SIGTARP | OFFICE OF THE SPECIAL INSPECTOR GENERAL FOR THE TROUBLED ASSET RELIEF PROGRAM

ADVANCING ECONOMIC STABILITY THROUGH TRANSPARENCY, COORDINATED OVERSIGHT AND ROBUST ENFORCEMENT

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JOINT ECONOMIC COMMITTEE

STATEMENT OF NEIL BAROFSKY

SPECIAL INSPECTOR GENERAL
TROUBLED ASSET RELIEF PROGRAM

BEFORE THE
UNITED STATES SENATE AND HOUSE
JOINT ECONOMIC COMMITTEE

April 23, 2009

Chairman Maloney, Vice Chair Schumer, Ranking Member Brownback and Members of the Committee, I am honored to appear before you today to deliver to this Committee my quarterly report to Congress.

The Troubled Asset Relief Program ("TARP") now includes 12 separate, but often interrelated, programs involving Government and private funds of up to almost $3 trillion— roughly the equivalent of last year's entire Federal budget. From programs involving large capital infusions into hundreds of banks and other financial institutions, to a mortgage modification program designed to modify millions of mortgages, to public private partnerships purchasing "toxic" assets from banks using tremendous leverage provided by Government loans or guarantees, TARP has evolved into a program of unprecedented scope, scale, and complexity. Before the American people and their representatives in Congress can meaningfully evaluate the effectiveness of this historic program, that scope and scale must be placed into proper context, and the complexity must be made understandable. That is what SIGTARP's quarterly report attempts to do.

In the April 21, 2009, report, the Office of the Special Inspector General for the Troubled Asset Relief Program ("SIGTARP") endeavors to (i) explain the various TARP programs and how the Department of the Treasury ("Treasury") has used those programs through March 31, 2009, (ii) describe what SIGTARP has done since its Initial Report to Congress, dated February 6, 2009 (the "Initial Report"), to oversee this historic program with respect to both audits and investigations, and (iii) set forth a series of recommendations for the operation of TARP.

TREMENDOUS EXPANSION IN THE SCOPE, SCALE, AND COMPLEXITY OF TARP

TARP, as originally envisioned in the fall of 2008, would have involved the purchase, management, and sale of up to $700 billion of "toxic" assets, primarily troubled mortgages and mortgage-backed securities ("MBS"). That framework was soon abandoned, however, and the program's scope, size, and complexity have dramatically increased. As of the drafting of this quarterly report, TARP funds are being used, or have been announced to be used, in connection with 12 separate programs that, as set forth in Table 1.1, involve a total (including TARP funds, Federal Reserve loans, Federal Deposit Insurance Corporation ("FDIC") guarantees, and private money) that could reach nearly $3 trillion.

Treasury has announced, as of March 31, 2009, the parameters of how $590.4 billion of the $700 billion in TARP funding authorized by the Emergency Economic Stabilization Act of 2008 ("EESA") would be spent through the 12 programs. Of the $590.4 billion that Treasury has committed, $328.6 billion has actually been spent as of March 31, 2009. This quarterly report provides an update on those TARP programs that had been announced as of SIGTARP's Initial Report, as well as descriptions of programs that have subsequently been announced.

TABLE 1.1

TOTAL FUNDS SUBJECT TO SIGTARP OVERSIGHT, AS OF MARCH 31, 2009 ($ BILLIONS)

Program	Brief Description or Participant	Total Projected Funding	Projected TARP Funding
Capital Purchase Program ("CPP")	Investments in 532 banks to date; 8 institutions total $125 billion	$218.0	$218.0
Automotive Industry Financing Program ("AIFP")	GM, Chrysler, GMAC, Chrysler Financial	$25.0	$25.0
Auto Supplier Support Program ("ASSP")	Government-backed protection for auto parts suppliers	$5.0	$5.0
Unlocking Credit for Small Businesses ("UCSB")	Purchase of securities backed by SBA loans	$15.0	$15.0
Systemically Significant Failing Institutions ("SSFI")	AIG Investment	$70.0	$70.0
Targeted Investment Program ("TIP")	Citigroup, Bank of America Investments	$40.0	$40.0
Asset Guarantee Program ("AGP")	Citigroup, Bank of America, Ring-Fence Asset Guarantee	$419.0	$12.5
Term Asset-Backed Securities Loan Facility ("TALF")	FRBNY non-recourse loans for purchase of asset-backed securities	$1,000.0	$80.0
Making Home Affordable ("MHA") Program	Modification of mortgage loans	$75.0	$50.0
Public-Private Investment Program ("PPIP")	Disposition of legacy assets; Legacy Loans Program, Legacy Securities Program (expansion of TALF)	$500.0 – $1,000.0	$75.0
Capital Assistance Program ("CAP")	Capital to qualified financial institutions; includes stress test	TBD	TBD
New Programs, or Funds Remaining for Existing Programs	Potential additional funding related to CAP; AIFP; Auto Warranty Commitment Program; other	$109.5	$109.5
Total		**$2,476.5 – $2,976.5**	**$700.0**

Note: See Table 2.1 in Section 2 for notes and sources related to the information contained in this table.

