Oversight Board makes minutes of its meetings publicly available, and the minutes of the meetings during the quarterly period are included in

[3] The Secretary must transmit any such determination in writing to certain specified Committees of Congress.

Appendix A of this report.[4] The following highlights some of the key oversight activities conducted by the Oversight Board during the quarter ending December 31, 2008.

As discussed in the minutes of the Oversight Board's meetings, the Oversight Board has met regularly to consider, review and discuss the significant programs, policies and financial commitments of the TARP to help restore financial stability and achieve the other important objectives of the EESA. These include —

- The $250 billion Capital Purchase Program to help stabilize and restore confidence in the financial system by providing capital to viable financial institutions throughout the United States;

- The acquisition by the TARP of $40 billion in preferred shares of American International Group, Inc. under the Systemically Significant Failing Institutions program as part of the restructuring of the U.S. government's support for the company;

- The proposed $20 billion investment by the TARP in the Term Asset-Backed Securities Loan Facility to be established by the Federal Reserve, which is designed to help market participants meet the credit needs of households and small businesses by supporting the issuance of asset-backed securities (ABS) collateralized by student loans, auto loans, credit card loans, and loans guaranteed by the Small Business Administration (SBA);

- The additional $20 billion preferred investment under the Targeted Investment Program and $5 billion in loss-sharing protection under the Asset Guarantee Program provided to Citigroup, Inc. as part of the package of governmental supports announced for the company by the Treasury, Federal Deposit Insurance Corporation ("FDIC") and the Federal Reserve; and

- The senior loans provided, or to be provided, by the TARP to General Motors Corporation and Chrysler Holding LLC under the Automotive Industry Financing Program to help prevent the disorderly failure of such firms and promote the restructuring of the companies to achieve long-term viability, and the equity capital provided to GMAC LLC under this program in support of its reorganization as a bank holding company.

Additional details concerning each of the programs and investments reviewed by the Oversight Board during the quarterly period are included in Part IV below.

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[4] Approved minutes of the Oversight Board's meetings are made available on the internet at http://www.ustreas.gov/initiatives/eesa/minutes.shtml.

In reviewing programs and investments under the TARP, the Oversight Board has received and considered information concerning the objectives, structure, and principal terms and conditions of the programs and investments. Among other things, the Oversight Board received and considered information concerning how the programs and investments were structured to protect the interests of taxpayers, comply with the executive compensation limitations and restrictions in section 110 of the EESA, and comply with the provisions of section 113 of the EESA that generally require that the Treasury receive warrants or senior debt instruments from financial institutions from which the TARP acquires troubled assets. Where relevant, the Oversight Board also discussed and considered the related actions taken or proposed to be taken by other governmental agencies, such as the FDIC or Federal Reserve, in conjunction with the TARP to help promote financial stability.

The Oversight Board also has monitored the programs established and investments made by the Treasury under the TARP, as well as the staffing, operations and procurement efforts of the Office of Financial Stability, through regular briefings and updates on these matters. For example, the Oversight Board has reviewed and discussed the progress being made by Treasury in hiring staff for the Office of Financial Stability, establishing a system of internal controls, and monitoring contractors and agents for the Office of Financial Stability. In addition, the Oversight Board has reviewed and considered the steps that Treasury has taken in coordination with the federal banking agencies to monitor and ensure compliance with the executive compensation restrictions applicable to institutions that receive TARP funding, and to develop ways of measuring the activities of banks that have received TARP funds. As part of these review activities, the Oversight Board also reviewed and discussed the reports prepared and recommendations made by the GAO and the Congressional Oversight Panel with respect to the policies and operations of the TARP.

During the past quarter, the Oversight Board also considered ways that the U.S. government, including the TARP, could help prevent avoidable foreclosures and reduce the impact of such foreclosures on households, communities, local housing markets and the financial system and the broader economy. For example, at its October 22, 2008, meeting, the Oversight Board and, at its invitation, Chairman Bair of the FDIC discussed the obstacles to private-sector loan modifications and potential ways the U.S. government could effectively and efficiently assist at-risk mortgage borrowers and reduce avoidable foreclosures. Subsequently, at its meeting on December 10, 2008, the Oversight Board reviewed and discussed the state of the housing and housing finance markets, and reviewed recent actions taken by the Administration, the government-sponsored enterprises, and the private sector to help reduce preventable foreclosures and restore greater stability to the housing and housing finance markets. In addition, the Oversight Board discussed and explored potential methods of using the TARP to supplement private-sector efforts and the potential timing of such actions directed towards foreclosure mitigation.

As discussed further in Part V of this report, the Oversight Board also considered and discussed data concerning the state of the financial markets both before and after the enactment of the EESA, the effect of the TARP in helping to stabilize the financial system, and the types of metrics that might be useful in assessing the effectiveness of the TARP in restoring stability and liquidity to the U.S. financial system.

During the past quarter, the Oversight Board also took several important steps to formalize its governance and promote transparency in its operations. For example, the Oversight Board adopted by-laws, elected Chairman Bernanke of the Federal Reserve Board as Chairperson of the Oversight Board, and appointed three individuals to serve as Executive Director, General Counsel and Secretary of the Oversight Board. In addition, the Oversight Board adopted and published procedures under which members of the public may request access to records of the Oversight Board, and adopted recordkeeping procedures designed to ensure that official records of the Oversight Board are adequately maintained. Oversight Board staff and representatives of the agencies represented on the Oversight Board have met regularly as a group with representatives of the GAO to coordinate and discuss the activities of the Oversight Board and GAO. Although outside the quarterly period, Mr. Neil Barofsky, the Special Inspector General for the TARP, participated in the Oversight Board's meeting held on January 8, 2009, and the Oversight Board expects periodic discussions will occur going forward with representatives of the Special Inspector General for the TARP and the Congressional Oversight Panel to facilitate effective oversight while minimizing overlap.

IV. DESCRIPTION OF THE ACTIONS TAKEN BY TREASURY UNDER THE TARP DURING THE QUARTERLY PERIOD

This section of the report provides an overview of the various programs, policies, financial commitments and administrative actions taken by the Treasury under the TARP during the quarterly period, subject to the review and oversight of the Oversight Board.

a. Capital Purchase Program

To address the severe stresses facing financial institutions and markets, the Capital Purchase Program ("CPP") was established under the TARP in October 2008. The purpose of the CPP is to help stabilize financial markets and bolster confidence in U.S. financial institutions, which is essential to the flow of credit to businesses and consumers. With higher capital levels and reinforced confidence, financial institutions can continue to play their vital role in our communities.

The CPP was purposefully designed to be a voluntary program, and its terms were structured both to protect taxpayers and encourage participation by a broad range of financial institutions and thereby maximize its effects. Under the terms of the program, which were reviewed and considered by the Oversight Board, Treasury will purchase senior preferred shares of U.S. controlled banks, savings associations, and certain bank and savings and loan holding companies ("qualifying financial institutions" or "QFIs").

To protect the interests of the taxpayer, only viable institutions are accepted into the program and applications for participation in the CPP are received and initially reviewed by the institution's primary federal regulator, which considers supervisory and other information to determine an institution's eligibility for the program. In addition, to facilitate participation by institutions and ensure that consistent standards are followed, Treasury worked with the Federal banking agencies to establish a common and streamlined applications process.[5] Under this process, recommendations of approval are made by the appropriate primary federal regulator or, in some cases, by a council of representatives from each federal regulator established specifically for this purpose. The Treasury, however, is responsible for final approval. The deadline for publicly-held QFIs to apply to the CPP was November 14, 2008, and the deadline for applications to the CPP from certain types of privately-held financial institutions was December 8, 2008.

As of December 31, 2008, the CPP had invested approximately $177.5 billion in the senior preferred shares of 214 financial institutions – located in more than 40 states and Puerto Rico – and had committed to purchase another $10 billion from an additional institution with a deferred settlement date. Numerous additional applications had been pre-approved by Treasury, subject to the completion of necessary authorizing actions by the institution and other closing conditions, and many more applications are currently in the review process.

The terms for a CPP investment in publicly-held QFIs and privately-held QFIs are standardized and the standard forms of agreement for each type of institution are made available on Treasury's website.[6] The Treasury is working to develop standard CPP terms for institutions that are mutually owned. For all QFIs, whether publicly or privately held, the minimum subscription amount available is 1 percent of risk-weighted assets and the maximum subscription amount is the lesser of $25 billion or 3 percent of risk-weighted assets.

Financial institutions participating in the CPP are subject to the same basic terms, although some adaptations are necessary to address differences across certain categories of financial institutions. Among the publicly-held financial institutions, special issues attend to those whose shares are not traded on public exchanges, so there are modestly different terms for these financial institutions. The coupon rate on Treasury's preferred stock under the CPP is set at 5 percent for the first five years after purchase, a relatively attractive (low) rate intended to encourage financial institutions across the country and across the spectrum of institution size to utilize this program. The dividend rate increases

[5] The application documents for the CPP are available at: http://www.treas.gov/initiatives/eesa/application-documents.shtml.

[6] On January 14, 2009, Treasury released standardized terms for CPP investments in privately-held QFIs that have elected to be taxed under subchapter S of chapter 1 of the Internal Revenue Code ("S Corporations"). The terms for CPP investments in S Corporations will be addressed in the next quarterly report of the Oversight Board and, accordingly, the following discussion does not pertain to such corporations.

to 9 percent after five years. The terms of the preferred stock also include other provisions designed to encourage institutions to replace the Treasury preferred stock with high quality capital in an expeditious manner, consistent with safety and soundness considerations.

The terms of the preferred shares contain certain provisions to protect the taxpayer. These protective terms include a restriction on paying dividends for both common shares and those preferred shares that are equal in seniority or subordinate to Treasury's investment unless the institution is currently paying full dividends to Treasury (subject to certain exceptions), a restriction on increasing common dividends, and limits on the institution's ability to repurchase other preferred and common shares within 3 years after the Treasury investment.

In addition, pursuant to EESA, Treasury will also receive warrants to purchase common shares in participating publicly-held institutions. These warrants allow the taxpayer to benefit from any appreciation in the market value of the institution. For non-publicly held financial institutions, Treasury receives warrants for preferred shares that bear dividends at a rate of 9 percent per annum. During the quarterly period covered in this report, the Treasury immediately exercised all warrants for preferred shares in each privately-held QFI that received a CPP investment. To promote community development financial institutions, however, the Treasury has not required the issuance of warrants as a condition to a CPP investment in such institutions.

All institutions participating in the CPP are subject to several executive compensation limits. For example, in accordance with EESA, these limits prohibit the institution from making any golden parachutes to its chief executive officer, its chief financial officer, or any of the next three most highly compensated executive officers (collectively, "senior executive officers"). In addition, the institution must recover any bonus or incentive compensation paid to a senior executive officer based on financial statements that are later proven to be materially inaccurate. The institution's compensation or similar committee also must promptly review with the institution's senior risk officers all incentive compensation arrangements for the institution's senior executive officers to ensure that they do not encourage such officers to take unnecessary and excessive risks that threaten the value of the financial institution.[7]

b. Systemically Significant Failing Institutions Program and Investment in American International Group, Inc.

On November 10, 2008, the Treasury, in conjunction with the Federal Reserve, announced a restructuring of the U.S. government's financial support for American International Group, Inc. (AIG). AIG is a large financial services company that operates in four general business lines through a number of domestic and foreign subsidiaries: (i) general insurance, (ii) life insurance and retirement services, (iii) financial services,

[7] Additional details about the Capital Purchase Program are available at: http://www.treas.gov/initiatives/eesa/.

and (iv) asset management. As of September 30, 2008, AIG reported consolidated total assets of slightly more than $1 trillion. In addition to its on-balance-sheet positions, AIG is a major participant in a wide range of derivatives markets and is a significant counterparty to a number of major national and international financial institutions. In order to prevent a disorderly failure of the company, the Federal Reserve, in September 2008, provided AIG with a senior revolving credit facility in an aggregate amount not to exceed $85 billion outstanding at any time.

The restructuring announced on November 10, 2008, was designed to promote financial stability by further stabilizing the company, alleviating liquidity and capital pressures on AIG, and facilitating AIG's execution of its plan to sell certain of its businesses in an orderly manner, the proceeds of which will be used to repay the government. As part of this restructuring, the TARP acquired $40 billion of senior preferred stock in AIG on November 25, 2008. This preferred stock investment constituted an important part of the restructuring actions by providing new equity capital to AIG, a tool that was not available to the U.S. government at the time the Federal Reserve initially provided the company the revolving credit facility. The proceeds of Treasury's investment were used by AIG to reduce the amount drawn under the Federal Reserve's revolving credit facility.[8]

The terms of Treasury's investment, which were reviewed and considered by the Oversight Board, are more stringent than those under the CPP. Under these terms, Treasury's preferred stock will accrue cumulative dividends at a rate of 10 percent per annum. The company generally is prohibited from paying dividends on its common stock or other securities unless all accrued dividends on the Treasury's preferred stock have been paid. In addition, even if all dividends on the Treasury preferred stock have been paid, the company may not pay common dividends (which were suspended prior to Treasury's investment) for five years (or earlier if the Treasury preferred is redeemed) without Treasury's approval. As part of the investment, Treasury also received warrants to purchase up to 2 percent of the common stock of AIG at an exercise price of $2.50 per

[8] In connection with Treasury's investment, the Federal Reserve reduced, from $85 billion to $60 billion, the maximum amount of credit available under the revolving credit facility, extended the term of the facility from two years to five years, and modified certain other terms of the facility. The Federal Reserve also established two additional lending facilities (in an aggregate amount of up to $52.5 billion) to alleviate capital and liquidity pressures on AIG associated with the portfolio of residential mortgage-backed securities held by its insurance subsidiaries as part of their securities lending program and with multi-sector collateralized debt obligations on which AIG had written credit default swaps or similar types of protection. As a result of the establishment of these credit facilities, the $37.8 billion securities borrowing facility previously authorized by the Federal Reserve for AIG in October 2008, was terminated and all advances under this facility were repaid on December 12, 2008.

share, subject to anti-dilution provisions.[9] In addition, the terms of the investment require that AIG comply with the executive compensation restrictions applicable to institutions that participate in the CPP, as well as additional restrictions. These additional restrictions extend the prohibitions on golden parachute payments to a wider range of senior AIG executives (approximately 60 people), and freeze the size of the annual bonus pool for such senior executives. Additionally, AIG must continue to maintain and enforce newly adopted restrictions put in place by the new management on corporate expenses and lobbying, and must receive Treasury's written consent before materially altering these policies. In addition, the company must establish and maintain a risk management committee under the board of directors to oversee the major risks involved in the company's business operations and review the company's actions to mitigate and manage those risks.[10]

The investment by the TARP in AIG was made under the Systemically Significant Failing Institution (SSFI) Program. The SSFI Program is intended to provide stability and prevent disruptions to financial markets from the failure of a systemically significant institution. In an environment of substantially reduced confidence, severe strains, and high volatility in financial markets, the disorderly failure of a systemically significant institution could call into question the financial strength of other similarly situated financial institutions, disrupt financial markets, raise borrowing costs for households and businesses, and reduce household wealth. The resulting financial strains could threaten the viability of otherwise financially sound businesses, institutions, and municipalities, resulting in adverse spillovers on employment, output, and income.

