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SENATE COMMITTEE ON FINANCE

STATEMENT OF NEIL BAROFSKY

SPECIAL INSPECTOR GENERAL
FOR THE TROUBLED ASSET RELIEF PROGRAM

BEFORE THE
SENATE COMMITTEE ON FINANCE

April 20, 2010

Chairman Baucus, Ranking Member Grassley, and Members of the Committee, I am honored to appear before you today to discuss SIGTARP's Quarterly Report to Congress.

There are clear signs that some aspects of the financial system may well be on the path to recovery. Many of the large banks and Wall Street firms propped up by unprecedented taxpayer support in the fall of 2008 — including massive infusions under the Troubled Asset Relief Program ("TARP") — have returned to profitability, attracted private-sector capital, and enjoyed substantially rebounded stock prices. Many of those firms have been able to repay TARP far sooner than anyone reasonably would have anticipated, resulting in a profit on those particular investments for the Treasury Department ("Treasury"), and thus the American taxpayer. Even Citigroup Inc. ("Citigroup") and Bank of America Corporation ("Bank of America"), firms that appear to have survived only with extraordinary TARP assistance, have rebounded, with Bank of America repaying its TARP bailouts in full and Citigroup on the verge of doing the same. All told, as of March 31, 2010, $205.9 billion has come back to the taxpayer through repayment of principal, interest, dividends, cancellation of guarantees, and warrant sales. As a result, although TARP is still expected to result in a large loss to taxpayers ($127 billion according to the Office of Management and Budget, as of February 2010), the expected loss is far lower than previous estimates, and is concentrated in the programs designed to support American International Group, Inc. ("AIG") ($50 billion), the automotive industry ($31 billion), and housing ($49 billion).

Even as Wall Street regains its footing, however, signs of distress on Main Street remain disturbingly persistent. Although unemployment has eased slightly in recent months, it still remains much higher than at any time since 1983. In addition, the long-term nature of unemployment is unprecedented in recent history — the March 2010 figure for the average duration of unemployment, 31.21 weeks, is the highest since such measurement began in 1948. Meanwhile, smaller and regional banks continue to struggle (with 50 closed so far in 2010), small-business lending remains substantially depressed from pre-recession levels, and the real estate markets, both residential and commercial, continue to suffer at crisis proportions in many areas of the country. Questions remain as to whether the real estate markets have truly found bottom or are headed for further decline. In sum, notwithstanding that the financial system appears to be stabilizing and record profits are returning to Wall Street, the plain fact is that too many Americans on Main Street are still in imminent danger of losing their businesses, their jobs, and their homes.

In light of these circumstances, Treasury has shifted much of TARP's focus to initiatives intended to offer economic relief to the broader public. A year ago this March, Treasury introduced the Making Home Affordable ("MHA") initiative, which was designed to address the growing wave of home foreclosures ravaging many areas of the country. The centerpiece of MHA is the Home Affordable Modification Program ("HAMP"), which was intended to result in millions of sustainable mortgage modifications that would allow homeowners to remain in their homes by reducing their monthly payments to affordable levels. The Administration has allocated $75 billion to HAMP, including $50 billion of TARP funds.

Despite Treasury's efforts, however, the home foreclosure crisis has not abated; indeed, the situation has continued to deteriorate since HAMP's rollout. Nearly 2.8 million foreclosures were initiated in 2009. More ominously, 2010 is on pace to be even worse: there were more than 932,000 foreclosure filings during the first three months — a 16% increase from the already staggering rate for the first quarter of 2009. Similarly, for the first quarter of 2010, actual bank repossessions rose 35% from 2009 levels to nearly 258,000. Unfortunately, HAMP has made very little progress in stemming this onslaught, resulting in only 230,000 permanent modifications initiated over the approximately 12 months of the program's existence. That figure represents only 8.2% of the foreclosures initiated in 2009 and fewer than just the most recent quarter's actual bank repossessions.