OVERSIGHT ACTIVITIES OF SIGTARP

Since the Initial Report, SIGTARP has been actively engaged in fulfilling its vital investigative and audit functions as well as in building its staff and organization.

On the investigations side, SIGTARP's Hotline (877-SIG-2009 or accessible at www.SIGTARP.gov) is staffed, operational, and providing an interface with the American public to facilitate the reporting of concerns, allegations, information, and evidence of violations of criminal and civil laws in connection with TARP. As of the drafting of this quarterly report, the SIGTARP Hotline has received and analyzed nearly 200 tips, running the gamut from expressions of concern over the economy to serious allegations of fraud. Both from the Hotline and from other leads, SIGTARP has initiated, to date, almost 20 preliminary and full criminal investigations. Although the details of those investigations generally will not be discussed unless and until public action is taken, the cases vary widely in subject matter and include large corporate and securities fraud matters affecting TARP investments, tax matters, insider trading, public corruption, and mortgage-modification fraud.

SIGTARP has been proactive in dealing with potential fraud in TARP. For example, to get out in front of any efforts to profit criminally from the Term Asset-Backed Securities Loan Facility ("TALF"), which, as announced, involves up to $1 trillion of lending by the Federal Reserve backed by up to $80 billion in TARP funds, SIGTARP has organized and leads a multi-agency task force to deter, detect, and investigate any instances of fraud or abuse in the program. In addition to SIGTARP, the TALF Task Force consists of the Office of the Inspector General of the Board of Governors of the Federal Reserve Board, the Federal Bureau of Investigation, Treasury's Financial Crimes Enforcement Network, U.S. Immigration and Customs Enforcement, the Internal Revenue Service Criminal Investigation division, the Securities and

Exchange Commission, and the U.S. Postal Inspection Service. Representatives from each member organization participate in regular briefings about TALF, collectively identify areas of fraud vulnerability, engage in the training of agents and analysts with respect to the complex issues surrounding the program, and will serve as points of contact for leads relating to TALF and any resulting cases that are generated. The TALF Task Force represents a historic law enforcement effort with an ambitious goal: to redefine the policing of complex Federal Government programs by proactively arranging a coordinated law enforcement response before fraud occurs.

On the audit side, SIGTARP has initiated and is in the process of conducting six audits:

- **Use of Funds**: SIGTARP's first audit examines the use of TARP funds by TARP recipients, and is based upon a survey that SIGTARP sent to 364 TARP recipients that had received funds as of January 31, 2009.
- **Executive Compensation Compliance**: SIGTARP's second audit, also based on SIGTARP's survey, examines how TARP recipients are implementing controls with respect to applicable executive compensation restrictions.
- **Bank of America:** The third audit examines the review and approval processes associated with TARP assistance to Bank of America under three different TARP programs and examines Treasury's decision making related to additional TARP assistance provided in connection with Bank of America's acquisition of Merrill Lynch. Since its commencement, the audit's scope has expanded to examine broadly Treasury's decision making regarding the first nine institutions to be considered for funding under TARP.
- **External Influences:** The fourth audit examines whether, or to what extent, external parties may have sought to influence decision making by Treasury or bank regulators in considering and deciding on applications for funding from individual banks seeking TARP funds. This audit seeks to determine what procedures are in place to avoid undue outside influence on the process, whether there are any indications of any undue influence, and what actions might be needed to strengthen existing processes to avoid such undue influences in the future.
- **AIG Bonuses:** The next audit examines Federal oversight of executive compensation requirements, with a particular focus on recent payouts of large bonus payments to American International Group, Inc. ("AIG") employees. SIGTARP has undertaken an audit to determine: (i) the extent to which the recent bonus payments were made in accordance with conditions imposed in return for TARP assistance, and (ii) Treasury's monitoring of AIG's executive compensation agreements and whether it was aware of the full range of executive compensation, bonus, and retention payments throughout AIG's corporate structure.
- **AIG Counterparty Payments:** AIG, which has received the largest amount of financial assistance from the Government during the current financial crisis, reportedly made counterparty payments to other financial institutions, including foreign institutions and other TARP recipients, at 100% of face value. SIGTARP will examine the basis for the counterparty payments and seek to determine whether any efforts were made to negotiate a reduction in those payments.