The potential eligibility of participants in the SSFI Program, as well as the form, terms, and conditions of any investment made pursuant to this program, will be established by Treasury on a case-by-case basis, subject to review and oversight by the Oversight Board in accordance with the EESA. Under the SSFI Program guidelines, which were reviewed and considered by the Oversight Board, the Treasury, in determining whether an institution is systemically significant and at substantial risk of failure, may consider, among other things:

1. the extent to which the failure of an institution could threaten the viability of its creditors and counterparties because of their direct exposures to the institution;

2. the number and size of financial institutions that are seen by investors or counterparties as similarly situated to the failing institution, or that would

[9] Under the terms of the Federal Reserve's revolving credit facility for AIG, as amended as part of the November restructuring, AIG will issue shares of convertible preferred stock to a trust that will hold the shares for the benefit of the Treasury. The preferred stock will be convertible into 77.9 percent of AIG's outstanding common stock.

[10] Additional details of the assistance provided by the TARP to AIG are available at: http://www.treas.gov/press/releases/reports/111008aigtermsheet.pdf.

otherwise be likely to experience indirect contagion effects from the failure of the institution;

3. whether the institution is sufficiently important to the nation's financial and economic system that a disorderly failure would, with a high probability, cause major disruptions to credit markets or payments and settlement systems, seriously destabilize key asset prices, significantly increase uncertainty or losses of confidence thereby materially weakening overall economic performance; or

4. the extent and probability of the institution's ability to access alternative sources of capital and liquidity, whether from the private sector or other sources of government funds.

Under the guidelines for the SSFI Program, Treasury will require any institution participating in the program to comply with the executive compensation restrictions established pursuant to EESA and provide Treasury with warrants or alternative consideration, as necessary, to minimize the long-term costs and maximize the benefits to the taxpayers. In addition, Treasury may impose other conditions or requirements, including corporate governance requirements or limitations on the institution's expenditures or bonuses, to protect the taxpayers' interests or reduce ongoing risks to the financial system.

c. Term Asset-Backed Securities Loan Facility

The ABS markets historically have funded a large share of consumer credit and small business loans guaranteed by the SBA. Credit market stresses led to a steep decline in securitization and issuance of ABS for these types of loans in the third quarter of 2008, and the market for these securities essentially came to a halt in October. Interest rate spreads of AAA-rated tranches were very high, indicating that investors were insisting on unusually high risk premiums. Continued disruption of the ABS markets threatened to curtail the availability of credit to households and small businesses and weaken U.S. economic activity.

In response to these deteriorating market conditions, the Treasury announced in November 2008, that the TARP will provide $20 billion as credit protection to support the Federal Reserve's $200 billion Term Asset-Backed Securities Loan Facility ("TALF"). The TALF is intended to help market participants meet the credit needs of households and small businesses by supporting the issuance, at more normal interest rate spreads, of ABS collateralized by student loans, auto loans, credit card loans, and loans guaranteed by the SBA. The TALF is expected to begin operation in February 2009.

Under the principal terms of the TALF, which were reviewed and considered by the Oversight Board, the Federal Reserve will lend on a non-recourse basis to any U.S. company that owns eligible collateral, provided it maintains an account relationship with a primary dealer. To facilitate these purchases and provide the ability for the TALF to absorb losses, the TARP will purchase up to $20 billion of subordinated debt issued by a

special purpose vehicle that the Federal Reserve Bank of New York ("FRBNY") will create to purchase and manage assets received in connection with TALF loans. The subordinated debt purchased by the TARP will be backed by the collateral received by eligible borrowers, but will be junior to, and thus provide protection for, any funding provided by the FRBNY to the vehicle. Any residual returns from the special purpose vehicle, however, will be shared between Treasury and the Federal Reserve.

TALF loans will have a term of 3 years and will be fully secured by eligible collateral. Eligible collateral includes U.S. dollar-denominated cash (that is non-synthetic) ABS that have a long-term credit rating in the highest investment-grade rating category (e.g., AAA) from two or more major nationally recognized statistical rating organizations ("NRSROs") and do not have a long-term credit rating below the highest investment-grade rating category from a major NRSRO. Eligible small business loan ABS also will include U.S. dollar-denominated cash ABS for which all of the underlying credit exposures are fully guaranteed as to principal and interest by the full faith and credit of the U.S. government. Haircuts (a percentage reduction used for collateral valuation) will be determined based on the riskiness of each type of eligible collateral and the maturity of the eligible collateral pledged to the Federal Reserve. The haircuts provide protection to the Treasury and the Federal Reserve from loss on the eligible collateral. The sponsor of the eligible ABS must agree to comply with the same executive compensation restrictions required for participants in the CPP.

Additional terms and restrictions aim to ensure the quality of eligible collateral and promote new lending. For instance, all or substantially all of the credit exposures underlying eligible ABS must be exposures to U.S.-domiciled obligors, and eligible ABS must be newly issued and backed by newly or recently originated loans. Going forward, the set of permissible underlying credit exposures of eligible ABS may be expanded later to include commercial mortgages, non-agency residential mortgages, or other asset classes.[11]

d. Targeted Investment Program, Asset Guarantee Program and Assistance Provided to Citigroup, Inc.

In order to promote financial stability, the TARP during the quarterly period also made an additional investment in Citigroup, Inc. ("Citigroup"), and agreed to provide certain loss-sharing guarantees with respect to a designated pool of assets held by Citigroup. These actions were taken as part of a package of guarantees, liquidity access and capital provided to Citigroup by the Treasury, FDIC and Federal Reserve. Citigroup is one of the largest financial institutions in the United States and has extensive and diversified operations both in the United States and abroad. As of September 30, 2008, Citigroup was the second largest banking organization in the United States, with total consolidated assets of slightly more than $2 trillion dollars. As of the same date,

[11] Additional information on the terms and conditions of the TALF are available at: http://www.federalreserve.gov/newsevents/press/monetary/20081219b.htm.

Citigroup's lead subsidiary bank, Citibank, N.A., had total consolidated assets of approximately $1.2 trillion, making the bank the third largest U.S. insured depository institution in terms of assets. Citigroup also is a major participant in numerous domestic and international payment, clearing and central counterparty arrangements and is a significant counterparty to many major national and international financial institutions. In addition, Citigroup provides a wide range of investment banking, capital markets, asset management, and retail brokerage services through its subsidiary Citigroup Global Capital Markets, Inc.

Under the terms of the additional capital investment,[13] which were reviewed and considered by the Oversight Board during the quarterly period, Treasury on December 31, 2008, acquired an additional $20 billion in perpetual preferred stock, which will accrue cumulative dividends at an 8 percent annual rate. As part of the investment, Treasury also acquired warrants for common stock of Citigroup with an aggregate exercise value of $2.7 billion, and a strike price of $10.61 per share. In addition, Citigroup is required to comply with certain additional executive compensation standards and other restrictions on corporate expenditures that are more stringent than for CPP investments. For example, Citigroup must develop, and obtain Treasury approval of, an executive compensation plan that rewards long-term performance and profitability.

The additional preferred stock investment by the TARP in Citigroup was made under the Targeted Investment Program (TIP), which is designed to prevent a loss of confidence in financial institutions that could result in significant market disruptions, threatening the financial strength of similarly situated financial institutions, impairing broader financial markets, and undermining the overall economy. Institutions will be considered by Treasury for inclusion in this program on a case-by-case basis, subject to review and oversight by the Oversight Board in accordance with the EESA, based on a number of factors described in the program guidelines, including:

1. the extent to which destabilization of the institution could threaten the viability of creditors and counterparties exposed to the institution, whether directly or indirectly;

2. the extent to which an institution is at risk of a loss of confidence and the degree to which that stress is caused by a distressed or illiquid portfolio of assets;

3. the number and size of financial institutions that are similarly situated, or that would be likely to be affected by destabilization of the institution being considered for the program;

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[13] In October 2008, Treasury acquired $25 billion in preferred stock of Citigroup as part of the CPP.

4. whether the institution is sufficiently important to the nation's financial and economic system that a loss of confidence in the firm's financial position could potentially cause major disruptions to credit markets or payments and settlement systems, destabilize asset prices, significantly increase uncertainty, or lead to similar losses of confidence or financial market stability that could materially weaken overall economic performance; and

5. the extent to which the institution has access to alternative sources of capital and liquidity, whether from the private sector or from other sources of government funds.

In making these judgments, Treasury will obtain and consider information from a variety of sources, and will take into account recommendations received from the institution's primary regulator, if applicable, or from other regulatory bodies and private parties that could provide insight into the potential consequences if confidence in a particular institution deteriorated.

In addition, the Treasury, FDIC and Federal Reserve have agreed to provide Citigroup protection against the possibility of large losses on a designated pool of approximately $306 billion of assets. These assets, which will include loans and securities backed by residential and commercial real estate, will remain on Citigroup's balance sheet. Under the principal terms of this loss protection, which were reviewed and considered by the Oversight Board, the guarantee provided by the government will be in place for 10 years for residential assets and 5 years for non-residential assets. In addition, under the terms of the agreement, Citigroup will absorb the first $29 billion in losses on the designated asset pool (the "first loss"); losses in excess of $29 billion are shared by the U.S. government (90 percent) and Citigroup (10 percent). TARP will absorb the second loss up to $5 billion, the FDIC will absorb the third loss up to $10 billion, and, if these loss protections are exhausted, the Federal Reserve will provide residual funding for the assets on a non-recourse basis. As a fee for the guarantees provided by Treasury and the FDIC, Citigroup will issue an additional $4 billion of preferred stock to TARP and $3 billion of preferred stock to the FDIC, which will accrue cumulative dividends at an 8 percent annual rate.[14] As part of the terms and conditions for the assistance provided by the TARP, Citigroup must implement a systematic program to provide at-risk homeowners loan modifications with lower monthly payments where such modifications are expected to result in an expected net present value greater than that expected through foreclosure.

[14] The Federal Reserve financing, if necessary, will be provided at the 3-month overnight index swap rate plus 300 basis points.

On December 31, 2008, Treasury transmitted to Congress a report that describes the Asset Guarantee Program (AGP) established under section 102 of the EESA.[15] Section 102 permits the TARP to guarantee troubled assets, and requires that Treasury receive premiums for such guarantees that, based on an actuarial analysis, are sufficient to fully protect taxpayers under the AGP, the TARP may provide guarantees for assets held by systemically significant financial institutions that face a risk of losing market confidence due in large part to a portfolio of distressed or illiquid assets. The AGP will be applied with extreme discretion in order to improve market confidence in the systemically significant institution and in financial markets broadly. It is not expected that this program will be made widely available. The Oversight Board notes that Treasury is exploring use of the AGP to address the guarantees to be provided by TARP under the non-binding agreement with Citigroup announced on November 23, 2008.

e. Automotive Industry Financing Program

During the quarterly period, the Treasury also took a series of actions under the TARP to: stave off the disorderly bankruptcy of General Motors Corporation ("GM") or Chrysler Holding LLC ("Chrysler") and the attendant effects such a bankruptcy would have on the financial system, jobs, and the broader economy; assist these domestic automotive companies in becoming viable and competitive; and support the flow of automobile and other credit to consumers. In particular, Treasury agreed to provide up to $13.4 billion in senior loans to GM and up to $4 billion in senior loans to Chrysler. Treasury funded $4 billion of the loan for GM on December 31, 2008, and is scheduled to provide an additional $5.4 billion of funding on January 16, 2009. The remaining $4 billion of funding for GM is scheduled to be provided on February 17, 2009, subject to GM meeting certain conditions and the availability of funds under the TARP as provided in section 115(a) of the EESA. On January 2, 2009, after the close of the quarterly period covered in this report, the $4 billion loan to Chrysler was fully funded.

Under the principal terms of the loan agreements, which were reviewed and considered by the Oversight Board, both loans bear an interest rate of LIBOR plus 300 basis points, with a floor of 2 percent on the calculated base (LIBOR) rate. The spread over LIBOR may increase to 800 basis points if certain events of default occur and are not cured in a timely manner. As part of the terms of the loans, Treasury will receive warrants from GM to purchase common stock with an aggregate exercise value of 20 percent of the loan amount, subject to a cap of 20 percent of the company's issued and outstanding common equity. If this cap is reached, the Treasury will receive additional compensation in the form of notes. In the case of Chrysler, which is not a publicly traded company, the Treasury will receive the economic equivalent of warrants in the form of notes in an amount equal to 6.67 percent of the loan amount.

[15] This report is available on Treasury's website at http://www.ustreas.gov/initiatives/eesa/congressionalreports102.shtm.

The terms of these loans are more stringent than for CPP investments. The terms of the agreements require that each company develop and submit to the U.S. government a restructuring plan and take other actions designed to assist each company to achieve and sustain long-term viability, international competitiveness and improved energy efficiency. For example, each company must prepare a restructuring plan that includes specific actions aimed at assuring: (i) the repayment of the loan extended by TARP; (ii) the ability of the company to comply with applicable federal fuel efficiency and emissions requirements and commence the domestic manufacturing of advanced technology vehicles in accordance with federal law; (iii) achievement of a positive net present value; (iv) rationalization of costs, capitalization, and capacity with respect to the manufacturing workforce, suppliers and dealerships of the company; and (v) a product mix and cost structure that is competitive in the U.S. marketplace. The companies must submit the required restructuring plans to one or more executive branch officers designated by the President (the "President's Designee") no later than February 17, 2009, and must submit a written certification and report detailing the progress being made in implementing the plans to the President's Designee for review and certification no later than March 31, 2009. The companies face significant short-term and long-term challenges, and it will be important for the Administration and the Congress to carefully consider whether or how the U.S. government should provide the additional assistance that may be required to support an orderly restructuring of the companies in accordance with the objectives of the restructuring plans.

The agreements also impose several restrictions on executive compensation and bonuses. Among other things, GM and Chrysler must maintain all suspensions and other restrictions on contributions to benefit plans in place on the closing date, and are prohibited from paying or accruing any bonuses to the company's top 25 corporate executives unless the company receives specific approval from the President's Designee. In addition, the companies are required to maintain and implement a comprehensive written policy on corporate expenses that covers, among other things, entertainment and the hosting, sponsorship or payment for conferences and events. Material deviations from the policy must be reported to the President's Designee, who also must approve material amendments to the policy. The companies also are required to take reasonable steps to divest their corporate aircraft.[16]

During the quarterly period, Treasury also purchased $5 billion in senior preferred equity with an 8 percent cumulative dividend from GMAC LLC ("GMAC") and provided an additional $1 billion loan to GM in support of GMAC's reorganization as a bank holding company. GMAC is currently an important source auto-related credit for consumers and dealers and, through a subsidiary, is the country's fifth largest mortgage servicer. Under the terms of this agreement, GMAC issued warrants to the Treasury in the form of additional preferred equity in an amount equal to 5 percent of the preferred stock purchase; these warrants were exercised and the preferred shares acquired accrue a

[16] Additional details on the terms of the assistance provided by the TARP to GM and Chrysler are available at: http://www.treas.gov/press/releases/hp1333.htm.

9 percent annual dividend. GMAC also is required to comply with the executive compensation restrictions applicable to GM and Chrysler.[17]

The $1 billion loan to GM is designed to permit GM to participate in a rights offering by GMAC and, thereby, augment the capital of GMAC. The loan will be secured by the GMAC equity acquired by GM in the rights offering, and the loan will be exchangeable at any time, at Treasury's option, for the GMAC equity acquired. In addition, the terms of the loan require that GM abide by substantially the same terms and conditions, including the executive compensation restrictions that apply under the $13.4 billion loan facility.