A SIGTARP audit report published on March 25, 2010, examined the design and operation of HAMP in detail. The audit first found that Treasury's publicly touted measure of success, the number of short-term trial modification *offers* that have been made to struggling homeowners, was largely meaningless, and that Treasury needs to clearly identify the total number of homeowners it actually intends to help stay in their homes through sustainable permanent mortgage modifications. The audit also found that the limited results to date stemmed from, among other things, flaws in HAMP's design, rollout, and marketing that diminished the program's effectiveness in providing sustainable relief to at-risk homeowners. In its original version, HAMP involved frequent and time-consuming revisions of guidelines that created confusion and delay; permitted reliance on unverified verbal borrower data that slowed down conversions to permanent modifications; suffered from insufficient outreach to the American public about eligibility and benefits; and did not fully address risk factors for re-defaults among participating borrowers, including negative equity and high total debt levels even after modification. Without addressing the dangers of re-default, HAMP risks merely spreading out the foreclosure crisis at significant taxpayer expense. While this may benefit financial institutions that would not have to recognize the losses from immediate foreclosures, it would do little to accomplish the Emergency Economic Stabilization Act's explicit purpose to "help families keep their homes."

Although Treasury was initially reluctant to address the issues raised in the audit report regarding re-default, including a suggestion that only modest changes would be made to the program to address negative equity, just days after the publication of SIGTARP's audit report and a subsequent Congressional hearing discussing the report's findings, Treasury changed course and introduced major revisions to HAMP, including new provisions designed to address the plight of unemployed homeowners and to require consideration of principal write-downs for borrowers with negative equity. To Treasury's credit, the program changes appear intended to expand HAMP participation and improve the rate of permanent modifications, as well as to address the significant re-default risk driven by homeowners' negative equity. On the whole, the revisions to HAMP constitute a potentially important step forward in addressing some of the flaws identified in SIGTARP's audit report.

However, the program changes, as announced, also raise several issues that could impede HAMP's effectiveness and efficiency. Treasury's urgency in rolling out the new initiatives, laudable as it is, risks significant costs in the form of ill-defined goals, incomplete program guidelines, increased vulnerability to fraud, incentives that may prove ineffective, and the potential for arbitrary treatment of participating borrowers. SIGTARP has made a series of recommendations designed to address these issues:

• Treasury should identify its participation goals and anticipated costs for each HAMP program and subprogram and measure success against those expectations in its monthly reports.

• Treasury should launch a broader based fraud awareness campaign for HAMP and include fraud warnings when it makes program announcements.

• To protect against fraud, Treasury should abandon its differing valuation standards across HAMP and adopt the Federal Housing Authority's appraisal standard for all HAMP principal reduction and short sale programs.