SIGTARP'S RECOMMENDATIONS ON THEOPERATION 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 Section 4 of the quarterly report, SIGTARP details instances in which Treasury has addressed recommendations made in and since the Initial Report, and makes a series of new recommendations, including:

- **Use of Funds:** SIGTARP continues to recommend that Treasury require all TARP recipients to report on their actual use of TARP funds. This recommendation is particularly important with respect to the potential application of the Capital Purchase Program ("CPP") to large insurance companies that may have purchased banks eligible for CPP in order to access TARP funds, and to Treasury's recent announcement of an additional $30 billion investment in AIG. Simply put, the American people have a right to know how their tax dollars are being used. This recommendation applies not only to capital investment and lending programs involving banks and other financial institutions, but also to programs in which TARP funds are used to purchase troubled assets, including transactions in the Public-Private Investment Program ("PPIP") and surrenders of collateral in TALF.
- **Expansion of TALF:** The announced expansion of TALF to permit the posting of MBS as collateral poses significant fraud risks, particularly with respect to legacy residential MBS ("RMBS"). SIGTARP has made a series of recommendations to mitigate these risks, including, among others, that Treasury should require a security-by-security screening for legacy RMBS; that any RMBS should be rejected as collateral if the loans backing particular RMBS do not meet certain baseline underwriting criteria or are in categories that have been proven to be riddled with fraud, including certain undocumented subprime residential mortgages (*i.e.*, "liar loans"); and that Treasury should require significantly higher haircuts for all MBS, with particularly high haircuts for legacy RMBS.
- **PPIP Fraud Vulnerabilities:** Aspects of PPIP make it inherently vulnerable to fraud, waste, and abuse, including significant issues relating to conflicts of interest facing fund managers, collusion between participants, and vulnerabilities to money laundering. SIGTARP has made a series of recommendations to address these concerns, including, among others, that Treasury should (i) impose strict conflict-of-interest rules upon Public-Private Investment Fund ("PPIF") fund managers, (ii) mandate transparency with respect to the participation and management of PPIFs, including disclosure of the beneficial owners of the private equity stakes in the PPIFs and of all transactions undertaken in them, and (iii) that all PPIF fund managers have stringent investor-screening procedures, including comprehensive "Know Your Customer" requirements at least as rigorous as that of a commercial bank or retail brokerage operation.
- **Interaction Between PPIP and TALF:** In announcing the details of PPIP, Treasury has indicated that PPIFs under the Legacy Securities Program could, in turn, use the leveraged PPIF funds (two-thirds of which will likely be taxpayer money) to purchase legacy MBS through TALF, greatly increasing taxpayer exposure to losses with no corresponding increase of potential profits. Such an expansion could cause great harm to one of the fundamental taxpayer protections in the original design of TALF by significantly diluting the private party's personal stake, the "skin in the game," and therefore reduce their incentive to conduct appropriate due diligence. Treasury should not allow Legacy Securities PPIFs to invest in TALF unless significant mitigating measures are included to address the dilution of this incentive, which could include prohibiting the use of leverage for PPIFs investing through TALF or proportionately increasing haircuts for PPIFs that do so.

- **Mortgage Modification Program:** To prevent fraud in the mortgage modification program, SIGTARP has recommended that Treasury build certain fraud protections into the mechanics of the program, including requiring third-party verification of residence and income, conducting a closing-like procedure in which identities of participants are confirmed, and delaying modification incentive payments to servicers. SIGTARP has also recommended that Treasury proactively educate homeowners about the nature of the program, publicize that no fee is necessary to participate in the program, and collect and maintain a database of the names and identifying information for each participant in each mortgage modification transaction.

Chairman Maloney, Vice Chair Schumer, Ranking Member Brownback 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.

SIGTARP Hotline

If you are aware of fraud, waste, abuse, mismanagement or misrepresentations affiliated with the Troubled Asset Relief Program, please contact the SIGTARP Hotline.

By Online Form: www.SIGTARP.gov *By Phone:* Call toll free: (877) SIG-2009

By Fax: (202) 622-4559

By Mail: **Hotline: Office of the Special Inspector General**
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