In connection with the loans and investments described above, the Automotive Industry Financing Program (AIFP) was established under the TARP. The objective of the AIPF is to prevent a significant disruption to the American automotive industry that poses a major risk to financial market stability and would have a serious negative effect on the real economy of the United States. The program requires, among other things, that participating institutions implement a plan to achieve long-term viability. Participating institutions also must adhere to rigorous executive compensation standards and other measures to protect the taxpayers' interests, including limits on the institution's expenditures and other corporate governance requirements. While program eligibility will be determined on a case-by-case basis by Treasury, subject to review and oversight by the Oversight Board in accordance with the EESA, the Treasury may consider, among other things, the following in deciding whether to apply the program to a particular institution:

1. The importance of the institution to production by, or financing of, the American automotive industry;

2. Whether a major disruption of the institution's operations would likely have a materially adverse effect on employment and thereby produce negative spillover effects on overall economic performance;

3. Whether the institution is sufficiently important to the nation's financial and economic system such that a major disruption of its operations would, with a high probability, cause major disruptions to credit markets and significantly increase uncertainty or losses of confidence, thereby materially weakening overall economic performance; and

4. The extent and probability of the institution's ability to access alternative sources of capital and liquidity, whether from the private sector or other sources of U.S. government funds.

[17] Additional details on the agreement between TARP and GMAC are available at: http://www.treas.gov/press/releases/hp1335.htm.

In making these judgments, Treasury must obtain and consider information from a variety of sources and must take into account recommendations received from regulatory bodies, as applicable, that could provide insight into the potential consequences of the failure of a particular institution.[19]

f. Administrative Activities of the Office of Financial Stability

During the quarterly period, the Oversight Board reviewed and monitored the progress made by Treasury in hiring staff, outside experts and vendors, and establishing the necessary infrastructure, internal controls and compliance and monitoring programs for the TARP. As part of these oversight activities, the Oversight Board reviewed and considered the recommendations included in the report submitted by the GAO to Congress on December 2, 2008.[20] The following highlights some of the important actions taken by Treasury in these areas during the quarterly period, which were key in allowing the TARP to quickly begin operation and implement the programs described above.

i. Staffing

On October 6, 2008, Secretary Paulson appointed Neel Kashkari as the Interim Assistant Secretary of the Treasury for Financial Stability to oversee the newly-created Office of Financial Stability ("OFS"). During the quarterly period, Treasury also recruited and retained experienced staff for the OFS from other government agencies and the private sector. For example, Treasury has successfully filled the executive roles of Chief Operating Officer, Chief Investment Officer, Chief Financial Officer, Chief Compliance Officer, Chief Risk Officer, Chief Counsel, Chief of Home Ownership Preservation, and Director of the Capital Purchase Program. Many other key career positions have also been filled using permanent TARP staff, career Treasury employees, and detailees drawn from career staff at other agencies. Treasury has more than 90 employees dedicated to the TARP. Treasury also has taken measures to provide for continuity of operations within the OFS during the transition to the new Administration. For example, Mr. Kashkari and Mr. Lambright, the Chief Investment Officer of the TARP, will serve in their current capacities on a temporary basis to facilitate the transition that will occur following the inauguration of President-elect Obama.

ii. Procurement

In implementing the TARP, Treasury has available two mechanisms for engaging private-sector firms. These mechanisms are financial agent authority, and procurement under the Federal Acquisition Regulation. Treasury has used these mechanisms to

[19] Additional information on the eligibility standards for the AIFP are available at: http://www.treas.gov/initiatives/eesa/program-descriptions/aifp.shtml.

[20] GAO, Troubled Asset Relief Program: Additional Actions Needed to Better Ensure Integrity, Accountability, and Transparency, GAO-09-161 (Dec. 2008).

quickly engage firms to assist the OFS in the implementation of the TARP. On October 13, 2008, Treasury announced that it had hired EnnisKnupp & Associates to serve as an investment adviser and, among other things, assist in the evaluation of potential asset managers and other vendors for the TARP. On the following day, October 14, 2008, the Treasury announced the selection of the Bank of New York Mellon to serve as custodian of the TARP and assist with custodial, accounting, auction management and other infrastructure services. Treasury subsequently selected Lindhold & Associates to provide human resources support for TARP on October 31, 2008.

During the quarterly period, Treasury also hired a number of legal advisors to assist Treasury with the significant volume of legal and transactional work under the TARP. For example, during the quarterly period, the law firms of Simpson, Thacher & Bartlett, Hughes Hubbard & Reed LLP, and Squire Sanders & Dempsey LLP were retained to provide legal advice on the implementation of the CPP. The firms have assisted in executing transactions under the program, which includes working directly with accepted financial institutions to identify and resolve any legal issues before closing, conducting the closing of transactions, and reviewing executed investment agreements. Sonnenschein Nath & Rosenthal LLP also has been retained to provide legal assistance in connection with the TALF and the auto programs.

The Oversight Board also has monitored Treasury's efforts to detect and resolve potential conflicts of interest. In early October, Treasury published, interim guidelines on the mitigation of conflicts of interest (COI) on its website, and regulations governing COI will be published shortly. The regulations will require firms interested in performing work under the TARP to identify potential COI, design plans for mitigating conflicts when they exist, and implement monitoring programs to ensure compliance on an ongoing basis. The Chief Compliance Officer for TARP will be responsible for ensuring compliance with these regulations.

iii. Internal Controls

Shortly after the EESA was enacted, Treasury retained PricewaterhouseCoopers LLP to assist the Treasury in establishing internal controls for the TARP and Ernst & Young LLP to provide general accounting support and accounting advice. Treasury also has established controls to ensure that the use of TARP funds under section 115 of the EESA does not exceed the current limit of $350 billion. In addition, Treasury has utilized expert review panels, comprised of Treasury employees, employees of other federal agencies and expert consultants, to review submissions and make recommendations regarding the quality of proposed TARP investments.

iv. Transparency

During the quarterly period, Treasury has publicly disclosed information relating to the objectives, structure, and terms of each TARP program and investment on its website and through a series of publicly available reports, including:

- **Transaction Reports:** Within two business days of completing each TARP transaction, Treasury must publish key details of the transaction including, among other things, the name of institution, the asset purchased, the price paid, and the pricing mechanism. During this quarterly period, Treasury published 10 transaction reports.

- **Tranche Reports:** Within seven days of each $50 billion commitment that is made under the TARP, Treasury must publish a tranche report that outlines the details of the applicable transactions by program; provides an assessment of the impact of the programs; and outlines the challenges still facing the financial system. During this quarterly period, Treasury published three Tranche Reports.

- **105(a) Reports:** Within 60 days of the first exercise of the TARP purchase authority and then monthly thereafter, Treasury must issue a report pursuant to section 105(a) of the EESA that provides, among other things, financial data concerning administrative expenses, projected administrative expenses and a detailed financial statement with respect to TARP investments. During this quarterly period, Treasury transmitted one section 105(a) report on December 5, 2008.

- **Insurance Program Report:** During the quarterly period, Treasury published its first insurance program report, which discusses, among other things, the public comments that Treasury received concerning the appropriate structure and scope for such a program and the AGP described above.

Treasury has met each of its reporting requirements under the TARP on time. In addition, Treasury has provided the public regular updates concerning its strategies and actions with respect to TARP through numerous press releases, testimonies and speeches.

V. EVALUATING THE EFFECTS OF EESA PROGRAMS

Congress passed the EESA to provide adequate "authority and facilities that the Secretary of the Treasury can use to restore liquidity and stability to the financial system of the United States." To date, the Treasury has established the programs described above. This section provides an early evaluation of the effects of those efforts.

a. Conditions in financial markets before EESA

Stresses in U.S. financial markets began to emerge in 2007 as the performance of nonprime mortgages deteriorated significantly, and losses on related securities began to climb. With the extent and distribution of losses quite uncertain, concerns began to rise about the financial condition of banks and other financial institutions. Pressures in short-

term funding markets escalated as some off-balance sheet funding vehicles were not able to roll their asset-backed commercial paper, raising concerns about the ability of sponsoring banks to meet funding needs. As a consequence, short-term credit markets came under considerable pressure and risk spreads in interbank funding markets and in some segments of the commercial paper (CP) market rose sharply. Announcements of large asset write-downs and weak financial reports for many large financial institutions in late 2007 raised additional concerns about the resilience and capital adequacy of financial counterparties and the likelihood of further large losses in the future.

Continuing declines in mortgage loan performance, market valuations of mortgage-related assets, and the credit ratings of even so-called "super-senior" tranches of structured finance securitizations heightened the pressure on financial institutions with significant known exposures in these areas. Investors 'ran' on the most-affected institutions, especially Bear Stearns. In March 2008, the Federal Reserve, with the full support of the Treasury, facilitated a merger of Bear Stearns with JPMorgan Chase to prevent a disorderly collapse of the firm and potentially severe spillover effects in the financial markets. The condition of financial guarantors weakened, calling into question the value of the insurance they had written, and led to declines in the value of products insured by these entities. In March, the Federal Reserve introduced two new liquidity facilities (the Primary Dealer Credit Facility and the Term Securities Lending Facility), which increased the liquidity available to primary dealers.

Pressures in financial markets initially appeared to ease somewhat as a consequence of these actions. However, housing conditions and the broader economy continued to deteriorate, and financial institutions came under renewed stress in the summer of 2008. Capital market dislocations and volatility combined with losses and expectations of further losses on mortgage-related assets resulted in the debt spreads of Fannie Mae and Freddie Mac widening and the firms becoming unable to raise new capital or long-term debt. In September, the FHFA placed these firms into conservatorship while obtaining backup capital and funding support from Treasury under authority granted by the Housing and Economic Recovery Act of 2008. Lehman Brothers came under heightened funding pressures, with the eventual result that the parent company filed for bankruptcy protection. AIG experienced similar liquidity pressures, necessitating assistance to prevent the potential for severe systemic consequences from a disorderly failure of the firm.

In the wake of the bankruptcy of Lehman Brothers and the difficulties at AIG, spreads on interbank borrowing jumped to a new record high as banks sought to safeguard their own liquidity and interbank lending volumes fell off. Losses on Lehman Brothers commercial paper caused a money market mutual fund to 'break the buck', and investors accelerated withdrawals from prime money market funds, forcing sales of their CP holdings. Total CP outstandings fell sharply, leaving many financial and nonfinancial businesses with sharply reduced access to needed short-term funds. Many such institutions tapped existing back-up lines of credit at banks, adding to the pressure on banks' own liquidity funding needs. To support the functioning of money funds and the CP market, the Treasury initiated an insurance program for existing balances at money

market mutual funds and the Federal Reserve established the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF) to provide liquidity to money funds that were holding asset-backed commercial paper.

The loss of confidence in financial institutions also led to the failure of Washington Mutual, the largest U.S. thrift institution. The FDIC sold the banking operations of the institution to JP Morgan Chase. Wachovia subsequently came under intense funding pressures, and ultimately was acquired by Wells Fargo. Moreover, as the financial crisis intensified in the U.S., it extended to countries that had not yet been significantly affected, and increased the risks to the stability of the international financial system. To help ease liquidity pressures, the Federal Reserve in coordination with other central banks around the globe provided dollar liquidity to banking institutions through reciprocal currency (or swap) lines.

Accompanying the pressures in interbank and other funding markets, and in light of the weakening economy, banks continued to tighten their credit terms and standards on loans to their customers. The tighter terms and standards reduced credit availability, leaving its imprint on economic activity. In the corporate bond market, borrowing costs increased dramatically and the spread of corporate yields to comparable maturity Treasury yields rose, reflecting financial market stresses and a weakening economic outlook. Broad stock price indexes fell sharply, nearly 15 percent in early October, leaving them down about 40 percent since the beginning of the year.

In summary, the accumulation of events placed severe financial stresses on financial markets and institutions, and strong pressures on institutions to deleverage and restrain lending. Because of the dependence of our economy on the flow of credit, serious strains on credit providers can impose disproportionately large costs on the broader economy. Responding to these severe conditions, the Treasury, Federal Reserve, FHFA, FDIC, and other U.S. government bodies undertook an array of unprecedented actions in accordance with their respective authorities. In addition, the Federal Open Market committee lowered the target federal funds rate an aggregate of 375 basis points from the beginning of 2007 to October 8, 2008. However, additional resources and authorities were needed to help address the significant problems in the financial markets and the dangers posed by such problems to the consumers, businesses, and the broader economy.

b. Early assessment of the effect of TARP

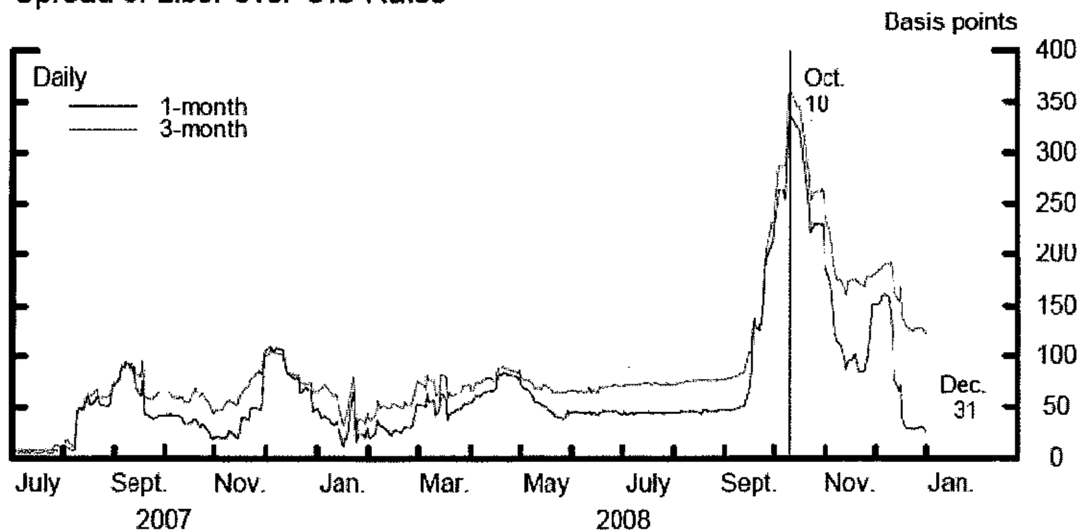
The actions taken under the TARP during the quarterly period had a significant stabilizing influence on the nation's financial system at a time of severe stress. Stabilizing the financial system and strengthening financial institutions are critical first steps to returning to more normal conditions that are supportive of lending to households and businesses. Moreover, the actions taken by the Treasury and by other U.S. and foreign governmental authorities may have forestalled the potential for a collapse of global financial markets that would unquestionably have led to an even greater weakening in global economic activity than is currently being experienced. In that

context, in early to mid-October, when risks to the financial system intensified globally, authorities in a number of other countries took actions to shore up banks and bolster investor confidence, often with a combined strategy of both providing capital and guaranteeing bank liabilities.

One useful indicator of stress in the financial markets is the spread of the LIBOR rate to the overnight index swap (OIS) rate, a measure of banks' short-term borrowing costs. The spread of three-month LIBOR over OIS has been elevated since August 2007, but rose especially sharply in September 2008 to a record peak of more than 3-1/2 percentage points (Fig. 1). The decline in this spread in the month after the CPP program was announced is striking, and three-month borrowing costs had fallen to 1 percentage point above the overnight funding rate in December, although the spread remains elevated relative to historical levels. The spread of the one-month LIBOR rate to the overnight index swap rate has declined even more.