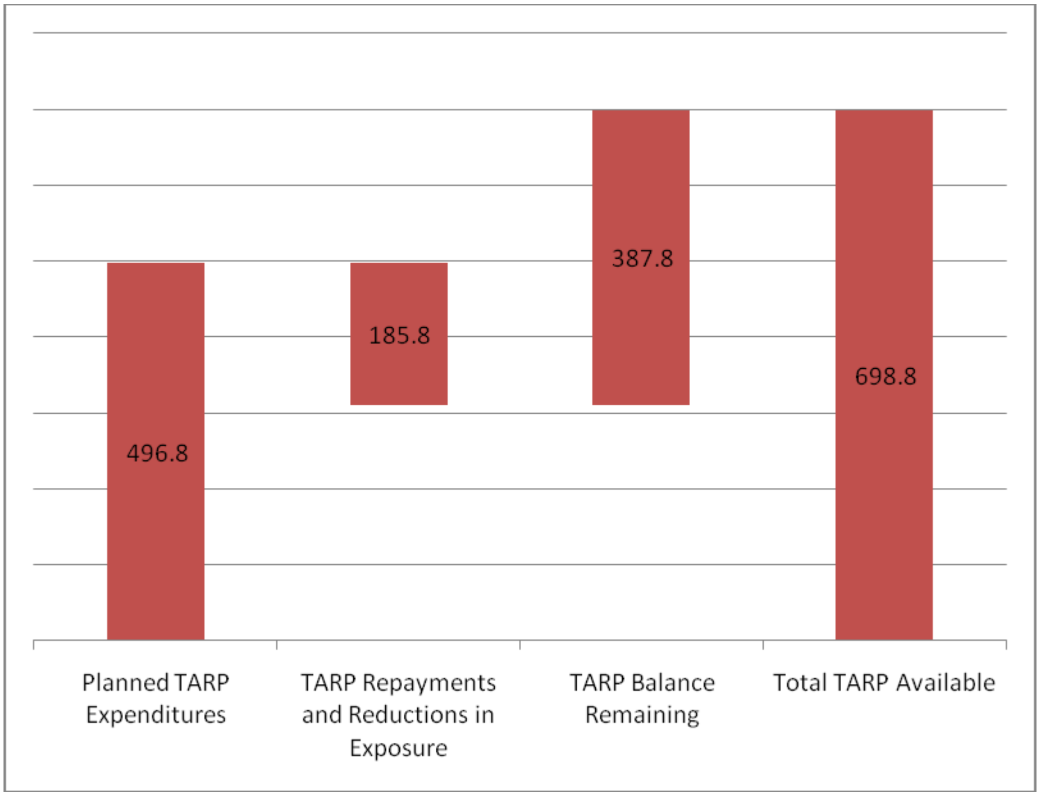
• Treasury should reevaluate the voluntary nature of its principal reduction program, considering changes to maximize effectiveness, to ensure to the greatest extent possible consistent treatment of similarly situated borrowers, and to address potential servicer conflicts of interest.

• Treasury should reconsider the length of the three-month minimum term of its unemployment forbearance program.

In sum, until Treasury fulfills its commitment to provide a thoughtfully designed, consistently administered, and fully transparent program, HAMP risks being remembered not for catalyzing a recovery from our current housing crisis, but rather for bold announcements, modest goals, and meager results.

PROGRAM UPDATES AND FINANCIAL OVERVIEW

TARP consists of 13 announced programs, all of which have been implemented. Six are closing or have already been wound down. As of March 31, 2010, Treasury had announced programs involving potential spending of $537.1 billion of the $698.8 billion maximum available for the purchase of troubled assets under TARP as authorized by Congress. Of this amount, Treasury had expended or committed to expend approximately $496.8 billion through the 13 implemented programs to provide support for U.S. financial institutions, the automobile industry, the markets in certain types of asset-backed securities ("ABS"), and homeowners. As of March 31, 2010, 77 TARP recipients had paid back all or a portion of their principal or repurchased shares for an aggregate total of $180.8 billion of repayments and a $5 billion reduction in exposure to possible further liabilities, leaving $387.8 billion, or 55.5%, of TARP's allocated $698.8 billion available. In addition to the principal repayments, Treasury has received interest and dividend payments on its investments, as well as revenue from the sale of its warrants. As of March 31, 2010, $14.5 billion in interest, dividends, and other income had been received by the Government, and $5.6 billion in sales proceeds had been received from the sale of warrants and preferred stock received as a result of exercised warrants. At the same time, some TARP participants have missed dividend payments: among participants in the Capital Purchase Program ("CPP"), 104 have missed dividend payments to the Government, although some of them made the payments on a later date. As of March 31, 2010, there was $188.9 million in outstanding unpaid CPP dividends. In addition, three TARP recipients have failed and several others have restructured their agreements with Treasury, increasing the potential for further losses.



Notes: Numbers affected by rounding. The "planned expenditures" referenced throughout this report represent the funds Treasury currently plans to expend for each program, and a majority of those are committed funds (e.g., signed agreements with TARP fund recipients).
a Repayments include $135.8 billion for CPP, $40 billion for TIP, $4.6 billion for Auto Programs, and a $5 billion reduction in exposure under AGP.
b Treasury experienced a $2.3 billion loss on some investments under the CPP program

Sources: Treasury, "Transactions Report," 4/2/2010; Treasury, response to SIGTARP data call, 4/12/2010.

OVERSIGHT ACTIVITIES OF SIGTARP

Since SIGTARP's Quarterly Report to Congress dated January 30, 2010, SIGTARP has actively sought to fulfill its vital investigative and audit functions. SIGTARP's Investigations Division continues to develop into a sophisticated white-collar investigative agency. Through March 31, 2010, SIGTARP has 84 ongoing criminal and civil investigations. Highlights from the last quarter include important developments in several cases that have been brought as the result of SIGTARP's investigations.

The Park Avenue Bank

On March 15, 2010, Charles Antonucci, the former President and Chief Executive Officer of The Park Avenue Bank, was charged by the United States Attorney's Office for the Southern District of New York with offenses including self-dealing, bank bribery, embezzlement of bank funds, and bank, mail and wire fraud, among others. In particular, Antonucci allegedly attempted to steal $11 million of TARP funds by, among other things, making fraudulent claims about the bank's capital position. These charges mark the first time an individual has been criminally charged with attempting to steal TARP funds.

According to the allegations, Antonucci falsely represented that he had personally invested $6.5 million in The Park Avenue Bank to improve its capital position. As set forth in the charges, however, the funds were actually borrowed from the Park Avenue Bank itself and reinvested as part of an undisclosed "round-trip" transaction. The complaint further alleges that this fraudulent transaction was touted by The Park Avenue Bank in support of its application for TARP funds as evidence of its supposedly improving capital position.

Bank of America
On February 4, 2010, the New York Attorney General charged Bank of America, its former Chief Executive Officer Kenneth D. Lewis, and its former Chief Financial Officer Joseph L. Price with civil securities fraud. According to the allegations, in order to complete a merger between Bank of America and Merrill Lynch & Co., Inc. ("Merrill Lynch"), the defendants failed to disclose to shareholders spiraling losses at Merrill Lynch. Additionally, after the merger was approved, it is alleged that Bank of America made misrepresentations to the Federal Government in order to obtain tens of billions of dollars in TARP funds. The investigation was conducted jointly by the New York Attorney General's Office and SIGTARP, and the case remains pending in New York state court.

SIGTARP also assisted the Securities and Exchange Commission ("SEC") with its Bank of America investigation. On February 22, 2010, the Honorable Jed S. Rakoff, United States District Judge for the Southern District of New York, approved a $150 million civil settlement between the SEC and Bank of America to settle all outstanding SEC actions against the firm.

Nations Housing Modification Center
On March 19, 2010, Glenn Steven Rosofsky was arrested by agents from SIGTARP and the Internal Revenue Service, Criminal Investigation Division and charged by the U.S. Attorney's Office for the Southern District of California with one count of conspiracy to commit wire fraud and money laundering and one count of money laundering. A separate information the same day charged Michael Trap with conspiracy to commit fraud and money laundering. As set forth in the charges, Rosofsky, Trap, and others operated a telemarketing firm, ostensibly to assist delinquent homeowners with loan modification services. Operating under the names "Nations Housing Modification Center" and "Federal Housing Modification Department," Rosofsky and Trap took advantage of the publicity surrounding the Administration's mortgage modification efforts under the TARP-supported MHA program and are alleged to have used fraudulent statements to induce customers to pay $2,500 – $3,000 each to purchase loan modification services that were not actually provided. It is alleged in court documents that the fraud grossed more than $1 million. Trap pled guilty to the charges listed in his March 19 information the following day. The case against Rosofsky remains pending.