Figure 1

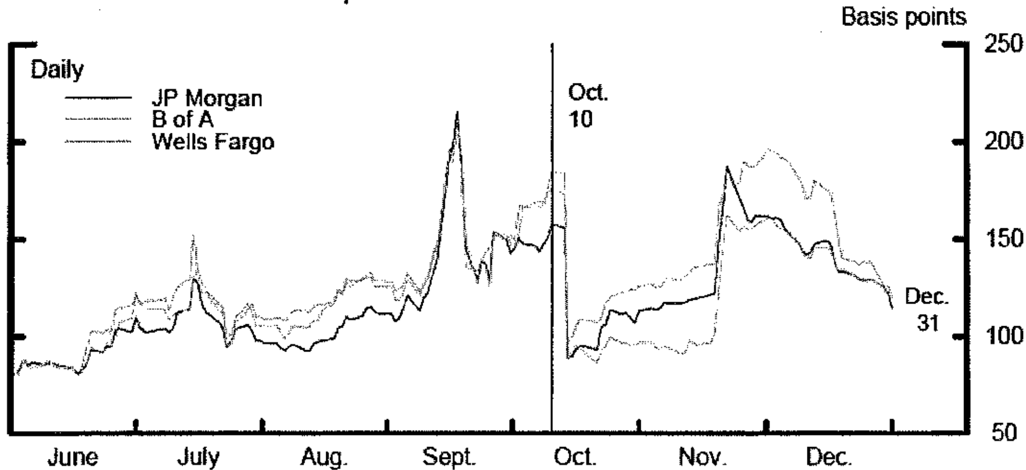
Spread of Libor over OIS Rates



Note: October 10 is the business day before the CPP was announced.
Source: British Bankers' Association.

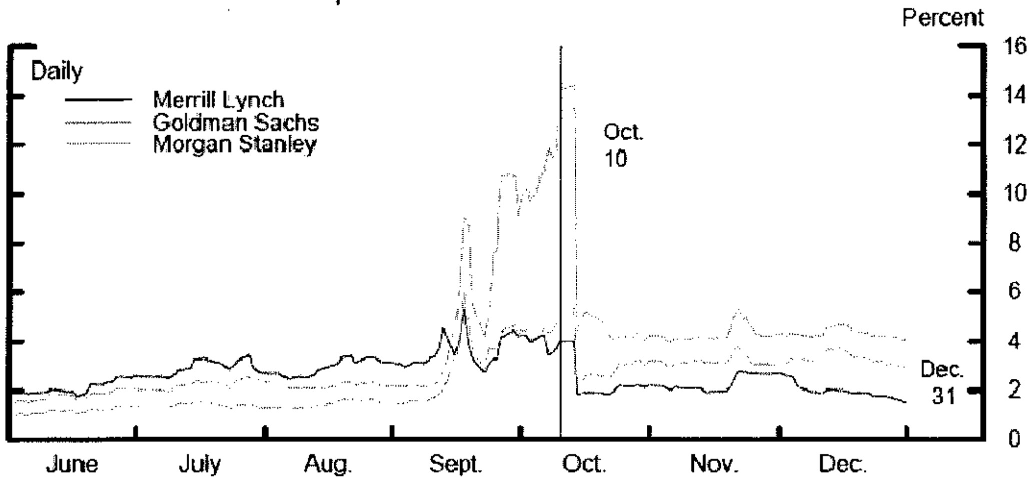
Another gauge of the effect of the TARP, as well as the FDIC funding guarantee that was implemented at the same time as the CPP, is the decline in the credit default swaps (CDS) rates on major financial institutions. CDS spreads for several major commercial and investment banks narrowed substantially after the CPP program was announced. While stresses reemerged at commercial banks in November, spreads were, on net, lower during the quarterly period than before CPP capital injections despite the continued deterioration in the macroeconomic outlook (Fig. 2 and 3). Commercial bank CDS spreads, however, spiked up again shortly after the quarterly period.

Figure 2



Note: October 10 is the business day before the CPP was announced.
Source: Markit

Figure 3

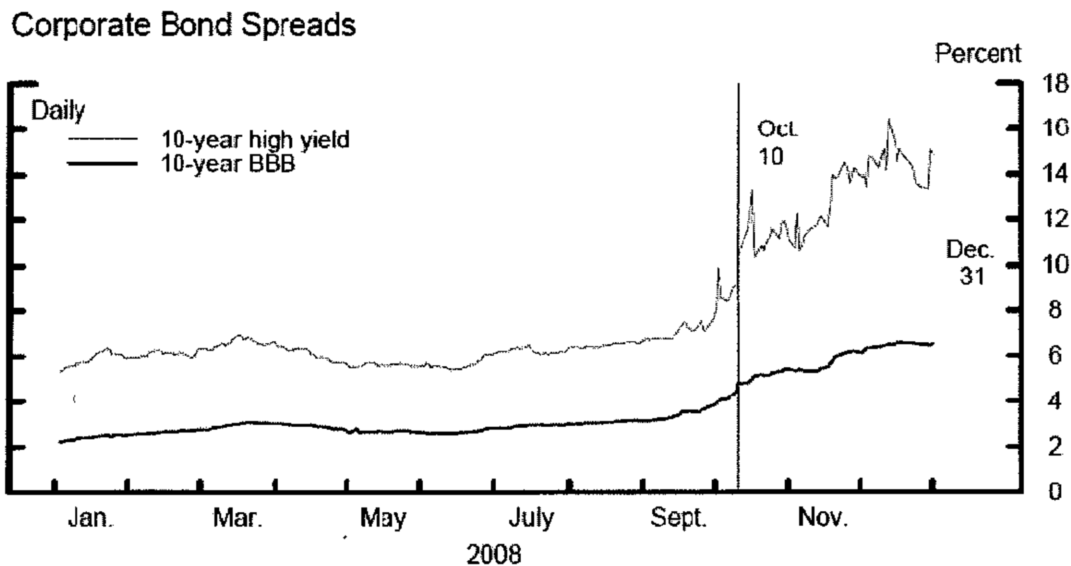


Note: October 10 is the business day before the CPP was announced.
Source: Markit

The lower LIBOR and CDS spreads during the quarterly period reflected that investors had become less fearful of a series of financial institution failures and required less compensation for holding the debt securities of these financial institutions. By providing capital to financially viable institutions, the CPP has supported balance sheets and helped ease the pressures on them to deleverage and restrict credit. Moreover, rating agencies have indicated that the CPP injections have generally been a significant positive factor in their assessment of the creditworthiness of the financial institutions they rate.

The financial market indicators discussed above likely understate the beneficial effects of the TARP, as these effects have occurred despite the fact that underlying economic conditions have deteriorated for reasons unrelated to the TARP since the CPP and other TARP actions were implemented. The sharp rise in risk spreads on corporate bonds since mid-October is indicative of the greater perceived risk and higher risk premiums required by investors who have a weaker outlook for the economy (Fig. 4). While the rate of decline on stock prices moderated on the announcement of the CPP and other measures, stock prices have continued to hover at their low levels, and implied equity risk premiums have risen from already extraordinarily high levels. These higher risk premia strongly suggest a significant weakening in underlying economic conditions. To be sure, one cannot know with certainty what conditions would have been without the TARP programs. Nonetheless, the case for there having been a positive effect is strengthened by the fact that underlying economic conditions have deteriorated since the CPP and other TARP actions were implemented.

Figure 4



Note: Spread to comparable-maturity Treasury securities.

But not all of the improvements can be attributed to TARP. The FDIC's expanded guarantees on liabilities of banks and banking organizations contributed importantly to stabilizing financial markets. In addition, at about the same time the CPP was announced, the Federal Reserve announced measures to improve liquidity and funding in the CP market, including the Commercial Paper Funding Facility (CPFF), which appears to have led to significant improvements in the commercial paper market. In particular, amounts outstanding of financial CP and asset-backed commercial paper (ABCP), which had dropped in September and October, have retraced the losses (Fig. 5). Yields on highly-rated commercial paper and ABCP have declined, though spreads for unsecured lower-rated paper remain elevated (Fig. 6).

Figure 5

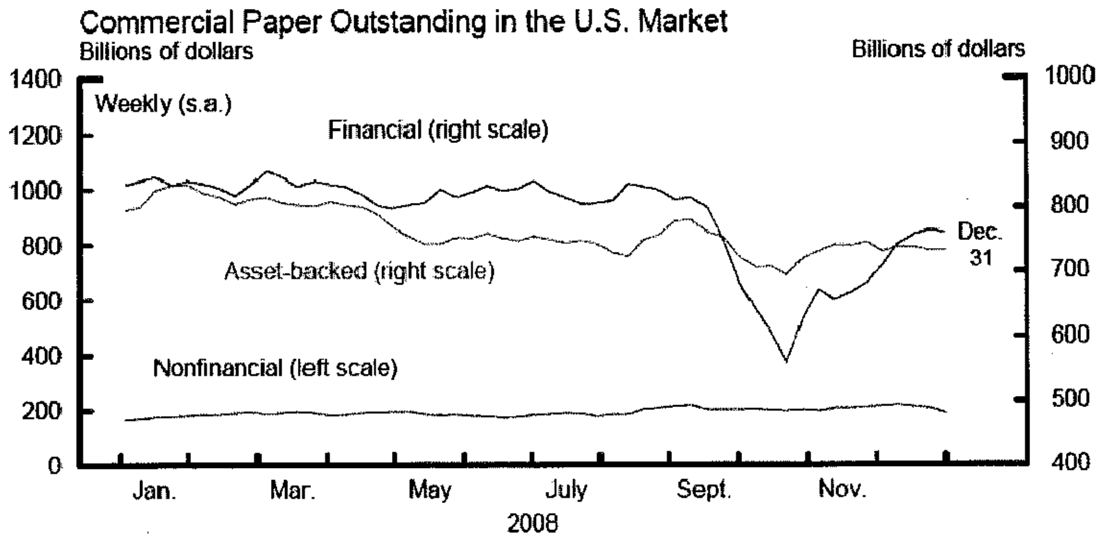
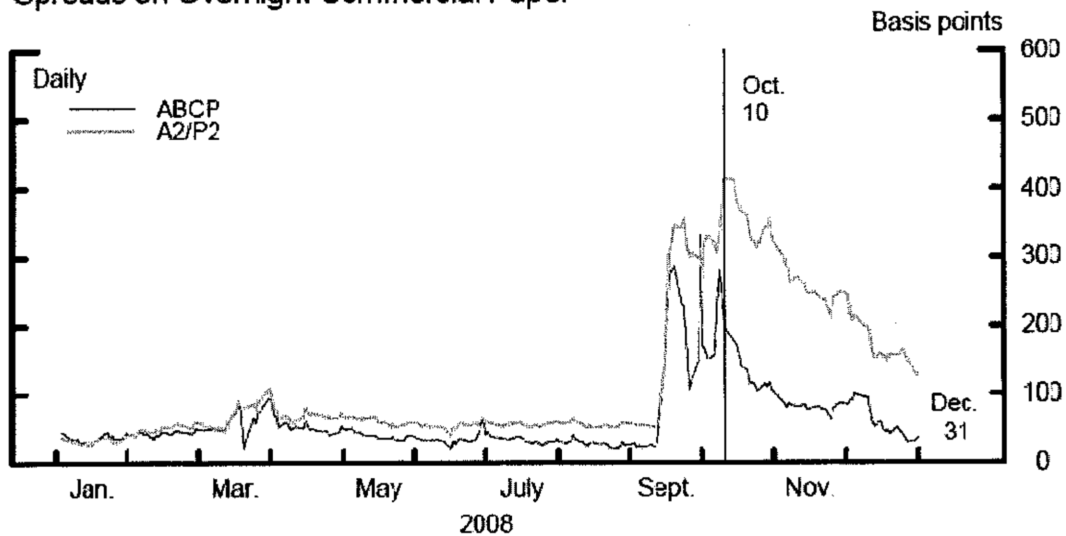


Figure 6



The CDS for Citigroup, after having dropped initially on the CPP injection in October, rose in November after Citigroup brought onto its balance sheet some financing vehicles it sponsored, but receded after TARP provided additional capital and the government provided insurance on a ring-fenced pool of Citigroup's assets (Fig. 7). CDS for AIG also show a considerable decline after receiving capital from TARP along with a restructuring of the credit facilities provided by the Federal Reserve (Fig. 8).

Figure 7

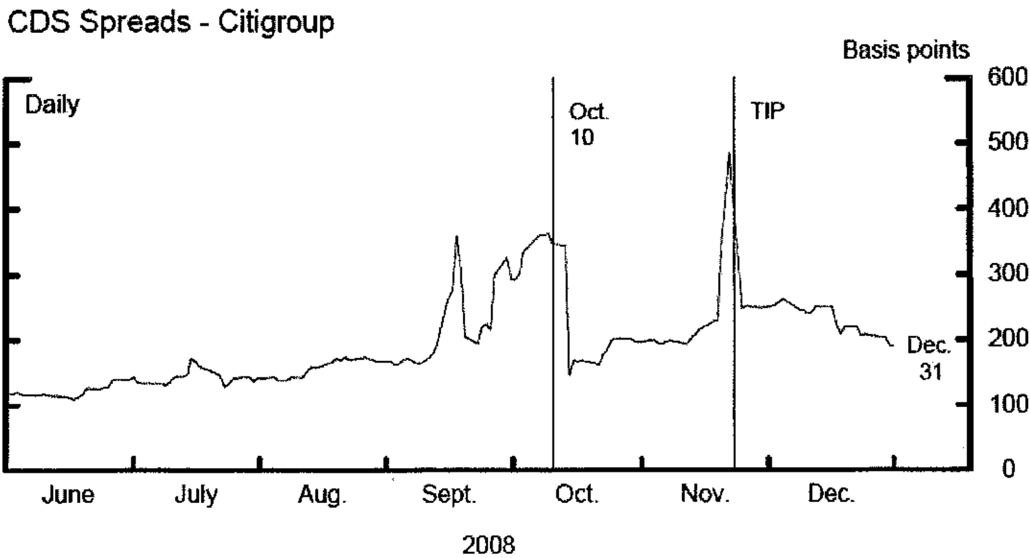
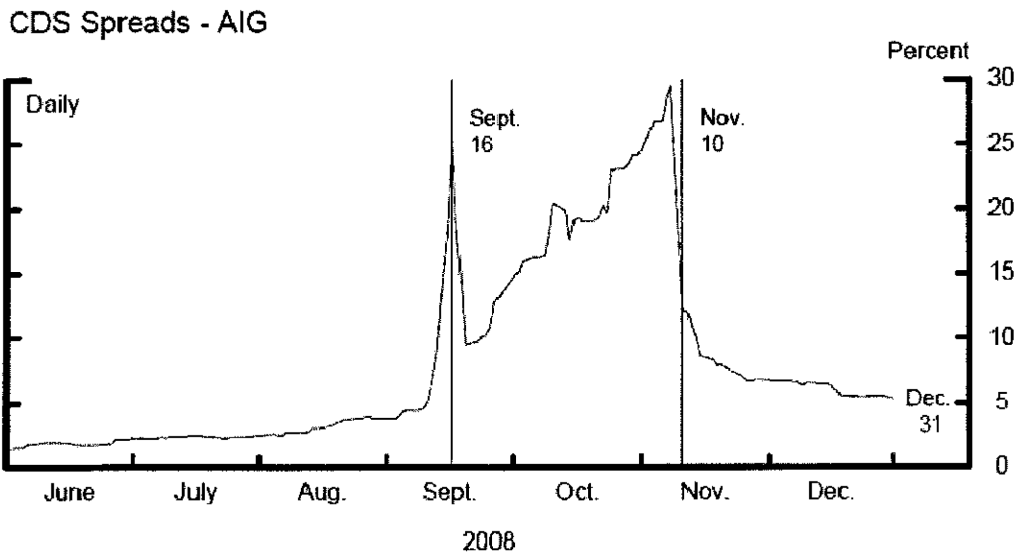


Figure 8



Treasury provided financing to GM and Chrysler to help stave off a disorderly bankruptcy filing by these firms, which could have increased losses on the substantial amount of their debt that is widely distributed among investors, and could have required immediate cuts in employees at these firms, as well as at related businesses, such as auto dealers and parts suppliers. As a condition for receiving funds, the companies are

required to submit plans to achieve long-term viability. GMAC received capital from the TARP in late December after the Federal Reserve Board approved its application to become a bank holding company. Financial markets received these developments positively: prices on GMAC bonds jumped on the news about the change in GMAC's status and the Treasury support, and GM's bond and stock prices also moved up in late December and early January. TARP has assisted GM and Chrysler to continue to operate and provide jobs while pursuing the restructuring of their businesses and financial commitments, and has assisted GMAC in continuing to provide credit to consumers and business, including small businesses, and fulfill its mortgage servicing obligations.