On the audit side, SIGTARP released its latest audit report on March 25, 2010, which examined the "Factors Affecting Implementation of the Home Affordable Modification Program." SIGTARP has 12 other ongoing audit projects, including 2 new audits that have been initiated over the past quarter:

• **Application of the HAMP Net Present Value ("NPV") Test:** This audit, which will be conducted in response to a request from Senator Jeff Merkley and eight other Senators, will assess: whether the participating loan servicers are correctly applying the NPV test under the program; the extent to which Treasury ensures that servicers are appropriately applying the NPV test per HAMP guidelines when assessing borrowers for program eligibility; and the procedures servicers follow to communicate to borrowers the reasons for NPV test failure, as well as to identify the full range of loss mitigation options available to such borrowers.

• **Material Loss Review of United Commercial Bank:** SIGTARP is participating in a Material Loss Review of United Commercial Bank, based in San Francisco, with the Office of the Inspector General of the Federal Deposit Insurance Corporation ("FDIC OIG"). In November 2008, United Commercial Bank received $298.7 million of TARP funds through CPP. On November 6, 2009, the California Department of Financial Institutions closed the bank and appointed FDIC as receiver. The objectives of the audit are to (1) determining the causes of the financial institution's failure and resulting material loss to the Deposit Insurance Fund; (2) evaluating FDIC's supervision of the institution; and (3) determining whether FDIC and Treasury followed applicable procedures in recommending the bank for CPP funding and in monitoring its compliance with the securities purchase agreement.

SIGTARP RECOMMENDATIONS ON THE OPERATION OF TARP

One of SIGTARP's oversight responsibilities is to provide recommendations to Treasury so that TARP programs can be designed or modified to facilitate effective oversight and transparency and to prevent fraud, waste, and abuse. In this quarter's report, we provide updates on existing recommendations and summarize implementation measures for previous recommendations. We make a series of recommendations concerning the new HAMP initiatives. We also discuss Treasury's introduction, on February 3, 2010, of the Community Development Capital Initiative ("CDCI"), a new TARP initiative designed to provide up to $1 billion in additional capital to Community Development Financial Institutions to incentivize lending. In addition to reviewing CDCI's provisions in detail, our report details a number of SIGTARP recommendations designed to improve the transparency of CDCI investments and better safeguard them against fraud or the failure of participating institutions.

Over the past quarter, Treasury has also announced another new initiative designed to spur small-business lending, the Small Business Lending Fund ("SBLF"). As announced, although SBLF will be funded with $30 billion that will be rescinded from TARP, SBLF will not be part of TARP, but rather will be operated outside of TARP and thus will not be subject to the executive compensation restrictions and perceived stigma associated with TARP. However, many of the characteristics of SBLF are the same or very similar to the TARP's CPP and CDCI: the economic structure is basically the same, with Treasury providing capital in the form of preferred equity, and, like CPP and CDCI, the maximum amount of capital available under SBLF will be a percentage of the institution's risk-weighted assets. It would also appear that the application and approval process for new participants will be similar and will involve the same primary regulators. Even many of the same banks will be participants — SBLF is expressly being designed so that many CPP participants will be able to convert their CPP capital into SBLF capital. SIGTARP has estimated that up to 95% of CPP participants could be eligible to convert to SBLF. In sum, the funds being utilized, the core mechanics, the economic terms of the program and even many of the participants all stem from TARP's CPP. Because SIGTARP has developed considerable experience and expertise in its oversight of the very similar (and similarly complex) CPP, particularly in reporting, monitoring, deterring, and investigating fraud, SIGTARP has strongly encouraged that SIGTARP be included in the oversight provisions of Treasury's legislative proposal concerning SBLF. SIGTARP has sent a letter to Treasury, attached to our quarterly report, objecting to its stated intent not to include SIGTARP in the proposed legislation.

Chairman Baucus, Ranking Member Grassley and Members of the Committee, I want to thank you again for this opportunity to appear before you, and I would be pleased to respond to any questions that you may have.