Prices of financial assets and conditions in financial markets provide an important perspective of the effects of the actions taken under EESA. The effects to date appear to have been notably positive, especially given that risk premiums for many nonfinancial assets have continued to rise as economic conditions have weakened, and the desire by financial institutions to hoard liquidity has remained strong. A stronger and more stable financial system is a critical first step toward the resumption of more normal conditions. An important next step is to restore more normal credit availability to ensure that banks are meeting the needs of creditworthy borrowers. In a joint statement on November 12, 2008, the federal banking regulators strongly encouraged examiners to work constructively with banks as they perform the careful analysis needed to identify sound lending opportunities.

In the past, borrowing by households and nonfinancial businesses has tended to slow significantly in periods of economic weakness because demand for credit slackens along with spending on investment and consumption and because financial institutions typically tighten lending standards and terms (Fig. 9). Indeed, since 1953, the growth rate of debt owed by households and nonfinancial businesses has fallen, on average, about 4 percentage points in the year following a business cycle peak (as dated by the National Bureau of Economic Research (NBER)). From the NBER-designated peak in the fourth quarter of 2007 to the third quarter of 2008, debt growth for households and nonfinancial businesses was more than 8 percentage points slower than in the previous year (Fig. 10). This sharper-than-average deceleration in debt growth reflects the more acute financial stresses in the current macroeconomic downturn.

Figure 9

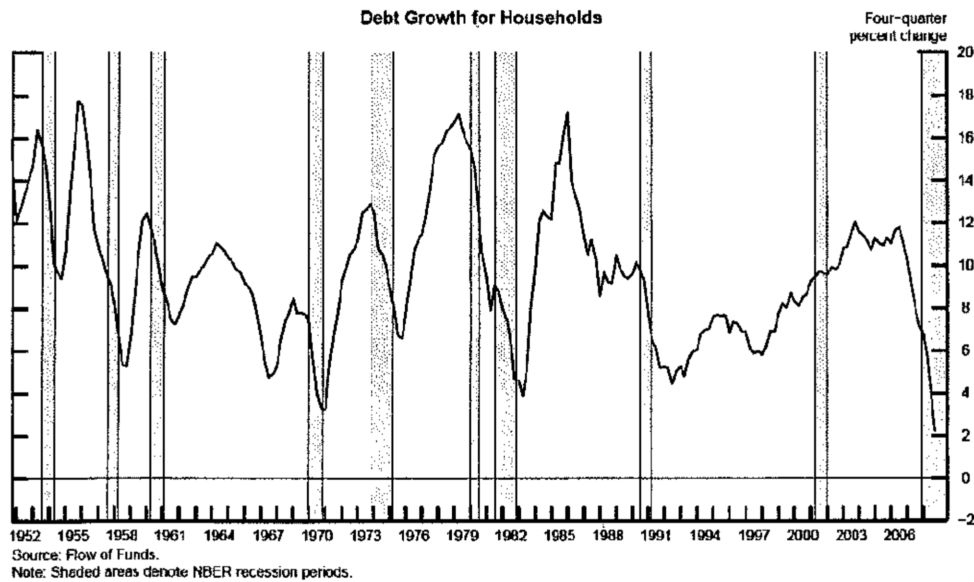
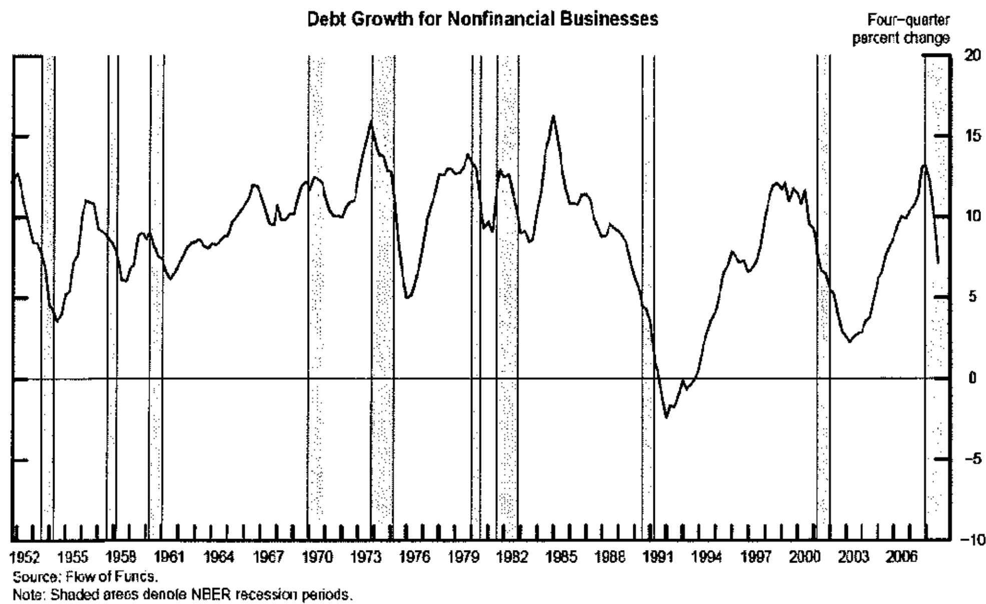


Figure 10



Banks and thrifts are an important source of direct credit to households and nonfinancial businesses. Direct lending by banks and thrifts to businesses and households has decelerated by an average of 5-3/4 percentage points in the first year of the nine recessions since 1953. From the fourth quarter of 2007 to the third quarter of 2008, the annualized growth rate of loans from banks and thrifts to households and nonfinancial businesses was nearly 9 percentage points slower than the previous year's pace. But the significance of banks in the provision of credit extends beyond their direct loans. Banks indirectly provide credit by providing back-up liquidity and credit support

to other financial institutions and conduits that also intermediate credit flows. For many types of credit, including credit cards and auto loans, these other sources have provided more funding in recent years than have banks.

Complete data on bank loan growth in the fourth quarter will not be available until the fourth-quarter Call Reports are released, but data from a weekly survey of banks summarized in the Federal Reserve's H.8 Statistical Release provide some preliminary information.[22] According to data from the H.8 (adjusted for sizable mergers between banks and nonbanks), total loans outstanding at commercial banks rose modestly in the fourth quarter of 2008 at about a 3 percent annual rate, about the same rate as in the third quarter, but significantly below that in the first half of this year. Importantly, some of the loan growth in recent quarters reflects loans drawn under pre-existing lending commitments arranged in previous periods. Commercial and industrial (C&I) loans grew at about an 18 percent annual rate in the fourth quarter as nonfinancial businesses reportedly drew heavily on back-up lines and letters of credit at banks, in part, because the availability of other sources of funding, such as CP, were severely limited in October. C&I loans then declined in November and December. Revolving home equity lines of credit at banks continued to expand at a rapid 14 percent pace in the fourth quarter. In contrast, commercial real estate loans outstanding increased slowly in the fourth quarter and residential mortgages held by banks declined. The slowdown in mortgage lending likely reflected, in part, the tighter lending standards on these loans reported by banks. Overall, bank lending would be expected to be weak in the current environment in light of the very weak economic outlook and the reduced demand for loans from both businesses and households reported by banks in Federal Reserve surveys.

The Oversight Board continues to monitor the work by Treasury, in conjunction with the federal banking agencies, to develop meaningful ways to assess the effect of the CPP funds on credit availability and lending activity. As noted above, lending generally declines in periods of weakness, so any efforts to measure the effect of the CPP needs to control for what would typically be expected. Additionally, as institutions return to more prudent and sustainable underwriting standards and risk premia return to more normal parameters, it is reasonable to see lower aggregate demand for loans. Areas of analysis under active consideration include:

- Filtering quarterly Call Report data on changes in loans outstanding at firms that received CPP funds.

- Polling for additional monthly information on lending from some subset of institutions that received CPP funds.

[22] The growth rates reported in this paragraph have been adjusted to remove the effects of sizable acquisitions of assets as a result of merger and other structure activity involving banks and nonbanks. Such activity is described in the notes to the Federal Reserve's H.8 Release.

As mentioned earlier, measuring the effectiveness of the CPP program on lending and credit availability will be challenging for several reasons. On a conceptual level, a number of other significant government initiatives aimed at strengthening the financial system and financial institutions were introduced at around the same time, making it difficult to isolate the effect of any one of them. Further, the pace of new lending activity will be affected by the fact that underlying economic conditions have deteriorated significantly in the months since the CPP was announced, and as a result, overall demand for credit from both businesses and households is reportedly weak. Even in more normal conditions, it is difficult to differentiate the effects of weaker demand versus tighter supply on slower loan growth.

There will also be practical challenges associated with developing robust measures of the program's effectiveness. Financial statements now produced by depository institutions and holding companies, including regulatory reports, show the amount of loans outstanding on the balance sheets at the end of each quarter. Simply comparing the change in these outstanding balances from one quarter to the next does not necessarily provide a good measure of new loan originations. Some new loans, for example, will be draw-downs under pre-existing commitments, other loans will have been securitized and sold, and would therefore not be reflected in balance sheet outstandings even though new credit had been extended. Still others will come due that borrowers have no interest in renewing, even though banks may have been willing to renew such loans. Moreover, comparisons of changes in loans outstanding between firms that received CPP funds and those that did not could be misleading; firms that chose to apply for CPP funds because they expected deterioration in the quality of their existing loans may find fewer prudent yet profitable lending opportunities within some or all of the product and geographic segments they serve.

A final challenge is the inherent difficulty of identifying the use of particular funds given that all monies are fungible. In that regard, one can monitor uses and sources of funds, but may not be able to conclude whether CPP funds were specifically used to increase lending or expand the availability of credit. Despite the many challenges, the Oversight Board will continue its efforts to monitor the TARP and provide to the Congress and the public the clearest possible assessment of TARP's effects.

c. Early assessment of the effects of the TARP on the housing markets

In light of the continuing challenges in the housing and mortgages markets, the Oversight Board has monitored the impact of the TARP on these challenges. The Oversight Board believes that the CPP and related actions initiated by the Treasury as well as the other programs in which the TARP participates (such as the Federal Reserve's TALF facility) have served as essential prerequisites to a return to economic health of both the nation's housing and mortgage markets. By providing capital assistance to numerous financial institutions, the TARP has played a key role in stabilizing the financial system at a critical juncture, helping to ensure that homeowners, businesses and communities continue to have access to credit. The positive impact on interest rates and credit spreads described in this report means that such credit is also more affordable, and

should stimulate demand for credit at a time of recessionary pressures in both housing and mortgage markets. The Oversight Board also believes that lower mortgages rates should allow more homeowners to refinance into new mortgages. For many homeowners this will permit exit from currently held risky or unaffordable mortgages. In addition, as discussed in Part IV, the package of assistance provided by the Treasury under the TARP, the FDIC and the Federal Reserve to Citigroup requires that Citigroup follow an agreed-upon protocol for the streamlined modification of mortgages held by delinquent, at-risk borrowers.

The Oversight Board expects to continue to monitor closely the state of the housing and mortgage markets, the activities of the TARP, and the housing-related programs and actions of other government and private market participants. The Oversight Board has and will continue to provide Treasury with perspectives on the need for and impact of the TARP on these markets and additional actions or programs which may be appropriate. In this regard, the Treasury, HUD and the Federal Reserve Board also are represented on the Board of Directors for the HOPE for Homeowners program, which is aimed at providing a meaningful alternative to foreclosure for homeowners struggling to make their payments.

The arrival of the new Administration next week will result in a careful review of how additional TARP resources can be used to further EESA's objectives. While much has been accomplished, more work remains. Among areas that the new Administration may wish to consider are: providing additional support for sustainable loan modifications for at-risk borrowers; the state of private mortgage insurance companies, which provide first-loss credit insurance on low down-payment mortgages purchased by Fannie Mae and Freddie Mac; asset purchases of mortgage-related assets, such as private-label mortgage-backed securities; liquidity for mortgage servicers; and possible support for affordable multifamily housing finance and mortgage financings undertaken by state and local housing finance agencies.

During the quarterly period, the Oversight Board also has reviewed and considered efforts underway at the Treasury and other federal agencies to assist American families in preserving homeownership. For example, the Treasury has worked directly with other agencies represented on the Oversight Board in developing and implementing plans to avoid foreclosures and help families preserve homeownership. This section highlights key aspects of these efforts and provides a brief summary of housing and mortgage market conditions of relevance to the goals of the EESA. Agencies represented on the Oversight Board have developed and reported on these conditions to the Treasury and the rest of the Oversight Board, and it is expected that they will continue to do so over time.

The Treasury and HUD assisted in the organization of HOPE NOW, the private sector alliance of mortgage servicers, counselors, and investors, created in July of 2007 to respond to the problem of rising mortgage defaults and foreclosures. The HOPE NOW alliance reported that the mortgage lending industry intervened to prevent 225,000 foreclosures in October 2008 alone, and assisted 1.7 million homeowners in the first 10

months of 2008. If the current trend continues, the mortgage lending industry will have prevented more than 2.2 million foreclosures in 2008, 45 percent more than in 2007. Since July 2007, almost 2.7 million foreclosures have been prevented.

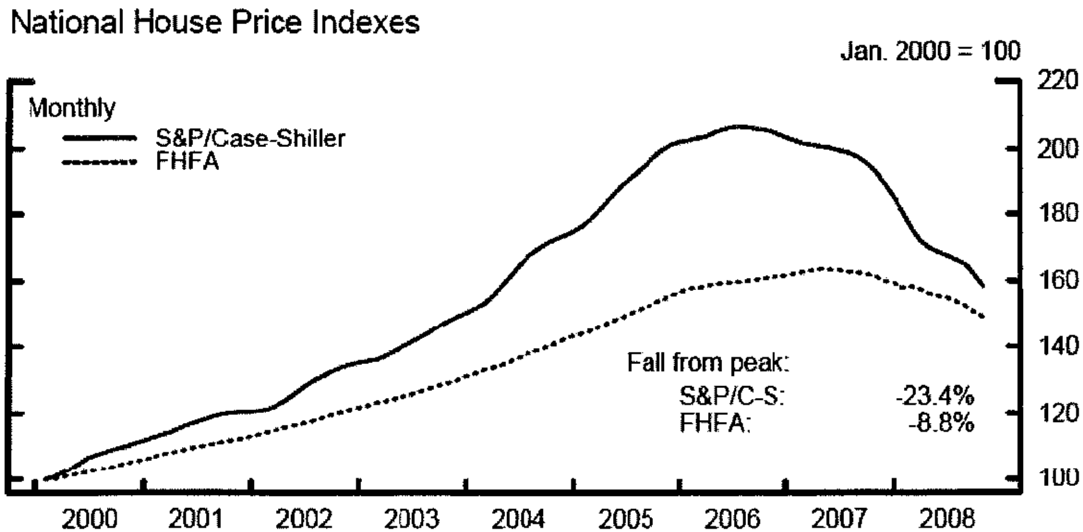
On November 11, 2008, the FHFA, along with the Treasury, HUD, and HOPE NOW, announced a streamlined modification program (SMP) to complement existing loss mitigation programs of participating lenders/servicers. Participants are Fannie Mae, Freddie Mac, and a majority of HOPE NOW portfolio lenders. The program was launched on December 15th. Eligible borrowers must be 90 days or more past due and can be in foreclosure but not in bankruptcy. The property must be a single-family unit and the borrower must be an owner-occupant. The goal of the program is to modify the existing loan to one that has a monthly housing payment that is no more than 38 percent of the borrower's monthly gross household income. The modification can be done through extending the term of the loan, lowering the interest rate, and/or forbearing principal. All outstanding late fees will be waived. Additionally, the borrower's current loan-to-value must be 90 percent or higher, and escrows for real estate taxes and homeowners' insurance must be set up if they are not currently escrowed. Finally, before the modification documents are signed, the borrower must make 3 payments within 90 days at the new modified payment level and be current on day 90.

Difficulties with wide-scale attempts to mitigate foreclosures are due in part to the large share of mortgages in private label securitizations (PLS), which typically puts servicing in the hands of a third-party servicer rather than a lender. The PLS agreements may restrict the amount or type of loan modifications, but more generally the rules under which servicers operate do not always provide clear guidance or the appropriate incentives to undertake economically sensible modifications. Seriously delinquent single-family mortgages are concentrated in pools that have been financed with PLS. That was the favored means of financing subprime and Alternative-A loans during the mortgage credit boom. An additional complication is that many nonprime loans originated between 2005 and 2007 used piggy-back second liens to finance down payments. Thus, negotiations to avoid foreclosure often must also involve second-lien holders. As described below, mortgages financed with PLS account for the majority of all seriously delinquent mortgages.

The actions described above were taken to help address the significant rise of mortgage delinquencies brought on, in part, by the broad-based decline in house prices. Prices of single-family homes continue to fall sharply at the national level, and in most areas of the country (Fig. 11). National indexes show that overall home price depreciation has been severe, based on repeat sales house price indexes. The FHFA index is constructed using homes with conforming, conventional mortgages that have been purchased or guaranteed by Fannie Mae or Freddie Mac (the "Enterprises"). The S&P/Case-Shiller index, by contrast, covers home sales with all types of financing - including cash sales, and transactions with jumbo and subprime mortgages - but has less complete geographic coverage than does the FHFA index. According to these measures, over the latest 12 months ending October 2008, price declines were between 7.5 percent and 18.0 percent. That would put total peak-to-current declines at between 8.8 (FHFA

index) and 23.4 percent (S&P/Case-Shiller Index). House price trends continue to vary dramatically by state and locality. The hardest-hit states remain primarily those that had experienced large boom-period run-ups (California, Nevada, Arizona, and Florida). Michigan continues to suffer sizable price drops as well, due to high and growing unemployment.

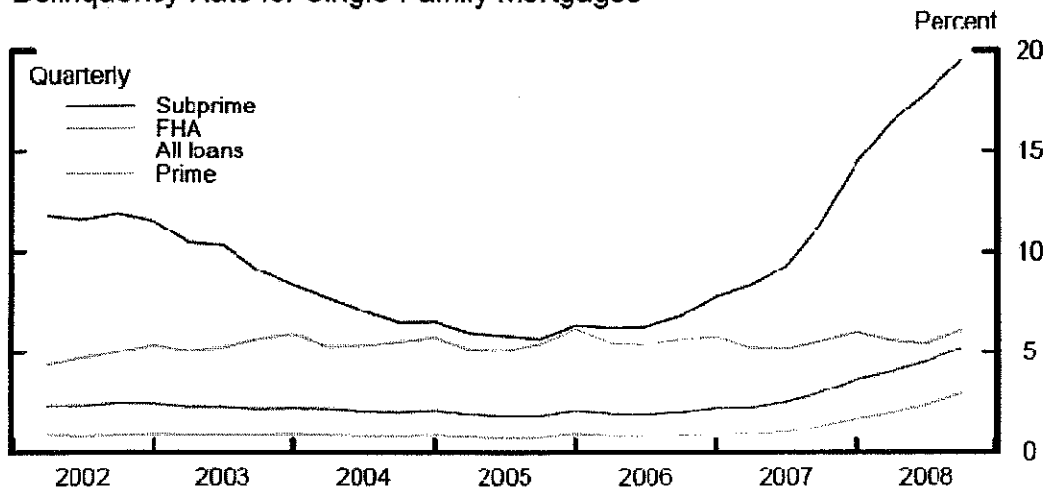
Figure 11



Source: FHFA National House Price Index and S&P/Case-Shiller 20-City Composite Index.

Delinquency rates on single-family first-lien mortgages have risen dramatically since the beginning of 2007. Although the performance of all categories of mortgage loans has deteriorated, delinquencies have risen most dramatically for subprime mortgages, which frequently carry adjustable rates that reset after a few years, exposing borrowers to substantial payment shock if they cannot refinance their loans. Refinancing such loans became more difficult starting in 2007, as home prices were falling, securitizations of subprime mortgages shut down, and credit conditions more generally tightened. The trend of rising delinquencies has continued through the third quarter of 2008, when there were significant further increases in the serious delinquency rate for all types of mortgages (Fig. 12). That rate includes all loans 90 days or more delinquent or in foreclosure processing.

Figure 12

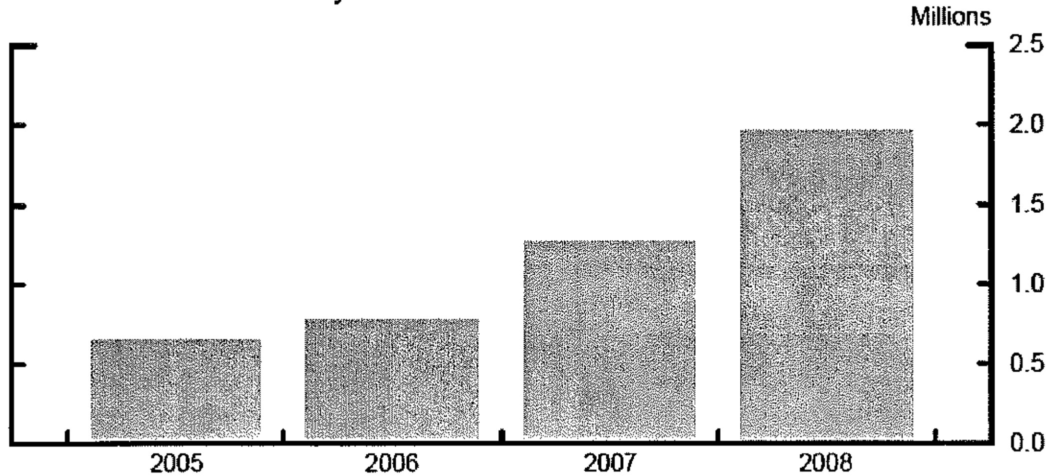


Sources: MBA National Delinquency Survey.

Subprime and near-prime mortgages originated during the mortgage credit boom were financed primarily with PLS, and those securities have a disproportionate share of seriously delinquent single-family mortgages. Freddie Mac estimates that, at the end of the third quarter of 2008, 16 percent of all outstanding single-family mortgages were financed with PLS, but those loans accounted for 62 percent of all seriously delinquent mortgages. In contrast, at that time Freddie Mac and Fannie Mae owned or guaranteed 56 percent of all outstanding single-family mortgages, but those loans accounted for only 19 percent of serious delinquencies.

The Mortgage Bankers Association (MBA) reports that more than half a million foreclosure actions were started in each of the first three quarters of 2008 (Fig. 13). Although the various available measures of foreclosures-in-process differ from each other, they all indicate significant increases in the number of foreclosure actions begun in 2008. High levels of foreclosures continue to be a major driver of house price depreciation. House price measures, particularly the S&P/Case-Shiller, would include such sales and reflect the discounts normally made to sell houses that have been through foreclosure.

Figure 13



Source: Mortgage Bankers Association. Estimate for 2008 assumes the rate of foreclosure starts in the third quarter of 2008 was unchanged in the fourth quarter.

On the plus side, recent actions taken by the Federal Reserve, including its purchase program of agency debt and mortgage-backed securities announced on November 25, 2008, have reduced the size of the potential foreclosure problem by keeping short-term interest rates low. Long-term mortgage interest rates also are at historic lows as they approach 5 percent. Low short-term rates mitigate the problem of rate-and-payment resets on adjustable-rate mortgages, and low long-term rates permits many homeowners to secure lower-cost financing for their homes.

Continuing home price declines and deteriorating loan quality combined with broader financial market dislocation and economic weakness led to a reduction in the volume of new mortgage lending, particularly in securitization markets. Issuance of private-label MBS through November 2008 was down 93 percent from the first eleven months of 2007. Mortgage originations with some form of government support have held up much better. Issuance of MBS guaranteed by Fannie Mae and Freddie Mac through November 2008 is slightly below 2007 issuance volume, while issuance of MBS guaranteed by Ginnie Mae is nearly triple the level of 2007.

FHA insurance in FY 2008 covered $181 billion of mortgages, compared with only $53 billion in FY 2006. Estimates produced by HUD indicate that FHA insurance in FY 2009 are likely to be close to $300 billion, based upon current market shares. Part of the recent growth in FHA insurance market share increase and the Enterprises' decreases has been the result of restrictions at the private mortgage insurers. As the Enterprises cannot make loans with loan-to-value ratios above 80 percent, without obtaining credit enhancement, they have relied on mortgage insurers for such loans.

APPENDIX A

Minutes of Financial Stability Oversight Board Meetings
During the Quarterly Period

Minutes of the Financial Stability Oversight Board Meeting October 7, 2008

The initial meeting of the Financial Stability Oversight Board ("Board") was held at the offices of the United States Department of the Treasury ("Treasury") on Tuesday, October 7, 2008, at 2:15 p.m. (EDT).

MEMBERS PRESENT:

Mr. Bernanke
Mr. Paulson
Mr. Cox
Mr. Preston
Mr. Lockhart

AGENCY STAFF PRESENT:

Mr. Kashkari, Interim Assistant Secretary of the Treasury for Financial Stability and Assistant Secretary of the Treasury for International Economics and Development

Mr. Hoyt, General Counsel, Department of the Treasury

Mr. Laughton, Senior Counsel, Department of the Treasury

Mr. Wilcox, Deputy Director, Division of Research and Statistics, Board of Governors of the Federal Reserve System

Mr. Covitz, Assistant Director, Division of Research and Statistics, Board of Governors of the Federal Reserve System

Mr. Fallon, Assistant General Counsel, Board of Governors of the Federal Reserve System

Mr. Cartwright, General Counsel, Securities and Exchange Commission

Mr. Sirri, Director, Division of Trading and Markets, Securities and Exchange Commission

Mr. Montgomery, Assistant Secretary for Housing and Commissioner of the Federal Housing Administration, Department of Housing and Urban Development

Mr. Borchert, Senior Advisor to the Secretary of the Department of Housing and Urban Development

Mr. DeMarco, Chief Operating Officer and Deputy Director for Housing Goals and Mission, Federal Housing Finance Agency

The meeting was called to Order by Mr. Paulson.

A discussion among the Members ensued regarding the governance and potential staffing needs of the Board. Using materials provided in advance of the meeting, Mr. Hoyt then reviewed the terms of the proposed bylaws for the Board. Following a discussion of the proposed bylaws, the Members adopted the following resolution:

RESOLUTION TO ADOPT BYLAWS

"Whereas, there is presented to the Board, Bylaws that describe the organizational structure of the Board and establish the general operational procedures by which the Board will carry out its oversight functions and duties,

Therefore, after discussion among the Board members and on motion duly made, seconded and unanimously carried, it was

Resolved, that the Board approve and adopt the Bylaws as presented to the Board."

A discussion then occurred regarding the position of Chairperson of the Board. Following this discussion, the Board, with Mr. Bernanke abstaining, adopted the following resolution:

RESOLUTION TO ELECT A CHAIRPERSON

"Whereas, Section 104 of the Emergency Economic Stabilization Act of 2008 provides for the election by members of the Financial Stability Oversight Board (Board) of a Chairperson from among the members of the Board other than the Secretary of the Treasury,

Therefore, after discussion among the Board members and on motion duly made, seconded and carried, it was

Resolved, that the Chairman of the Board of Governors of the Federal Reserve System, Mr. Bernanke, is hereby elected Chairperson of the Board."

Mr. Paulson and other officials of the Treasury, using materials provided, then briefed the Board with respect to the steps that Treasury had taken and proposed to take to implement the Troubled Asset Relief Program ("TARP") and related provisions of the Emergency Economic Stabilization Act of 2008 ("EESA") to help promote stability in the U.S. financial system. A discussion among Treasury officials and Members of the Board ensued concerning the types of programs that Treasury planned to implement under the TARP, as well as the potential ability of the TARP to provide capital to financial institutions. Members and staff also discussed expected operations, policies procedures and systems to ensure compliance with the requirements of the EESA and potential policies governing executive compensation and the prevention of avoidable foreclosures. In addition, Members and staff discussed the progress being made by Treasury in identifying and hiring officers for the TARP, as well as the development of requests for proposals and the selection of financial agents and contractors for the TARP, including investment management advisers, custodians, asset managers, and accounting firms.

The meeting was adjourned at approximately 3:15 pm (EDT).

[Signed Electronically]

Jason A. Gonzalez
Secretary

Minutes of the Financial Stability Oversight Board Meeting
October 13, 2008

A meeting of the Financial Stability Oversight Board was held telephonically on Monday, October 13, 2008, at 11:30 a.m. (EDT).

MEMBERS PARTICIPATING BY TELEPHONE:

Mr. Bernanke, Chairperson
Mr. Paulson
Mr. Cox
Mr. Preston

AGENCY STAFF PARTICIPATING BY TELEPHONE:

Mr. Kashkari, Interim Assistant Secretary of the Treasury for Financial Stability and Assistant Secretary of the Treasury for International Economics and Development

Mr. Nason, Assistant Secretary for Financial Institutions, Department of the Treasury

Mr. Hoyt, General Counsel, Department of the Treasury

Mr. Jester, Department of the Treasury

Mr. Alvarez, General Counsel, Board of Governors of the Federal Reserve System

Mr. Wilcox, Deputy Director, Division or Research and Statistics, Board of Governors of the Federal Reserve System

Mr. Fallon, Assistant General Counsel, Board of Governors of the Federal Reserve System

Mr. DeMarco, Chief Operating Officer and Deputy Director for Housing Goals and Mission, Federal Housing Finance Agency

Mr. Borchert, Senior Advisor to the Secretary of the Department of Housing and Urban Development

The meeting was called to Order by the Chairperson.

Officials from the United States Department of the Treasury ("Treasury") provided the Oversight Board with an overview of the capital purchase program that the Treasury proposed to establish under the Troubled Assets Relief Program ("TARP"). Using materials provided, Treasury officials generally reviewed, among other things, the types of institutions that would be eligible to participate in the capital purchase program, the proposed aggregate size of the program and the types, terms and conditions of the securities that the Treasury would acquire under the program. Consistent with the provisions of the Emergency Economic Stabilization Act of 2008 ("EESA"), the officials reported that Mr. Paulson, in consultation with Mr. Bernanke, expected to determine that the purchase by the Treasury of the equity and other securities to be issued by financial institutions under the capital purchase program is necessary to promote financial market stability.

Treasury officials also provided the Oversight Board with an overview of how the Treasury proposed to implement the executive compensation limitations and restrictions in section 111 of EESA for institutions that participate in the capital purchase program.

Using documentation provided, Treasury officials also provided the Oversight Board with an overview of additional potential actions that might be taken by the Secretary of the Treasury, the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation ("FDIC") to complement the capital purchase program and help promote financial stability. These actions included the potential guarantee by the FDIC of certain uninsured deposit liabilities of insured depository institutions and certain senior unsecured debt obligations of insured depository institutions and qualifying holding companies of such institutions.

Following these presentations, Mr. Bernanke noted that the Federal Reserve Board expected to announce soon approval of a new commercial paper funding facility that would help dislocations in the commercial paper market. Mr. Bernanke also noted that the programs being developed in the United States were generally consistent with the principles developed by the G-7 countries over the previous days during the annual meeting of the International Monetary Fund. Mr. Bernanke and Mr. Paulson also provided Members an update on recent developments in Europe with respect to the condition of European financial institutions and the actions that European authorities were planning on taking to promote financial stability.

A discussion among the Members then ensued regarding the objectives, terms and expected impact of the proposed capital purchase program and related proposals. Members discussed the expected level of participation by financial institutions in the proposed capital purchase program, the amount of funding that would remain available under the TARP for other programs, the relationship between the TARP and the guarantee program that might be implemented by the FDIC, and the process for briefing the appropriate committees and members of Congress regarding the proposed capital purchase program. In addition, Members discussed the terms of the investments that would be made by the Treasury under the capital purchase program, including the types of capital instruments that would be acquired by the Treasury and the voting and dividend rights associated with the proposed instruments. Members also discussed the potential impact of the programs on financial institutions and financial markets, including money market mutual funds and government-sponsored enterprises.

During this discussion, representatives from the Treasury indicated that Treasury was continuing to move forward with other TARP-related programs focused on troubled mortgage-related assets.

The meeting was adjourned at approximately 12:15 p.m. (EDT).

[Signed Electronically]

Jason A. Gonzalez
Secretary

Minutes of the Financial Stability Oversight Board Meeting October 22, 2008

A meeting of the Financial Stability Oversight Board ("Board") was held at the offices of the United States Department of the Treasury ("Treasury") on Wednesday, October 22, 2008, at 11:00 a.m. (EDT).

MEMBERS PRESENT:

Mr. Bernanke, Chairperson
Mr. Paulson
Mr. Cox
Mr. Preston
Mr. Lockhart

STAFF PRESENT:

Mr. Treacy, Executive Director
Mr. Fallon, General Counsel
Mr. Gonzalez, Secretary

AGENCY OFFICIALS PRESENT:

Mr. Kashkari, Interim Assistant Secretary of the Treasury for Financial Stability and Assistant Secretary of the Treasury for International Economics and Development

Mr. Hoyt, General Counsel, Department of the Treasury

Mr. Swagel, Assistant Secretary for Economic Policy, Department of the Treasury

Mr. Wilcox, Deputy Director, Division of Research and Statistics, Board of Governors of the Federal Reserve System

Mr. Cartwright, General Counsel, Securities and Exchange Commission

Mr. Sirri, Director, Division of Trading and Markets, Securities and Exchange Commission

Mr. Kroeker, Deputy Chief Accountant for Accounting, Office of the Chief Accountant, Securities and Exchange Commission

Mr. Montgomery, Assistant Secretary for Housing and Commissioner of the Federal Housing Administration, Department of Housing and Urban Development

Mr. Borchert, Senior Advisor to the Secretary of the Department of Housing and Urban Development

Mr. DeMarco, Chief Operating Officer and Deputy Director for Housing Mission and Goals, Federal Housing Finance Agency

GUESTS PRESENT FOR A PORTION OF THE MEETING:

Ms. Bair, Chairperson, Federal Deposit Insurance Corporation

Ms. McInerney, Deputy General Counsel, Federal Deposit Insurance Corporation

Mr. Brown, Associate Director, Division of Insurance and Research, Federal Deposit Insurance Corporation

Chairperson Bernanke called the meeting to order at 11:05 am (EDT).

The Board first considered draft minutes for the meetings of the Board on October 7, and October 13, 2008, which had been circulated in advance of the meeting. Following a discussion of the minutes, and upon a motion duly made and seconded, the Members unanimously voted to approve the minutes of the meetings held on October 7, and October 13, 2008, subject to such technical amendments as may be received from the Members.

Using written materials provided in advance of the meeting, Chairperson Bernanke then discussed the proposal to adopt amended and restated bylaws for the Board. Chairperson Bernanke indicated that the only change proposed to the bylaws would allow appointment of an Executive Director and a General Counsel of the Board, in addition to the currently authorized position of Secretary, to assist the Board in fulfilling its responsibilities. Following a discussion of the proposed bylaws, the Members unanimously adopted the following resolution:

RESOLUTION TO ADOPT AMENDED AND RESTATED BYLAWS

"Whereas, there is presented to the Board, Amended and Restated Bylaws that describe the organizational structure of the Board and establish the general operational procedures by which the Board will carry out its oversight functions and duties,

Therefore, after discussion among the Board Members and on motion duly made, seconded and unanimously carried, it was:

Resolved, that the Board approve and adopt the Amended and Restated Bylaws as presented to the Board."

Chairperson Bernanke then discussed his intention to appoint William J. Treacy, Kieran J. Fallon and Jason A. Gonzalez to fill the positions of Executive Director, General Counsel and Secretary of the Board, respectively. Information concerning the proposed individuals had been circulated in advance of the meeting. At the Chairperson's request and without objection, the following statement was entered into the record:

STATEMENT BY THE CHAIRPERSON TO APPOINT STAFF OF THE FINANCIAL STABILITY OVERSIGHT BOARD

"I hereby appoint the following individuals to the staff positions of the Financial Stability Oversight Board, as authorized by the Amended and Restated Bylaws of the Oversight Board:

William F. Treacy, as Executive Director of the Board;

Kieran J. Fallon, as General Counsel of the Board; and

Jason A. Gonzalez, as Secretary of the Board."

Mr. Paulson and other Treasury officials, using materials circulated at the meeting, then provided a briefing concerning recent and proposed actions by Treasury under the Troubled Asset Relief Program ("TARP") and related

provisions of the Emergency Economic Stabilization Act of 2008 ("EESA") to help promote stability in the U.S. financial system. Throughout this briefing, Members discussed various aspects of the TARP and Treasury's progress in implementing the TARP.

The briefing and discussion initially focused on the capital purchase program established by Treasury under the TARP to provide financial stability and increase the flow of financing to U.S. businesses and consumers. Treasury officials described the status and likely timing of the capital purchases under the program, recent vendor hirings to assist in the implementation of the program, and the efforts by Treasury to establish the terms under which privately held financial institutions and institutions organized as S-corporations or in mutual form could participate in the program. Treasury officials also described the manner in which the executive compensation provisions of the EESA were being applied to institutions participating in the capital purchase program. In addition, Members discussed the potential for widening the classes of financial institutions eligible to participate in the capital purchase program.

The briefing and discussion then turned to the purchase programs under development for mortgage-backed securities ("MBS") and whole loans, including the types of assets that would be the most effective for the TARP to purchase and the methods for purchasing such assets. Members also discussed the consultants and advisers that Treasury had retained to assist in the development of auction-based procedures for the purchase of MBS and whole loans, as well as the status of proposals to hire auction and asset managers.

Members and Treasury officials also discussed the status of potential programs to insure troubled assets under section 102 of EESA. Treasury officials and Members of the Board also discussed the timeline for funding TARP programs, including the timing and process for requesting an increase in the amount of authorized purchases in accordance with section 115 of EESA.

Treasury officials then briefed the Members concerning the procurement process being used by Treasury to request bids from, screen and retain private firms to assist in the implementation of the TARP. Treasury officials informed the Board that the procurement process involved permanent procurement staff and ethics counsel from Treasury, as well as an on-site review of each vendor once a contract is signed. Members and Treasury officials also discussed the roles of the Special Inspector General and Government Accountability Office in overseeing the TARP and the potential for the Oversight Board to coordinate its activities with the activities of these organizations.

Treasury officials and Members also discussed the process for identifying and retaining permanent officials of the TARP to replace the interim officials currently in place.

At the invitation of the Board, Ms. Bair and the other guests from the Federal Deposit Insurance Corporation (FDIC) then joined the meeting. A discussion occurred concerning potential ways for the U.S. government to assist at-risk mortgage borrowers and reduce

avoidable foreclosures. Ms. Bair described one method under which the U.S. government could encourage the modification of troubled mortgages modeled on a loan modification process currently being employed by the FDIC at IndyMac Bancorp. A discussion ensued concerning the details of that process, including the manner in which loans would be modified, the criteria used in assessing borrower eligibility, the potential costs of such a program under differing assumptions, and methods of controlling such costs. Members and others also discussed the current obstacles to private-sector loan modifications, the importance of targeting government assistance towards loan modifications that otherwise would not be made by servicers or investors, and the potential to use asset purchases by TARP to speed price discovery and aid troubled markets.

Members concurred that it was important for the government to help reduce avoidable foreclosures and to analyze alternatives to identify the best and most effective ways for doing so. Mr. Paulson and Ms. Bair indicated that the Administration had a process underway to review and consider potential policies for preventing avoidable foreclosures and that the Treasury and the FDIC were working through this process. Mr. Preston also stated that the Department of Housing and Urban Development was hosting an inter-agency forum later in the day to identify and coordinate methods for helping at-risk borrowers. Ms. Bair and the other guests from the FDIC then departed.

A discussion then occurred concerning the designation of one or more staff liaisons from each agency represented on the Board to serve as points of contacts on administrative and other issues related to the Board. Members unanimously supported this proposal, and it was agreed that the names of such liaisons would be forwarded to the Secretary of the Board.

The meeting was adjourned at approximately 12:28 p.m. (EDT).

[Signed Electronically]

Jason A. Gonzalez
Secretary

Minutes of the Financial Stability Oversight Board Meeting
November 9, 2008

A meeting of the Financial Stability Oversight Board ("Board") was held at the offices of the United States Department of the Treasury ("Treasury") on Sunday, November 9, 2008, at 4:00 p.m. (EST).

MEMBERS PRESENT:

Mr. Bernanke, Chairperson
Mr. Paulson
Mr. Cox
Mr. Preston
Mr. Lockhart

STAFF PRESENT:

Mr. Fallon, General Counsel
Mr. Gonzalez, Secretary

AGENCY OFFICIALS PRESENT:

Mr. Kashkari, Interim Assistant Secretary of the Treasury for Financial Stability and Assistant Secretary of the Treasury for International Economics and Development

Mr. Fromer, Assistant Secretary of the Treasury for Legislative Affairs, Department of the Treasury

Mr. Hoyt, General Counsel, Department of the Treasury

Mr. Albrecht, Counselor to the General Counsel, Department of the Treasury

Mr. Lambright, Chief Investment Officer, Office of Financial Stability, Department of the Treasury

Mr. Alvarez, General Counsel, Board of Governors of the Federal Reserve System

Mr. Wilcox, Deputy Director, Division of Research and Statistics, Board of Governors of the Federal Reserve System

Mr. Gibson, Deputy Associate Director, Division of Research & Statistics, Board of Governors of the Federal Reserve System

Mr. Greenlee, Associate Director, Division of Banking Supervision & Regulation, Board of Governors of the Federal Reserve System

Mr. Cartwright, General Counsel, Securities and Exchange Commission

Mr. Scott, Senior Advisor to the Chairman, Securities and Exchange Commission

Mr. Montgomery, Assistant Secretary for Housing and Commissioner of the Federal Housing Administration, Department of Housing and Urban Development

Mr. Borchert, Senior Advisor to the Secretary of the Department of Housing and Urban Development

Mr. DeMarco, Chief Operating Officer and Deputy Director for Housing Mission and Goals, Federal Housing Finance Agency

Chairperson Bernanke called the meeting to order at 4:05 p.m. (EST).

The Board first considered the proposed minutes for the meeting of the Board held on October 22, 2008, which had been circulated in advance of the meeting. Upon a motion duly made and seconded, the Members unanimously voted to approve the minutes of the meeting held on October 22, 2008, subject to such technical amendments as may be received from the Members.

Using materials distributed at the meeting, Chairperson Bernanke, Mr. Paulson and other officials from the Treasury and the Board of Governors of the Federal Reserve System ("Federal Reserve") provided a briefing on certain complementary actions that the Treasury and the Federal Reserve expected to announce the following morning to help promote stability in the U.S. financial system by restructuring the U.S. government's financial support to the American International Group, Inc. ("AIG"). During this briefing, Members raised and discussed various matters related to AIG, its financial condition, the condition of the financial markets, and the terms and conditions of the expected actions.

As part of this briefing, agency officials provided certain background information concerning AIG, its business operations, and the size and scope of its relationships with other domestic and international financial institutions. Federal Reserve officials also reviewed the steps previously taken by the Federal Reserve to address the significant liquidity pressures facing AIG and avoid a disorderly failure of AIG. These officials also discussed the reasons why the Federal Reserve, with the support of the Treasury Department, had taken such actions in light of the conditions prevailing at the time. As part of this discussion, Federal Reserve officials provided an overview of the terms and conditions of the $85 billion revolving credit facility authorized for AIG on September 16, 2008, and the $37.8 billion securities borrowing facility authorized for AIG on October 6, 2008.

Members and officials also discussed the effect of the continuing market turbulence and decline in the value of mortgage-related assets on AIG, as well as the continuing potential risks to the financial system and the broader economy that would result from a disorderly failure of AIG. Chairperson Bernanke, Mr. Paulson, and officials of the Federal Reserve and Treasury explained that the actions to be announced were designed to provide AIG a more durable capital structure, address certain pools of assets and exposures that had contributed significantly to the liquidity and capital pressures of the company, and facilitate AIG's execution of its plan to sell certain of its businesses in an orderly manner with the least possible disruption to the overall economy. These officials explained that the objective of the package of actions was to provide stability to financial markets, support economic growth and protect American jobs, savings and retirement security. Officials also noted that the form and terms of the package had been crafted to protect the interest of taxpayers to the maximum extent possible.

Federal Reserve officials described the changes that the Federal Reserve expected to announce with respect to the credit facility established

for AIG on September 16, 2008. These actions included a reduction in the maximum amount of credit available under the facility from $85 billion to $60 billion, a reduction in the interest rate and fees payable under the facility, and an extension of the term of the facility. Federal Reserve officials also reviewed the collateral arrangements for this credit facility.

In addition, Federal Reserve officials described the scope, terms, and collateral and security arrangements of two new lending facilities the Federal Reserve expected to establish for AIG under section 13(3) of the Federal Reserve Act. The first of these facilities (the "RMBS facility") would address the ongoing liquidity and capital pressures posed by approximately $23.5 billion of residential mortgage-backed securities acquired with the cash collateral obtained through the securities lending operations of certain of AIG's regulated insurance subsidiaries. Federal Reserve officials explained that establishment of the RMBS facility would eliminate the need for the $37.8 billion securities borrowing facility established on October 8, 2008, and that, accordingly, this securities borrowing facility would be wound down and terminated. The second new facility to be established by the Federal Reserve (the "CDO facility") would involve up to $30 billion of senior Federal Reserve financing and would address the liquidity and capital pressures resulting from AIG's exposure to credit default swaps on multi-sector collateralized debt obligations ("CDOs").

Treasury officials then described the terms and conditions of the $40 billion preferred stock investment that Treasury expected to make in AIG using the new authority granted by the EESA, which authority was not available prior to October 3, 2008. Among other things, Treasury officials reviewed the dividends payable on the preferred stock, as well as restrictions on the ability of AIG to pay dividends on or repurchase other securities. Treasury officials also reviewed the terms of the warrants to purchase common stock of AIG that Treasury would receive in connection with the investment, as required by the EESA. Treasury officials explained that the investment in AIG would be made under guidelines established under the TARP to assist systemically significant failing institutions.

Treasury officials and Members then reviewed and discussed the restrictions that would apply to AIG under the terms of the investment, including restrictions on corporate expenses, restrictions on lobbying, and limitations on executive compensation that would apply under EESA, as well as the additional limitations that would apply to senior executive compensation and bonuses. In addition, AIG would be required to comply with certain corporate governance requirements, including the formation of a risk management committee under the company's Board of Directors.

Members and officials also discussed the impact of the Treasury investment on the amount of funds available under the TARP, and the timing and prospects of asset purchase and other programs under the TARP. In addition, Members discussed the manner in which investments under the TARP would be sold and the budgetary treatment of the receipts from such sales.

The meeting was adjourned at approximately 5:10 p.m. (EDT).

[Signed Electronically]

Jason A. Gonzalez
Secretary

Minutes of the Financial Stability Oversight Board Meeting December 10, 2008

A meeting of the Financial Stability Oversight Board ("Board") was held telephonically on Wednesday, December 10, 2008, at 5:00 p.m. (EST).

MEMBERS PARTICIPATING:

Mr. Bernanke, Chairperson
Mr. Paulson
Mr. Cox
Mr. Preston
Mr. Lockhart

STAFF PARTICIPATING:

Mr. Treacy, Executive Director
Mr. Fallon, General Counsel
Mr. Gonzalez, Secretary

AGENCY OFFICIALS PARTICIPATING:

Mr. Kashkari, Interim Assistant Secretary of the Treasury for Financial Stability and Assistant Secretary of the Treasury for International Economics and Development

Mr. Hoyt, General Counsel, Department of the Treasury

Mr. Wolfteich, Deputy Compliance Officer, Office of Financial Stability, Department of the Treasury

Mr. Wilcox, Deputy Director, Division of Research and Statistics, Board of Governors of the Federal Reserve System

Ms. Liang, Associate Director, Division of Research & Statistics, Board of Governors of the Federal Reserve System

Mr. Cartwright, General Counsel, Securities and Exchange Commission

Mr. Scott, Senior Advisor to the Chairman, Securities and Exchange Commission

Mr. Montgomery, Assistant Secretary for Housing and Commissioner of the Federal Housing Administration, Department of Housing and Urban Development

Mr. Borchert, Senior Advisor to the Secretary of the Department of Housing and Urban Development

Mr. DeMarco, Chief Operating Officer and Deputy Director for Housing Mission and Goals, Federal Housing Finance Agency

Chairperson Bernanke called the meeting to order at 5:03 p.m. (EST).

The Oversight Board first considered the proposed minutes for the meeting of the Oversight Board held on November 9, 2008, which had been circulated in advance of the meeting. Upon a motion duly made and seconded, the Members unanimously voted to approve the minutes of the meeting held on November 9, 2008, subject to such technical amendments as may be received from the Members.

The Oversight Board also considered proposed procedures governing requests by the public for access to records of the Oversight Board. In order to promote transparency, the procedures provide that the Oversight Board will provide access to its records using the procedures set out in the Freedom of Information Act and establish a process for the public to request access to the Oversight Board's records. After discussion, it was unanimously:

"Resolved, that the Financial Stability Oversight Board (Oversight Board) hereby adopts the Statement and Procedures Regarding Public Access to Records of the Financial Stability Oversight Board; and further

Resolved, that the Secretary of the Department of Housing and Urban Development is hereby designated and authorized to make appellate determinations with respect to requests for public access to records of the Financial Stability Oversight Board, as provided in the procedures for requesting records of the Oversight Board."

Members and officials then engaged in a discussion regarding the policies and programs established by the Department of the Treasury ("Treasury") under the TARP, the current level of funding committed to these programs, and the reports concerning the TARP recently submitted to Congress by the General Accountability Office ("GAO") and the Congressional Oversight Panel ("COP"). As part of this discussion, officials from the Treasury provided the Oversight Board with an update on the capital purchase program ("CPP"). Treasury officials reviewed, among other things, the number of applications received and approved by Treasury, recently closed transactions, the amount of funds requested and disbursed, and the status of efforts to develop workable program criteria for banking organizations that are mutually owned or established as S corporations.

Members and officials then discussed the Term Asset-Backed Securities Lending Facility ("TALF") established by the Treasury and the Federal Reserve to help market participants meet the credit needs of households and small businesses. Members and officials discussed, among other things, the purpose, terms and structure of the TALF, the expected start date for the program, and the types of asset-backed securities that could potentially be offered to the TALF, including auto loans, student loans, credit card loans and small business loans. Treasury officials noted that additional work to finalize the details of the TALF were ongoing.

Members and officials then discussed the package of governmental supports provided to Citigroup, Inc. by the Treasury, the Federal Deposit Insurance Corporation, and the Federal Reserve to promote financial stability and announced on November 23, 2008. Members and officials discussed the terms and structure of the additional preferred stock in Citigroup to be acquired or received by the TARP as part of these transactions, and the terms governing the loss protection and residual financing to be provided by Treasury, the FDIC and Federal Reserve to Citigroup on a designated pool of up to $306 billion assets. Members and officials also discussed the manner in which the

investment and guarantee by Treasury would be structured under the TARP.

Treasury officials then provided an update concerning the program established under the TARP for systemically significant failing institutions ("SSFI"). Members and officials discussed, among other things, the current financial health of large financial institutions.

Members and officials also discussed the progress being made by Treasury in hiring staff, establishing a system of internal controls, and monitoring contractors and agents for the Office of Financial Stability, as well as the steps that Treasury was taking in coordination with the federal banking agencies to monitor and ensure compliance with the executive compensation restrictions applicable to institutions that receive TARP funding. Members and officials also discussed the efforts being made to provide for a smooth transition to the next Administration.

Using written materials prepared by various agencies represented on the Board, the Members then engaged in a discussion regarding the current state of the U.S. housing and financial markets. As part of this discussion, the Members discussed the types of metrics that might be useful in assessing the effectiveness of the TARP in restoring stability and liquidity to the U.S. financial system and, in doing so, protect home values, college funds, retirement accounts, and life savings; preserve homeownership and promote jobs and economic growth; maximize overall returns to the taxpayers of the United States; and provide public accountability. Members discussed, among other things, the importance of assessing the effectiveness of the TARP in light of the very difficult market conditions extant at the time the TARP was established and implemented and the broader decline in economic activity in recent months. Members also discussed the difficulty of isolating the effects of the TARP given the variety of policy actions taken by the U.S. government to support financial stability and promote economic growth and the short time that has elapsed since the TARP was first implemented, and the difficulties associated with monitoring the use of specific funds by individual institutions.

Members also discussed a variety of housing-related data provided by the Members, including data related to housing prices, home sales, housing inventory, and delinquency and foreclosure rates. Members also discussed recent actions taken by the Administration, the government-sponsored enterprises, and the private sector to help reduce preventable foreclosures and restore greater stability to the housing and housing finance markets. Members also discussed potential methods of using the TARP to supplement these efforts and the potential timing of such actions directed towards foreclosure mitigation.

Members also discussed the importance of developing a strategy for the eventual sale or other disposition of the assets acquired by the TARP and the actions taken to provide for such sales or dispositions to occur in a timely and orderly fashion.

The meeting was adjourned at approximately 6:05 p.m. (EDT).

[Signed Electronically]

Jason A. Gonzalez
Secretary

Minutes of the Financial Stability Oversight Board Meeting
December 19, 2008

A meeting of the Financial Stability Oversight Board ("Board") was held on Friday, December 19, 2008. The first part of the meeting occurred by telephone conference call and commenced at 8:30 a.m. (EST). The second part of the meeting occurred at the offices of the Department of the Treasury ("Treasury") and commenced at 2:00 p.m. (EST).

MEMBERS PARTICIPATING OR PRESENT:

Mr. Bernanke, Chairperson
Mr. Paulson
Mr. Cox
Mr. Preston
Mr. Lockhart

STAFF PARTICIPATING OR PRESENT:

Mr. Treacy, Executive Director
Mr. Fallon, General Counsel
Mr. Gonzalez, Secretary

AGENCY OFFICIALS PARTICIPATING OR PRESENT:

Mr. Kashkari, Interim Assistant Secretary of the Treasury for Financial Stability and Assistant Secretary of the Treasury for International Economics and Development

Mr. Swagel, Assistant Secretary of the Treasury for Economic Policy[2]

Mr. Hoyt, General Counsel, Department of the Treasury

Mr. Jester, Department of the Treasury[1]

Mr. Shafran, Senior Advisor to the Secretary, Department of the Treasury[1]

Mr. Lambright, Chief Investment Officer, Office of Financial Stability, Department of the Treasury[2]

Mr. Wolfteich, Chief Compliance Officer, Office of Financial Stability, Department of the Treasury

Mr. Alvarez, General Counsel, Board of Governors of the Federal Reserve System[1]

Ms. Liang, Associate Director, Division of Research & Statistics, Board of Governors of the Federal Reserve System[2]

Mr. Cartwright, General Counsel, Securities and Exchange Commission

Mr. Scott, Senior Advisor to the Chairman, Securities and Exchange Commission

Mr. Borchert, Senior Advisor to the Secretary of the Department of Housing and Urban Development

Mr. Montgomery, Assistant Secretary for Housing and Commissioner of the Federal Housing Administration, Department of Housing and Urban Development[2]

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[1] Participated in morning session only.

[2] Present for afternoon session only.

Mr. DeMarco, Chief Operating Officer and Deputy Director for Housing Mission and Goals, Federal Housing Finance Agency

Chairperson Bernanke called the meeting to order at approximately 8:30 a.m. (EST).

Mr. Paulson and other officials from the Treasury provided a briefing on certain actions that Treasury expected to announce later that morning to promote stability in the U.S. financial system by providing assistance under the Troubled Asset Relief Program ("TARP") to General Motors Corp. ("GM") and Chrysler Holding LLC ("Chrysler"). During the briefing, Members raised and discussed various matters related to the assistance to be provided to GM and Chrysler, including the financial condition of both companies, the potential effects of a disorderly failure of GM and Chrysler on the U.S. economy and the financial system, and the terms and conditions of the expected actions.

Treasury officials provided an overview of the principal terms and conditions of the $13.4 billion loan that would be provided to GM and the $4 billion loan that would be provided to Chrysler under the TARP. Among other things, Members and Treasury officials discussed the interest rate on the loans, the timing of the loan disbursements, and the terms and conditions of the warrants to purchase common stock or obtain additional notes of GM and Chrysler that Treasury would receive in connection with the investment. Members also discussed the collateral available to support repayment of the loans, including whether such collateral included the cash accounts of the companies. Members and officials also reviewed and discussed the timing and substance of various reports and certifications that GM and Chrysler would be required to submit to, or obtain from, a special designee of the President of the United States ("President's Designee") under the terms and conditions of the loans. For example, Members and officials discussed the restructuring plan and term sheets that each company would have to submit to the President's Designee no later than February 17, 2009; the written certifications and progress reports that each company would have to submit to the President's Designee no later than March 31, 2009; and the certification that the President's Designee would be required to make within 30 days of March 31, 2009, regarding the efforts of the each company to achieve and sustain the long-term viability, international competitiveness and energy efficiency of the company in accordance with its restructuring plan. Treasury officials also provided an overview of the restrictions on executive compensation and bonuses and corporate expenses that would apply to the companies under the terms of the loan agreements.

Members and officials also discussed the resources available to address financial stability concerns under the TARP in light of the assistance to be provided to GM and Chrysler. As part of this discussion, Treasury officials noted that funding of the last tranche of the assistance to be provided to GM would be contingent on the receipt of additional TARP funds as provided in section 115(a)(3) of the Emergency Economic Stabilization Act ("EESA").

Members also discussed the financial and regulatory status of certain

auto-finance companies, the authority granted to the Pension Benefit Guaranty Corporation under Title IV of the Employee Retirement Income Security Act of 1974 (§4042 and §4047), and the issues (including competitive implications) that might be associated with such an exercise of authority.

At approximately 9:10 a.m. (EST), Chairperson Bernanke called the meeting to recess until 2:00 p.m. (EST).

When the meeting reconvened, the Board first considered the minutes for the meeting of the Board held on December 10, 2008. After discussion of the minutes and potential modifications thereto, the Members agreed to circulate the minutes for approval by notation vote.

The Board then considered proposed procedures, which had been circulated in advance of the meeting, to ensure that sound and effective recordkeeping practices are in place for the Board and that all official records of the Board are maintained and preserved appropriately. After discussion, it was unanimously:

"Resolved, that the Financial Stability Oversight Board hereby adopts the Procedures of the Financial Stability Oversight Board Regarding Official Records."

Treasury officials then provided an update concerning the capital purchase program ("CPP") established under the TARP. Members and officials discussed, among other things, the current number of applications received and approved by Treasury, recently closed transactions and the amount of funds requested and disbursed. Members also discussed the standards applied in reviewing requests for TARP funds, including the types of firms that might seek assistance from the TARP in light of recent actions and the standards for reviewing current or potential future requests for assistance from the automotive or other industries.

Members and officials then engaged in a discussion regarding the first quarterly report to Congress that will be issued by the Board pursuant to section 104(g) of the EESA. Using materials, Members and officials discussed, among other things, the timing and potential contents of the report. Members also discussed, among other things, conditions in the domestic and global markets prior to the implementation of the TARP, the limitations of the policy tools available to policymakers before the TARP, the size of the TARP relative to the size of the U.S. economy and financial system, the changes observed in certain financial market indicators immediately following TARP-related actions, and the potential impact on the economy and the financial system if capital from the TARP had not been made available to the banking system.

The meeting was adjourned at approximately 3:00 p.m. (EST).

[Electronically Signed]

Jason A. Gonzalez
Secretary